

Getting out of the box: transitioning out of direct payments

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Content of the paper

1. Review empirical evidence on production impacts of direct and counter-cyclical payments
2. Evaluate the results of these studies in the light of WTO trade disputes (e.g., Canada, Brazil)
3. Explore the replacement of existing payments by transitional payments based on compensation for asset value losses

How might payments affect production?

1. Income effect
2. Capital constraints
3. Risk aversion
4. Expectations of rebasing
5. Wealth effect
6. Resource retention effect

Empirical studies attempt to determine the “bottom” line (total effect)

Econometric studies

Break down into three types:

- Acreage decisions
- Labor allocation
- Structural change

Acreage decision studies

- The largest number of studies
- Use farm, county or state-level time series or cross-section data
- Typically include payments as a separate variable in an acreage response equation, or include payments in some measure of returns for a particular crop
- Generally find that effects are either statistically insignificant or a small positive impact
- Elasticity estimates for direct payments around 0.02 or 0.03
- Estimates for price-linked payments higher – up to 0.1

Labor allocation studies

- Limited number of studies
- Use farm operator or household data
- Studies suggest small but positive effect on total labor allocated to on-farm activities
- Average increase in on-farm labor allocation of roughly 2 percent from price-linked payments in 2001
- Some evidence of negative impact on allocation to off-farm activities

Structural change studies

- Limited number of studies
- Use farm panel or size distribution data
- Findings suggest that payments increase the probability of farm survival with the effect biased towards larger farms
- Payments may increase the shift in structure towards larger farm size

Production linkages and the WTO

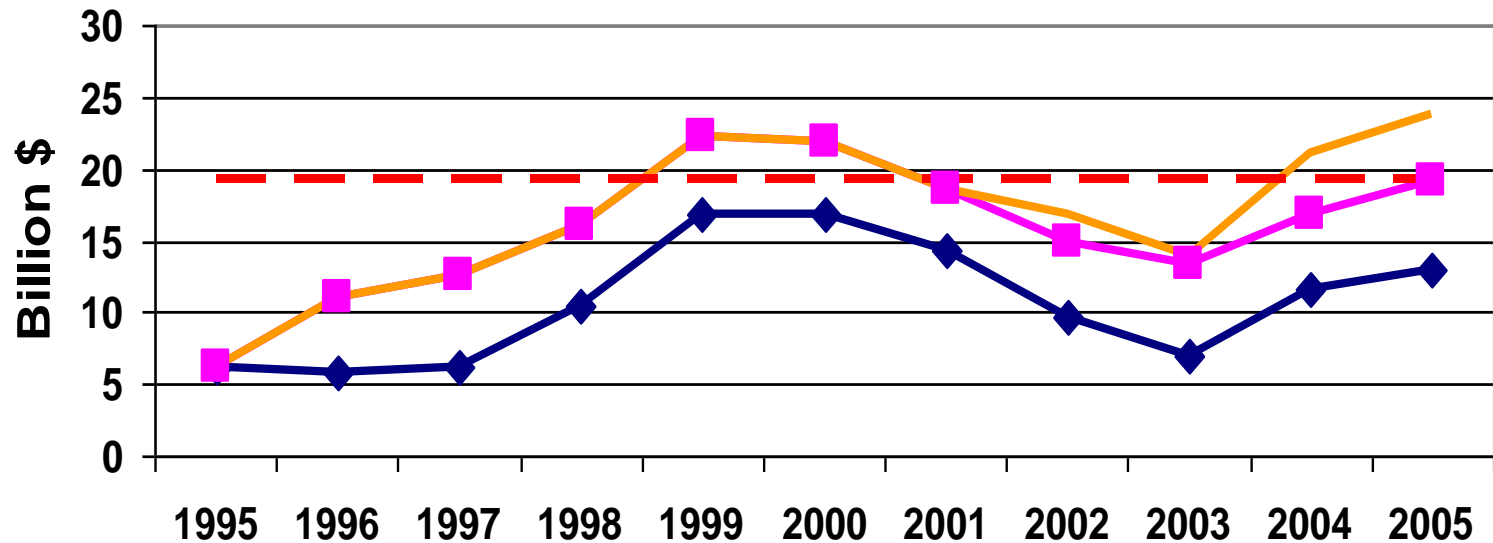
- Support that “distorts” production is supposed to be included in the Amber Box
- Product-specific and non-product-specific support is included in the Aggregate Measure of Support (AMS)
- *De minimis* amounts are not included in the Total AMS
- Support that has “minimal” impact on production can be included in the Green Box
- A key issue is whether support provided through direct or counter-cyclical payments is counted in the AMS
- US has notified direct payments as Green and CCPs as Amber (NPS AMS)

Challenges to US notifications

- Brazil cotton case (2005) called into question the Green Box status of direct payments for cotton
- Recent cases brought by Canada and Brazil extend this to all U.S. direct payments
- Question whether CCPs should be NPS AMS
- Question whether other government subsidies are correctly notified (e.g., disaster payments)
- Question whether some subsidies (e.g., taxation concessions) that are not currently notified, should be

Support Reclassification

Reclassification and the Total AMS



◆ Total AMS

■ Total AMS + income support

— Total AMS + income support + CCPs

- - - AMS binding

Solving the problem

- **Make existing payments Green**
 - Would need to eliminate any production linkage (planting limitations)
 - Would need to eliminate any linkage to the production of the commodity on which the payment is based – very difficult for programs based on crop prices (CCPs)
- **Move away from price-linked support to revenue stabilization**
 - Needs to be whole-farm rather than crop based to be Green Box compliant
 - Needs to meet other Green Box conditions on when compensation is triggered and how much can be paid
 - Revenue stabilization payments and disaster payments combined cannot exceed income loss

Solving the problem

- Use transitional payments (buyout) to transition out of commodity-linked support
 - Have already been used for peanut and tobacco quotas
 - Use of per acre payments (of limited amount and duration)
 - Payments could be notified under decoupled income support
 - Would be less likely to be challenged by other countries provide the payments are not open-ended
 - Would not preclude the use of other forms of Green Box assistance (e.g., environmental payments)
 - Would not preclude the use of non-commodity assistance (e.g., rural development)
 - But would require a fundamental shift in policy away from the current commodity-based approach

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