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Chapter 18

Mind the Gap: ‘Greening’, Direct Payments and the WTO

Fiona Smith

1. Introduction

A crucial element of the post-2013 CAP reform is the ‘greening’ payment. ‘Greening’ is a compulsory part of the new direct payment scheme, accounting for 30 per cent of national ceilings.¹ To qualify, farmers must undertake compulsory agricultural practices that are ‘beneficial for the climate and the environment’, to include crop diversification, maintenance of existing permanent grassland and establishing an ecological focus area or putting in place ‘equivalent measures’.² The payment had a controversial legislative passage, with several environmental groups questioning its pro-environmental effects and alleging that it was merely a clever way of disguising product support to European farmers, even before several of the provisions were watered down by the European Parliament.³ Despite these difficulties, throughout the process all parties assumed the ‘greening’ payment was compatible with the Green Box exemption in the Agreement on Agriculture (AoA) of the World Trade Organization (WTO), so that it would be exempt from the EU’s domestic support reduction commitments in that Agreement. Specifically, it was understood that the payment would be decoupled income support under paragraph 6 of Annex 2 to the AoA and as such had ‘no, or at most minimal trade-distorting effects or effects on production’ under paragraph 1 of the same Annex (the so-called ‘fundamental requirement’). The reality is not so clear, with even the European Commission surprisingly acknowledging early in the process that the ‘greening’ payment would not qualify as a ‘payment under an environmental programme’ for the purposes of paragraph 12 of Annex 2.⁴

This Chapter assesses whether the ‘greening’ payment is compatible with the Green Box. It posits the view that, as currently drafted, the payment is not fully decoupled income support in accordance with paragraph 6 of Annex 2 to the AoA, but despite these issues, there may be a case for arguing that the payment has no trade distorting effects or no effects on production and so does not violate the fundamental requirement contained in paragraph 1. This last point calls for a re-imagining of the fundamental requirement in the Green Box on the basis of both a quantitative and a qualitative test that takes into account the nature of the support and the fact that it is provided to encourage public goods such as preservation of biodiversity and rural landscape, which in the absence such incentives would not be provided. It further suggests that it is also time to re-imagine the relationship between the policy-specific criteria in paragraphs 2-13 of Annex 2 and the fundamental requirement in paragraph 1 in order to take into account this more nuanced interpretation of paragraph 1. The Chapter concludes that what we are seeing with the introduction of the ‘greening’ payment’ is not a return to protectionism in international

¹ Regulation (EU) 1307/2013 of the European Parliament and of the Council establishing rules for direct payments to farmers under support schemes within the framework of the common agricultural policy, [2013] OJ L 347/608, Article 47(1).

² *Ibid*, Article 43(1).

³ See A. Matthews, ‘Greening agricultural payments in the EU’s Common Agricultural Policy’, (2013) 2 *Bio-Based and Applied Economics* 1, 20.

⁴ European Commission, *Impact Assessment: Common Agricultural Policy Towards 2020* SEC (2011) 1153, Annex 2, 17, n 8.

agricultural trade, but rather the teething problems of an attempt to address the contemporary problems of agricultural production using international trade rules that were designed for a very different era.⁵

The discussion is in three parts. First, it sets out a limited history of the ‘greening’ payment. Second, it explores whether the payment is decoupled income support; and, finally, it considers whether the payment violates the fundamental requirement and how this test might be re-imagined in the light of current concerns about climate change, commodity speculation and food security.

2. ‘Greening’ and Direct Payments⁶

Direct payments play a critical role in the CAP. Originally designed to compensate farmers for the drop in their incomes caused by a shift in the structure of financial support away from agricultural production towards the producer following the MacSharry reforms in 1992,⁷ direct payments are now regarded as the ‘lever for consistent market-oriented reforms’ that ‘enhance competitiveness of the agricultural sector by encouraging farmers to adapt to market conditions’.⁸ These ‘market measures’ only manage market volatility and therefore act as a financial ‘safety net’ to farmers in instances of ‘significant price decline’.⁹ As the European Commission highlighted in its 2010 communication on the post-2013 CAP reforms, *The CAP Towards 2020*, the role of direct payments in providing basic income support to the farmer, insulating him/her from true market prices, is set to further diminish over time as farmers continue to reorient their production decisions in line with market conditions.¹⁰

The post 2013-CAP reforms set out a reinvigorated role for direct payments. In its response to the European Parliament’s call for the CAP to accommodate the contemporary challenges of food security, the impact of climate change, and the need to improve the diversity and quality of rural landscapes,¹¹ the European Commission advocated direct payments be redesigned, redistributed and targeted to farmers on the basis of economic and environmental criteria.¹² Under the European Commission’s first suggestions, ‘active farmers’ would be eligible for basic income support in the form of a decoupled direct payment provided to all farmers within the Member State, subject to an upper ceiling (‘cap’) on payments received by large farms

⁵ On the ageing of the WTO Agreement on Agriculture see generally, M.N. Cardwell & F. Smith, ‘Renegotiation of the WTO Agreement on Agriculture: Accommodating the New Big Issues,’ (2013) 62 *International and Comparative Law Quarterly* 865.

⁶ This Chapter focuses on the direct payments starting from the commencement of the current reforms for the period 2014-2020. For a discussion on ‘greening’ generally under Pillar 1 and Pillar 2 of the CAP from the MacSharry reforms onwards, see Matthews, (above n 3) 4-16. On ‘greening’ in Pillar 2, see J. Dwyer, ‘Transformation for sustainable agriculture: what role for the second Pillar of CAP’, (2013) 2 *Bio-Based and Applied Economics* 29.

⁷ S. Tangermann, *Direct Payments in the CAP Post 2013 – Note* (European Parliament, Brussels, 2011) (Tangermann Report) 13.

⁸ European Commission, *The CAP Towards 2020: Meeting the Food, Natural Resources and Territorial Challenges of the Future* COM (2010) 672, 3-4.

⁹ The European Commission explicitly refers to all the constituent instruments of the CAP, including direct payments, as ‘market management tools,’ to reinforce the message that the CAP is market orientated, not protectionist per se: *Ibid*, 9&3.

¹⁰ *Ibid*, 4.

¹¹ European Parliament, *European Parliament resolution of 8 July 2010 on the future of the Common Agricultural Policy after 2013*, (2009/2236 (INI)), paras. 6 and 7 (Parliament differentiating between ‘first’ and ‘second generation’ public goods.)

¹² COM (2010) 672, (above n 8) 8.

(with the size to be determined) to facilitate more equitable distribution of payments between farmers.¹³ In addition to this basic income support, direct payments would contain a *compulsory* ‘greening’ component supporting environmental measures across all EU Member States.¹⁴ Priority for payments would be based on measures taking the form of ‘simple, generalized, non-contractual and annual environmental actions that go beyond cross-compliance and are linked to agriculture’.¹⁵ And permanent pasture, crop rotation and ecological set-aside were amongst the measures first to be singled out by the European Commission as examples eligible for the ‘greening’ top up.¹⁶ In the Commission’s view, this compulsory ‘greening’ recognized that farmers are important providers of ‘public goods,’ for which they are not adequately remunerated by the market.¹⁷

Agricultural production is inextricably, or ‘jointly’ linked to ‘public goods’ like the preservation of agricultural landscapes and, in the case of arable production particularly, to soil and water quality.¹⁸ Water availability is equally critical to permanent pasture. Close links have been established between livestock production and greenhouse gas emissions responsible for climate change and biodiversity loss results from some fertilizer and pesticide usage. In addition to these ‘first generation’ or ‘environmental public goods’, social benefits may be derived from public goods provided by agriculture (so called, ‘second generation’ or ‘social public goods’).¹⁹ Notably, animal welfare and health, food security and maintaining rural vitality are all examples of goods in this second category.²⁰ For example, preserving farmland features such as stone walls and terraces can stimulate a range of economic activity because rural landscapes attract tourists who may also visit local businesses for recreation and sample local specialty foods, although the rural landscape, the walls and terraces remain public goods by their very nature.²¹

First generation and second generation public goods are so-called because they exhibit two characteristics to a greater or lesser extent: firstly, they are ‘non-excludable,’ because the very nature of the good means that, if one person enjoys it, other individuals cannot be excluded from enjoying the good at the same time; and secondly, they are ‘non-rival’, as enjoyment by

¹³ Ibid, 8.

¹⁴ Ibid, 9.

¹⁵ Ibid.

¹⁶ Ibid. Note that the European Commission seemed set at this stage to pursue the economic and environmental dimensions to the direct payment regime, although precisely how these were to be implemented was dependent on which policy direction was chosen: respectively, the three directions canvassed were ‘adjustment,’ ‘integration’ and ‘refocus’: *ibid*, 12; and on this point see Matthews, (above n 3) 17.

¹⁷ COM (2010) 672, (above n 8) 8.

¹⁸ L. Madureira, J. Lima Santos, A. Ferreira & H. Guimarães, *Feasibility Study on the Valuation of Public Goods and Externalities in EU Agriculture*, (JRC Scientific and Policy Reports, European Commission, 2013), 14. Note the important link between agricultural production (commodity output) with the simultaneous production public goods (non-commodity output). This linkage between commodity and non-commodity production is explored by the OECD in its work on the ‘multifunctionality’ of agriculture, the term used to capture the joint production of commodity and non-commodity outputs from agriculture. This issue will be returned to below, but in general see OECD, *Multifunctionality: Towards an Analytical Framework*, (2001), 13 on the definition of ‘multifunctionality’; OECD, *Multifunctionality in Agriculture: Evaluating the Degree of Jointness*, Policy Implications, (2008) exploring how ‘jointness’ occurs and how it might be measured & OECD, *Multifunctionality: The Policy Implications*, (2003) exploring which are the best policies to promote positive commodity outputs in agriculture.

¹⁹ T. Cooper, K. Hart and D. Baldock, *Provision of Public Goods through Agriculture in the European Union* (Institute for European Environmental Policy, 2009) viii.

²⁰ Madureira, Lima Santos, Ferreira & Guimarães (above n18), 14.

²¹ T. Cooper et. al (above 19), viii.

one person does not reduce the amount of the good that is available for enjoyment by others.²² Conventional economic theory posits the view that public goods will not be supplied by the market as their non-excludability and non-rivalry means consumers need not pay for them because the goods are already in abundant supply (although there is a risk of over exploitation in the case of the environment); and that farmers will not supply them because they have no incentive to incur the costs involved in, for example, maintaining an attractive landscape, farmland diversity, biodiversity and climate stability, as they cannot recoup the value by selling these goods on the market.²³ The assumption is that without further (financial) incentives, there will be chronic undersupply of public goods.

Undersupply is particularly worrying for a second generation public good like food security. Food security exists when ‘all people, at all times, have physical, social and economic access to sufficient, safe and nutritious food to meet their dietary needs and food preferences for an active and healthy life’.²⁴ It is the responsibility of each State to determine its own food security needs, but equally there is a global dimension to the State’s policy commitment as ‘all people’ at ‘all times’ must have access to nutritiously appropriate food. As early as March 2010, the European Parliament’s Committee on Agriculture and Rural Development (the Lyon Report) agreed that any CAP reform must respond to the predicted rise in global population from 6 to 9 billion by 2050 and the corresponding doubling in demand for food, especially by economies such as India and China, which would inevitably increase pressure on natural resources.²⁵ In some respects, agricultural markets will in any event supply food in response to market signalling, but food security displays the characteristics of a public good in that shortfalls in agricultural production, whether caused by adverse climactic conditions or otherwise, mean that it may be difficult to guarantee access to affordable and safe food without specific financial incentives to maintain a consistent food supply.²⁶

In some respects, in advocating the ‘greening’ component for direct payments, the European Commission was responding to these concerns embodied in statements from the European Parliament that preserving all ‘public goods’ produced by agriculture remains the ‘primary *raison d’être* of the CAP’ and corresponds to the ‘first concerns of Europe’s citizens’.²⁷ Indeed, it had been shown previously that the European public place a high value on public goods derived from agriculture, with attitudinal surveys revealing particular concern for potential loss

²² Ibid, v. Note the European Commission includes food safety and security in this list of first generation public goods and the environment, land management and animal welfare in second generation public goods c/f Cooper et al *ibid.*: *European Parliament resolution of 8th July 2010 on the Future of the CAP*, (above n 11), Recital 6.

²³ Ibid, v-vi.

²⁴ World Food Summit, Plan of Action, Rome, 13 November 1996, para. (as amended by the 2009 Declaration of the World Summit on Food Security, 16-18 November 2009, para. 2).

²⁵ European Parliament Committee on Agriculture and Rural Development, *The Future of the Common Agricultural Policy after 2013*, (2009/2236(INI)), 24 March 2010, paras. O, P and 8. The Report notes that there are over 1 billion hungry people and that there are over 40 million in the EU who are poor and do not have enough to eat: *ibid*, para. O. Further, the Commission identified food security as one of the three strategic aims of the reformed CAP: COM (2010) 672, (above n 8) 2.

²⁶ T. Cooper *et al*, (above n 17) vii. The extent to which financial incentives for domestic agricultural production have positive effects on domestic and global food security has been questioned: see S. Rickard, ‘Liberating farming from the CAP’, (2012) 32 *Economic Affairs* 85; and O. Schmid, S. Padel and L. Levidow, ‘The bio-economy concept and knowledge base in a public goods and farmer perspective’, (2012) 1 *Bio-Based and Applied Economics* 47.

²⁷ European Parliament: *European Parliament resolution of 8 July 2010 on the future of the Common Agricultural Policy after 2013*, (2009/2236 (INI)), (above n 11) para. 6 (and see also the Lyon Report, (above n 22) para. 24).

of rural biodiversity and the need to preserve rural landscapes.²⁸ However, as Matthews notes, the Lyon Report advocated ‘greening’ through expansion of Pillar 2 (rural development), not Pillar 1 (direct payments).²⁹ In fact, when in 2010 the European Parliament voted on the future of the CAP, it accepted that direct payments could both ‘contribute to the provision of public goods’ otherwise unavailable on the market and protect farms against market and price fluctuations,³⁰ but at the same time there was emphasis on the importance of limiting support to active agricultural production³¹ and adequately addressing the diversity of farming and its production locations in the EU.³² As such, the European Parliament rejected a flat-rate per hectare payment,³³ running contrary to the European Commission’s objective of the ‘simplification’ of the CAP and cast doubt on the all-encompassing ‘greening’ which the European Commission envisaged for Pillar 1 payments (as opposed to expanding ‘greening’ within Pillar 2).³⁴ Instead, the European Parliament supported a ‘top up’ payment, but only when linked closely to strong sustainability criteria built in to multiannual contracts for farmers as their ‘reward’ for reducing carbon emissions per unit of agricultural production.³⁵ And this payment was to be based on ‘clear and measurable criteria and targets’.³⁶

When the Regulation for the revised direct payments regime was issued, it was proposed that the payment of 30 per cent of national ceilings be conditional on implementing mandatory ‘greening’ measures, (specifically, crop diversification, the maintenance of permanent grassland and ecological focus areas) as these measures were beneficial to the climate and the environment,³⁷ while enabling the EU to deliver a strong CAP that addressed the three key challenges for future agricultural production, namely food security, sustainable management of natural resources and territorial development.³⁸

Despite consensus on the general direction of travel towards a stronger environmental dimension to the CAP, the European Commission and the European Parliament continued to disagree on the extent to which such policy objectives should be accommodated within direct

²⁸ T. Cooper *et al.*, (above n 19) vii.

²⁹ Matthews, (above n 3) 17.

³⁰ European Parliament: *European Parliament resolution of 8 July 2010 on the future of the Common Agricultural Policy after 2013*, (2009/2236 (INI)), (above n 11) para. 64.

³¹ *Ibid.*, para. 70.

³² European Parliament Committee on Agriculture and Rural Development, *The CAP Towards 2020: Meeting the Food, Natural Resources and Territorial Challenges of the Future*, (2011) (Dess Report) para. 9.

³³ European Parliament: *European Parliament resolution of 8 July 2010 on the future of the Common Agricultural Policy after 2013*, (2009/2236 (INI)), (above n 11) para. 64. Note too domestic opposition to a single flat rate payment: see, eg, House of Commons, Environment, Food and Rural Affairs Committee, *Greening the Common Agricultural Policy*, First Report of the Session 2012-3, HC-170 (2012), para. 13.

³⁴ Above n 8, 8.

³⁵ Interestingly, the starting point from which to measure whether the farmer has in fact reduced carbon emissions is specified in the proposal: European Parliament, *European Parliament resolution of 8 July 2010 on the future of the Common Agricultural Policy after 2013*, (2009/2236 (INI)), (above n 11) para. 71.

³⁶ *Ibid.*, para. 72.

³⁷ COM (2011) 625, *Proposal for a Regulation of the European Parliament and the Council establishing rules for Direct Payments to Farmers under Support Schemes within the Framework of the Common Agricultural Policy*, Explanatory Memorandum, 3. Despite the European Commission’s conviction of the pro-environment/sustainability credentials of the greening component, non-governmental organisations (NGOs) including Greenpeace, Friends of the Earth and WWF remained skeptical. A full discussion of the greening top-up payment’s effectiveness is outside the scope of this article, but see BirdLife & others, *Inter-Service Consultation on CAP Reform: Concerns that Greening of the CAP is Being Jeopardized and Losing Environmental Focus*. Brussels, 1 September 2011 (the ‘BirdLife report.’)

³⁸ *Ibid.*, Explanatory Memorandum, 5.

payments.³⁹ Nonetheless, in June 2013 political agreement was reached on the main aspects of the reforms.⁴⁰ Direct payments will consist of the Basic Payment; a mandatory ‘greening component’ to consist of 30 per cent of national ceilings in respect of measures aimed at crop diversification, the maintenance of permanent grassland and ecological focus areas; an additional, compulsory payment for eligible ‘young farmers’ for a maximum period of five years; and a range of other schemes available at the option of Member States. It is upon the compatibility of the ‘greening component’ with WTO rules that this discussion will focus.⁴¹

3. The ‘Greening Component’ and the WTO

Throughout the reform process both the European Commission and the European Parliament, despite their divergence over precisely how ‘greening’ within direct payments should be conceived, assumed the reforms complied with the AoA. In the *Impact Assessment* which accompanied the proposed legislation, the European Commission highlighted the EU’s strong contribution to international agriculture and food trade for both imports and exports of agricultural products brought about by the gradual movement to a more market-orientated system of support for agriculture post-1992.⁴² Observing that for the period 2008-10 the EU was the world’s largest agricultural importer, with average annual imports of €83 billion, and that even exports amounted to an annual average of €82 billion, an equivalent level to that of the United States,⁴³ the European Commission expressly stated that the EU’s positive success in international agricultural trade was achieved against a background of the CAP’s *full compatibility* with the WTO rules, specifically the AoA.⁴⁴

The AoA’s rules are designed to ‘establish a fair and market-oriented agricultural trading system’ and to provide a framework for ‘substantial progressive reductions in agricultural support and protection’.⁴⁵ They also aim to restructure the system of support for agriculture within each WTO Member towards one where farmers’ production decisions respond solely to the demand for the product on the market and where neither that demand nor supply is itself shaped by support measures or other protectionist measures used by the Member.⁴⁶ The WTO compatibility of the ‘greening’ payment will be determined under the AoA’s second Pillar, that is, the rules governing domestic support.

Under these rules, each Member must quantify the levels of domestic support given to their domestic agricultural producers.⁴⁷ As a first stage, each Member calculates the level of support

³⁹ For a comprehensive treatment of these disagreements, see Matthews (above n 3) 16-19.

⁴⁰ European Commission, IP/13/613, *Political Agreement on New Direction for Common Agricultural Policy*, Brussels, 26 June 2013; and note that the outstanding issues were resolved in September 2013: European Commission, IP/13/864, *Reform of the Common Agricultural Policy (CAP): Political Agreement Reached on Last Remaining Points*, Brussels, 26 September 2013.

⁴¹ On the single payment generally, see Cardwell, Chapter 4.

⁴² European Commission, *Impact Assessment: Common Agricultural Policy Towards 2020*, (above, n 4) 32.

⁴³ Ibid. citing *Global and EU agricultural exports rebound*, MAP Newsletter, May 2011, <http://ec.europa.eu/agriculture/publi/map/brief3.pdf>. It is difficult to say how far these figures can be externally verified, see OECD-FAO, *Agricultural Outlook 2013-2022*, (OECD Publishing, 2013), 45, Fig. 1.15.

⁴⁴ Ibid. For a detailed exposition on the AoA, see, eg, J.A. McMahon, *The WTO Agreement on Agriculture: a Commentary* (Oxford University Press, 2006). Doubts as the compatibility of the CAP with the WTO rules have long been expressed: see, eg, A. Swinbank, ‘The Reform of the EU’s Common Agricultural Policy’, in R. Meléndez-Ortiz, C. Bellmann and J. Hepburn (eds), *Agricultural Subsidies in the WTO Green Box: Ensuring Coherence with Sustainable Development Goals* (Cambridge University Press, 2009) 70.

⁴⁵ AoA, Preamble, Recitals 2 and 3.

⁴⁶ See generally M. Cardwell and F. Smith, (above n 5), 874.

⁴⁷ For a detailed exposition of the AMS, see McMahon, (above n 44) 67-69.

provided to their producers on a product-specific basis. This figure determines the Member's Aggregate Measurement of Support (AMS), namely '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'.⁴⁸ Complex calculations to determine the AMS are undertaken in accordance with the methodology outlined in Annex 3 to the AoA. It is the sum of all aggregate measurements of support for 'basic agricultural products',⁴⁹ all non-product-specific aggregate measurements of support and all equivalent measurements of support⁵⁰ that reveals the total domestic support given by each Member to their agricultural producers. This is referred to as the Member's 'Total AMS'.⁵¹

Members were required first to calculate their Total AMS for the years 1986-1988 (the 'base period'). Each developed Member was then required to reduce their base AMS by 20 per cent over the six-year implementation period (1995-2001);⁵² and all developing Members were allowed to apply lower rates of reduction provided that they were no less two-thirds of the rate required for developed nations.⁵³ All Members were required to specify in their Schedule of Commitments their Annual Bound AMS for each year of the implementation period, together with a Final Bound AMS which would represent the maximum allowable level of domestic support the Member could give to its domestic agricultural producers at the end of the implementation period (i.e., 2001).⁵⁴ Following the end of the implementation period, liability for violation of the reduction commitments arises if the level of domestic support provided by the Member in any given year (i.e., the Current Total AMS) exceeds the Member's Final Bound AMS as specified in their Schedule.⁵⁵ As specified under Article 3.2 of the AoA, a Member is not permitted to provide support for its domestic producers above the levels notified in its Schedule of Commitments.⁵⁶

Under Article 6.1 of the AoA, these reduction commitments apply to 'all domestic support *measures*' which are the means by which support is deployed to a Member's agricultural producers, unless the Member can show that those measures (and, as a corollary, the support) are exempt.⁵⁷ Measures may be exempt from reduction commitments either because they are *de minimis*;⁵⁸ they fall in Article 6.5 of the AoA as a 'direct payment under a production-limiting programme' (the so-called 'Blue Box'); or they fall within Annex 2 to the AoA (the

⁴⁸ AoA, Article 1(a). Support is calculated on a product-specific basis for each product receiving support, with one total provided for all non-product-specific support: *ibid*, Annex 3, para. 1.

⁴⁹ *Ibid*, Article 1(b): '...the product as close as practicable to the point of first sale as specified in a Member's Schedule...'.

⁵⁰ For equivalent measurements of support in situations 'where market support as defined in Annex 3 exists, but for which the calculation of this component of the AMS is not practicable', see Annex 4.

⁵¹ *Ibid*, Article 1(h).

⁵² *Ibid*, Article 1(f).

⁵³ No reductions were required for least-developed countries (LDCs). On developing country and LDC domestic support reduction commitments, see GATT, *Modalities for the Establishment of Specific Binding Commitments under the Reform Programme*, MTN.GNG/MA/W/24, 20 December 1993, paras. 15 and 16.

⁵⁴ AoA, Article 1(h)(i) and 1(h)(ii).

⁵⁵ For more detail, see McMahan, (above n 44) 69.

⁵⁶ AoA, Article 3.2 (with reference to Section I of Part IV of its Schedule).

⁵⁷ Emphasis added. See also L. Brink, 'The WTO Disciplines on Domestic Support', in D. Orden, D. Blandford and T. Josling (eds.), *WTO Disciplines on Agricultural Support: Seeking a Fair Basis for Trade* (Cambridge University Press, 2011) 23, 26 (together with the useful table at 27 outlining how the AoA impacts on domestic support measures and how the rules work).

⁵⁸ AoA, Article 6.4.

so-called ‘Green Box’).⁵⁹ For a measure to be exempt from reduction commitments under the Green Box, it must meet the fundamental requirement that the measure has ‘no or at most minimal, trade-distorting effects or effects on production’ and the two basic criteria that the support is ‘provided through a publicly-funded government programme (including revenue foregone) not involving transfers from consumers’ and that the support does ‘not have the effect of providing price support’. In addition, the measure must also comply with one or more of the policy-specific criteria set out in paragraphs 2-13 of Annex 2 to the AoA. The crucial issue for the new post-2013 CAP ‘greening’ component is whether it is an exempt measure that falls within the Green Box.

Two possible arguments in support of exemption can be made: first, that the ‘greening’ component is ‘decoupled income support’ under paragraph 6 of Annex 2; and, second, that it is a ‘payment under an environmental programme’ under paragraph 12. However, as has been seen, in the *Impact Assessment* which accompanied the proposed legislation the European Commission took the view that, if the ‘greening’ component were to be Green Box compatible, it would be by virtue of its qualifying as ‘decoupled income support’: in a surprising statement given the stated pro-environmental objectives, possible exemption under paragraph 12 of Annex 2 was rejected, it being argued instead that it is the ‘*decoupled nature* of the greening component [that] must be safeguarded’ because ‘it would *not be possible to qualify the greening component as an environmental payment*, since this would require a costs incurred/income foregone calculation’.⁶⁰ Therefore, the case for exemption of the ‘greening’ component from the EU’s domestic support reduction commitments under the AoA rests solely on compatibility with paragraph 6 to Annex 2. Although the European Commission has proceeded in its reforms to the direct payment regime on the basis that compliance with WTO rules is assured, the position under the Direct Payments Regulation is less certain.⁶¹

Accordingly, the discussion will consider next whether the ‘greening’ component is decoupled income support in accordance paragraph 6 of Annex 2. This is consistent with the analysis adopted by the WTO Appellate Body when deciding whether the upland cotton regime of the United States provided ‘decoupled income support’, so qualifying for Green Box exemption: it first determined whether the measures provided ‘decoupled income support’ and then moved on to evaluate their compatibility with the ‘fundamental requirement’.⁶²

a. Decoupled Income Support

According to the decision of the Appellate Body in *United States-Subsidies on Upland Cotton (US-Upland Cotton)*, for the purposes of securing Green Box exemption from domestic support reduction commitments, a measure provides decoupled income support under paragraph 6 of Annex 2 if:

⁵⁹ For a tour de force on the scope of the Green Box, see R. Meléndez-Ortiz *et al*, (above n 44).

⁶⁰ European Commission, *Impact Assessment: Common Agricultural Policy Towards 2020*, (above n 4) Annex 2, 17, n 8 (emphasis added). Ironically, the European Commission lists ‘providing environmental public goods’ as a specific objective in the *Legislative Financial Statement* accompanying the Impact Assessment: *ibid*, 72.

⁶¹ Regulation (EU) 1307/2013 of the European Parliament and of the Council establishing rules for direct payments to farmers under support schemes within the framework of the common agricultural policy, [2013] OJ L347/608 (Direct Payments Regulation).

⁶² WT/DS267/AB/R, *United States – Subsidies on Upland Cotton*, paras. 313 and 334. Note that the interpretation of the Green Box did not form part of subsequent WTO disputes surrounding the United States’ implementation of the Appellate Body’s rulings: *United States – Subsidies on Upland Cotton-Recourse to Article 21.5DSU by Brazil*, WT/DS/267/RW (panel report) and WT/DS267/AB/RW (Appellate Body).

- (a) eligibility for the payment is determined on the basis of ‘clearly-defined criteria’ including the producer’s income, their status as an agricultural producer/landowner, factor usage or the production level in a ‘defined and fixed base period’;
- (b) there is no link between the amount of payment and the type or volume of production undertaken by the farmer in any given year after the initial base period;
- (c) the link is severed between the payment to farmers and domestic or international prices for the production in any year after the ‘base period;’
- (d) there is no link between the payment and factors of production used by the farmer in any year after the base period; and,
- (e) no production is required for the farmer to receive the payment.⁶³

Paragraph 6 of Annex 2 therefore ‘seeks to decouple or de-link direct payments to producers from various aspects of their production decisions and thus aims at neutrality in this respect.’⁶⁴ As noted above, the post-2013 CAP’s revised direct payment regime consists of a basic payment, a ‘greening’ component, the payment for young farmers and various optional schemes: the redistributive payment; voluntary coupled support; the payment for areas with natural constraints; and a small farmer scheme.⁶⁵ The focus of this analysis is on the ‘greening’ component’s compatibility with the Green Box, specifically whether or not it is decoupled income support.

The ‘greening’ component is available only to farmers who are already entitled to payment under the basic payment scheme as set out in the Direct Payments Regulation.⁶⁶ To be compatible with paragraph 6(a) of Annex 2 to the AoA, the eligibility criteria for the payment (including a number of factors expressly listed in paragraph 6(a)) must be ‘clearly defined’ in respect of a ‘defined and fixed base period’. Whether the ‘greening’ component conforms to this paragraph is uncertain, with several issues arising.

As Tangermann noted in his policy paper for the European Parliament, the European Commission believed that the post-2013 CAP reforms only modify the previous, allegedly WTO-compliant, direct payment scheme; and that, as such, the reforms do not implement a completely new scheme.⁶⁷ Whether the scheme is in fact an updated scheme with a revised base period, or a new, successor regime remains unclear. The Direct Payments Regulation together with the Direct Payments Implementing Regulation both state that the *legal* regime has been ‘repealed and replaced,’ with 2014 as the new date from which eligibility for the basic payment scheme will be assessed.⁶⁸ And, further, that the change in rules should ‘in principle, result in the expiry of payment entitlements... and the allocation of new ones.’⁶⁹ Yet, direct payments as a general *form* of EU support for farmers remain. Indeed, the advice to farmers in

⁶³ Ibid, paras. 321-3.

⁶⁴ Ibid, para 325.

⁶⁵ European Commission, *Overview of CAP Reform 2014-2020: Agricultural Policy Perspectives Brief No. 5* (December 2013) 7 (and Chart 4).

⁶⁶ Direct Payments Regulation, (above n 61) Article 43(1).

⁶⁷ Tangermann, (above n 6), 10. Doubts have, however, been raised as to whether the previous scheme was in fact WTO-compliant: see, eg, A. Swinbank and R. Tranter, ‘Decoupling EU farm support: does the new Single Farm Scheme fit within the Green Box?’, (2005) 6 *Estey Centre Journal of International Law and Trade Policy* 47.

⁶⁸ Direct Payments Regulation (above n 61) Recital (1) & Commission Delegated Regulation (EU) No 639/2014 of 11 March 2014 supplementing Regulation (EU) No 1307/2013 of the European Parliament and of the Council establishing rules for direct payments to farmers under support schemes within the framework of the common agricultural policy and amending Annex X of that Regulation (Direct Payments Implementing Regulation), Recitals (1), (78) & (79).

⁶⁹ Direct Payments Regulation (above n 61) Recital 21.

England from the Rural Payments Agency charged with the stewardship of the scheme is that farmers need not apply for new ‘entitlements’ as their existing ones will simply become their ‘entitlements’ for the purposes of the new scheme, although a *claim* for the payment is predicated on the farmer meeting the ‘active farmer’ and ‘greening’ eligibility criteria.⁷⁰ Some remnants of the previous scheme appear to endure therefore. This uncertainty raises difficult questions as to compatibility with paragraph 6(a) of Annex 2 since it requires that the eligibility for payments must be established in a ‘defined and fixed base period’, thus suggesting that once it is established, the base period *cannot* be changed at all after that time.

This point was raised by Brazil before the panel and Appellate Body in the context of the United States’ modifications to the eligibility criteria of its production flexibility contracts in the *US – Upland Cotton* dispute.⁷¹ Brazil argued that updates to a scheme of payment would violate paragraph 6(a), but both the panel and Appellate Body exercised judicial economy on this point as they found violation under paragraph 6(b). The point remains open therefore. Interestingly, before the panel, the EU as a third party to the dispute, argued that there was nothing in paragraph 6(a) of Annex 2 in principle ‘that prevented different base periods where *eligibility* was based on previous eligibility for production distorting subsidies.’⁷² Although it went on to express concern that continually updating the base period might lead to an expectation on the part of farmers that they *will* receive the payment at some point in the future for production of certain crops, which, for the EU, undermined the very nature of the support being decoupled.⁷³ The panel did not discuss this point however.

Even if modification to the base period is possible for the payment to remain compatible with paragraph 6(a) of Annex 2, farmers may only qualify for direct payments under the Direct Payments Regulation if they exercise an ‘agricultural activity’: more precisely, they must produce, rear or grow agricultural products, including livestock; they must maintain an agricultural area in basic readiness for grazing or cultivation; or they must carry out a ‘minimum level of activity’ as defined by their Member State on agricultural areas naturally kept in a state suitable for grazing or cultivation.⁷⁴ Further, the Direct Payments Regulation specifically confines entitlement to ‘active farmers’, specifically excluding natural or legal persons, or groups of natural or legal persons, who ‘operate airports, railway services, waterworks, real estate services, permanent sport and recreational grounds’.⁷⁵ Predicating payment on the carrying out of conventional farming activities by a natural or legal person, or a group of such persons, clearly links the payment to their ‘status as an agricultural producer or landowner’ and as such meets a key criterion of paragraph 6(a).

The Direct Payments Regulation also provides that entitlement to the Basic Payment is dependent upon the number of ‘eligible hectares’ which the farmer enjoys.⁷⁶ As has been seen,

⁷⁰ Rural Payments Agency, *CAP reform in England: What you need to know now*, (DEFRA, UK, February 2014), 3 (note that the document makes it clear it is not a definitive statement of the legal position, but is guidance to farmers only.). Note that in its consultation on the CAP reforms, the UK government announced it will be ‘rolling forward the Single Payment Entitlements Scheme’ into the eligibility criteria for the Basic Payments Scheme: DEFRA, *Consultation on the implementation of CAP reform in England: summary of responses and government response*, December 2013, para 2.48.

⁷¹ *United States-Subsidies on Upland Cotton*, Report of the Panel, WT/DS267/R, para. 7.393-7.405 and WT/DS267/AB/R, (above n 62), paras. 343-344.

⁷² WT/DS267/R, *ibid*, para 7.392 (emphasis added).

⁷³ *Ibid*.

⁷⁴ Direct Payments Regulation, (above n 61) Articles 4(1)(c)(i)-(iii). See also Chapter 4 above.

⁷⁵ *Ibid*, Article 9(2).

⁷⁶ *Ibid*, Article 32(2)-(5).

paragraph 6(a) requires that, to be decoupled income support, eligibility can be determined by reference to ‘status as a producer or landowner’; and tying entitlement to the number of ‘eligible hectares’ would seem to forge a link both with the identity of the farmer in one or more of such capacities, and to ‘factor use’ to the extent that the farmer’s *land* eligible for payment is a ‘factor’ of production, to this extent at least ensuring compatibility with paragraph 6(a).

In some respects, the farmer’s right to receive the ‘greening’ component relates to the climate and environment-friendly nature of the production which the farmer undertakes *after* his/her eligibility to receive the Basic Payment has been established. As such, whether the ‘greening’ component is decoupled income support or not falls to be considered under paragraph 6(b), rather than paragraph 6(a), as it is paragraph 6(b) that interrogates the potential link between the payment and agricultural production in subsequent years after initial eligibility is established: by contrast, paragraph 6(a) sets out the mandatory requirements to receive the support only in the ‘base period’. Whilst it is clear that an analysis under paragraph 6(b) must be undertaken in relation to the ‘greening’ component, the precise relationship between the criteria listed in paragraph 6 has not been articulated fully by the Appellate Body, although the panel in *US-Upland Cotton* argued that each of the criteria should be given ‘meaning and effect’.⁷⁷

An EU farmer, entitled to the Basic Payment, must undertake *compulsory* ‘greening’ practices on their ‘eligible hectares’ to secure that Basic Payment. Failure to do so results in financial penalties for the farmer: more precisely, the aid is not to be paid or is to be withdrawn in full or part.⁷⁸ This would seem to tie the availability of the Basic Payment firmly to the ‘greening’ criteria as the farmer’s failure to undertake the requisite practices beneficial to the climate and the environment would appear to lead, in the correct circumstances, to no payment at all.⁷⁹ This seems, at least on the surface, to be a similar link to that which existed in the US Production Flexibility Contracts which were the subject of the *US-Upland Cotton* dispute: if the farmer did not comply with the requirement to plant crops other than the specified fruits, vegetables and wild rice, they ceased to be eligible for payment.

At first glance, the ‘greening’ component looks unproblematic for the purposes of paragraph 6(a) of Annex 2 to the AoA. It ‘clearly defines’ the preferred agricultural practices beneficial for the climate and the environment which the farmer must observe in order to receive payment.⁸⁰ As indicated, these practices are crop diversification, the maintenance of permanent grassland and ecological focus areas.⁸¹ And, for each practice, the Direct Payments Regulation goes on to specify exactly how much land must be covered by the scheme, and in the case of

⁷⁷ WT/DS267/R, (above n 71) para. 7.368.

⁷⁸ Regulation (EU) 1306/2013 of the European Parliament and of the Council on the financing, management and monitoring of the common agricultural policy [2013] OJ L347/549, Article 63(1). One reading of Article 63(1) suggests that it is the ‘greening’ component which is not paid or withdrawn on the basis that this is ‘the aid’ in respect of which the farmer has failed to comply with the criteria: see Matthews, (above n 3), who argues that the penalties would therefore have little deterrent effect: at 20. However, the express link in Article 43(1) of the Direct Payments Regulation between the Basic Payment and the ‘greening’ component means that this is not an inevitable interpretation.

⁷⁹ Direct Payments Regulation, (above n 61) Recital 39; and Regulation (EU) 1306/2013, (above n 78) Article 63(1).

⁸⁰ Direct Payment Regulation, (above n 61) Title III, Chapter 3 generally.

⁸¹ *Ibid*, Articles 43(2)(a)-(c).

crop diversification, the number of crops to be planted before the planting is suitably ‘diversified’.⁸²

A note of doubt is, however, injected by the fact that the Direct Payments Regulation also states the farmer can receive payment if s/he adopts ‘equivalent’ practices that ‘yield equivalent or higher level[s] of benefit for the climate and the environment’ when compared to one or more of the three definitive ‘greening’ measures already mentioned, namely crop diversification, permanent grassland and ecological focus areas.⁸³ What is an ‘equivalent’ practice is set out in Annex IX to the Direct Payments Regulation itself. But, it is interesting to note that compliance can be achieved, for example, through national or regional environmental certification schemes that ‘go beyond’ the cross-compliance requirements laid down by Regulation (EU) 1306/2013.⁸⁴ Precisely when a national or regional environmental certification scheme will be deemed to ‘go beyond’ cross-compliance such that it becomes ‘equivalent’ for the purposes of Article 43(1) of the Direct Payments Regulation is unclear from an EU perspective.⁸⁵ Recital 40 of the Regulation does state that ‘[f]or reasons of legal certainty’ the European Commission is to ‘assess whether the practices covered by the notified equivalent measures are covered by [Annex XI]’. Yet it is not immediately obvious that the WTO Appellate Body would find that tying farmers’ eligibility for the ‘greening’ component to equivalent environmental practices expressed in such vague terms is sufficiently clear definition for the purposes of paragraph 6(a). On the other hand, there is a strong argument that the critical issue is whether the criteria for eligibility are defined with sufficient clarity at the point when the *farmer* makes the claim in the Member State. As such, the issue may become moot and compatibility with paragraph 6(a) secured.⁸⁶ Compatibility with paragraph 6(b) is more difficult.

b. Paragraph 6(b) of Annex 2 – Linkage Requirements after the Base Year

As noted above, paragraph 6(b) of Annex 2 stipulates that a measure purporting to link eligibility for the payment with the ‘type or volume of production’ in any year after the base period is not decoupled income support. Such a link is found if the payment is ‘based on, or related to’ the ‘type or volume’ of production. Any measure that fails this test is not exempt from the Member’s domestic support reduction commitments in Article 6(1) of the AoA, and as a consequence falls within the member’s Current Total AMS.⁸⁷ A partial analysis of the scope of paragraph 6(b) was undertaken by the Appellate Body in *US – Upland Cotton*.

For the Appellate Body, the requisite prohibited relationship between the payment and production for the purposes of paragraph 6(b) arises either where there is a close and proximate (though not strict) connection between the payment and the type/volume of production,

⁸² Ibid, Article 44.

⁸³ Ibid, Article 43(1) and (3).

⁸⁴ Ibid, Article 43(3)(b).

⁸⁵ See the discussion by Matthews, (above n 3) regarding the ‘watering down’ of the ‘greening’ measures by the European Parliament.

⁸⁶ Note also that Brazil appealed the ‘updating’ of the base period for the purposes of determining the eligibility for production flexibility payments in *US – Upland Cotton*, which opened the possibility for the Appellate Body to analyse the scope of paragraph 6(a) in more detail. However, the Appellate Body declined to do so, arguing on the basis of judicial economy that they had sufficiently determined that the US measure was not decoupled income support on the basis of paragraph 6(b), so leaving the scope of paragraph 6(a) unclear:

WT/DS267/AB/R, (above n 62) paras. 343-344.

⁸⁷ AoA, Article 7.2(a).

meaning that the payment is ‘based on’ that production after the base period,⁸⁸ or where there is a ‘broader set of connections’ between the payment and the type/volume of production, meaning that the payment is ‘related to’ that production after the base period.⁸⁹ The latter alternative was the focus of the decision of the Appellate Body.⁹⁰ It reiterated the panel’s argument that ‘related to’ was a ‘very general notion’ which could encompass both positive and negative connections between the payment and the type/volume of production.⁹¹ Indeed, it could cover the situation where some crops were partially excluded from the payment, as this ‘had the potential to channel production towards the production of crops not so excluded’.⁹²

When finding the United States’ planting flexibility and direct payments violated paragraph 6(b) of Annex 2, the Appellate Body stressed that any programme which prevented the farmer from claiming the payment when s/he planted certain crops did ‘relate’ the payment to the ‘type’ of production. As the panel had noted, there was no *general* requirement to produce any particular crop, because the programme did give the farmer a choice whether to produce the prohibited crops or not.⁹³ But the Appellate Body thought this choice was more apparent than real because if the farmer did produce those crops, the payment s/he received was reduced. As a consequence, the system created ‘an incentive to switch from producing excluded crops to producing crops eligible for payment’.⁹⁴ It is the payment’s impact on the production decisions of the farmer which seems to be key to determining whether the payment is decoupled or not under paragraph 6(b).⁹⁵ As the Appellate Body stated in its deliberations, paragraph 6 ‘seeks to decouple or de-link direct payments to producers from various aspects of their production decisions and this aims at neutrality in this regard’.⁹⁶ Thus, paragraph 6(b) is violated if payments are related to or based on a positive or negative requirement to grow certain crops or a combination of the two. It appears therefore to be sufficient for violation if there is a link to ‘certain’ unnamed crops, provided that those crops can be sufficiently identified. On this basis, the ‘greening’ component may prove equally problematic.

It may be reiterated that, to be eligible for the ‘greening’ component, the farmer must undertake ‘agricultural practices beneficial for the climate and the environment’. And it has also been seen that the preferred climate and environmentally-friendly practices are those set out in Article 43(2)(a) to (c) of the Direct Payments Regulation, namely crop diversification, the maintenance of existing permanent grassland and having an ecological focus area, although the farmer may also adopt ‘equivalent practices’ which may be covered, for example, by national and regional certification schemes (so long as they go beyond cross-compliance).⁹⁷ For the European Commission therefore, the requirement to shift to crop diversification is a requirement based on land use rather than production of specific crops and, as such, is unproblematic for paragraph 6(b).

⁸⁸ WT/DS267/AB/R, (above n 62) para 324 (fn 315), drawing on its findings on how to determine the relationship between two things in the context of whether a measure was a ‘reasonably available less trade restrictive measure’ for the purposes of Article XX(d) GATT in WT/DS135/AB/R *EC – Absestos*, paras. 165-166 and 171.

⁸⁹ WT/DS267/AB/R, (above n 62) paras. 324 and 331.

⁹⁰ *Ibid.*, para. 324.

⁹¹ *Ibid.*

⁹² *Ibid.*, para. 329.

⁹³ WT/DS267/R, (above n 71) para 7.383.

⁹⁴ WT/DS267/AB/R, (above n 62) para. 331.

⁹⁵ See Swinbank and Tranter, (above n 67) 50.

⁹⁶ WT/DS267/AB/R, (above n 62) para. 325.

⁹⁷ Direct Payment Regulation, (above n 61) Article 43(3).

Yet under the crop diversification requirements, farmers with 10-30 hectares of arable land must cultivate at least two different crops and farmers with arable land in excess of 30 hectares must cultivate at least three.⁹⁸ In both cases, the main crop cannot cover more than 75 per cent of the holding; and, where the holding exceeds 30 hectares, the two main crops together cannot exceed 95 per cent of the holding.⁹⁹ There are various exceptions to these rules: for example, they do not apply where more than 75 per cent of the arable land is used for the production of grasses or other herbaceous forage, is fallow or is subject to a combination of these uses (so long as the arable area not covered by these uses does not exceed 30 hectares).¹⁰⁰

Whilst arable farmers with medium and large holdings must move away from monoculture towards diversified production, the crop diversification requirement seems at first glance to be compliant with paragraph 6(b). This is because there is no requirement for the farmer to diversify from or into any explicit type of production in the sense that the United States' production flexibility and direct payments were found to be linked expressly to the (non-) production of fruits, vegetables and wild grains.¹⁰¹ Although it should be noted that the alternative crops for the diversification must come within the four broad categories listed in Article 44(4)(a)-(d) of the Direct Payments Regulation, namely 'a culture of a different genera defined in the botanical classification of crops; a culture of the species in the case of *Brassicaceae*, *Solanaceae* and *Cucurbitaceae*; land lying fallow, and grasses or other herbaceous forage'. This is not a wholly unfettered choice of substitution, therefore, as those farmers growing cauliflower for example, may not swap their production over to Brussels sprouts, because both crops fall within the scope of Article 44(4)(b) as a 'culture of the species in the case of *Brassicaceae*, *Solanaceae* and *Cucurbitaceae*' and, as such, will not be sufficiently diversified for the purposes of eligibility for the 'greening' component.¹⁰²

The precise point at which a payment is no longer deemed linked to the type or volume of production in this way for the purposes of satisfying paragraph 6(b) and possibly paragraph 6(e) of Annex 2 AoA is not discussed by the Appellate Body in *US-Upland Cotton*, although the answer may lie in whether the payment meets the 'fundamental requirement' as having 'no, or at most minimal, trade-distorting effects or effects on production' in paragraph 1 of Annex 2 to the AoA.¹⁰³ The scope of the fundamental requirement and its application to the greening component is returned to below. The Appellate Body was careful to state however that a total prohibition on production was not at issue in *US-Upland Cotton*, so the determination as to whether it was possible to adjudicate a complete prohibition under both paragraph 6(b) and 6(e) was left open.¹⁰⁴

In the case of farmers with 10 hectares or more of arable land who are producing *more* than 75 per cent of one crop on that land, failure to *change* the pattern of production in order to meet the 75 per cent threshold would mean incurring financial penalties. So, just as the Appellate Body found in *US – Upland Cotton*, the farmer has 'an incentive to switch from producing excluded crops to producing crops eligible for payment'.¹⁰⁵ And it is argued that violation

⁹⁸ Ibid, Article 44(1).

⁹⁹ Ibid.

¹⁰⁰ Ibid, Article 44(3)(a).

¹⁰¹ WT/DS267/AB/R, (above n 62) para. 331.

¹⁰² DEFRA, *Greening: Work out what it means for you*, June 2014, (UK Government), 12.

¹⁰³ WT/DS267/AB/R (above n 62), para 322.

¹⁰⁴ Ibid, para 322.

¹⁰⁵ Ibid. The Appellate Body was happy in that case to draw on other WTO rules on goods to interpret the obligations in paragraph 6 of Annex, notably interpretations of Article XX(d) GATT; and perhaps the

occurs even though eligibility for the ‘greening’ component is not based on or related to production of named crops in Article 44(1) of the Direct Payments Regulation, since it is possible to identify both the type and the volume of the crop that the farmer no longer produces in order to become eligible for the payment.

Equally problematic are exceptions to the crop diversification rules such as that applicable where more than 75 per cent of the arable land is used for the production of grasses or other herbaceous forage, is fallow, or is subject to a combination of these uses. Whilst this requirement might be designed to tie the ‘greening’ component to beneficial land use rather than production/non-production as such, it is arguable that eligibility for the ‘greening’ component is nonetheless ‘based on’ or ‘related to’ the type or volume of production in violation of paragraph 6(b).

The maintenance of permanent grassland is also an agricultural practice beneficial for the climate and the environment for the purposes of eligibility for the ‘greening’ component.¹⁰⁶ Article 45(1) of the Direct Payments Regulation makes it clear that the Member States must designate permanent grasslands which are environmentally sensitive in areas covered by the Habitats Directive and Wild Birds Directive,¹⁰⁷ or on the grounds that the land is environmentally valuable for other reasons, such as, for example, it has carbon-rich soil.¹⁰⁸ Farmers will be eligible for the ‘greening’ component if they ‘do not convert or plough’ the land so designated, although this prohibition does not preclude other forms of agricultural activity including grazing livestock on the grassland¹⁰⁹; and the Member States must ensure that the land so designated does not decrease by more than 5 per cent of the reference ratio chosen by the Member State in 2015 (the base period) and calculated in accordance with criteria in Article 45(2).

Like the crop diversification requirement, the Member State’s obligation to designate certain areas as permanent grassland is aimed at land use, rather than agricultural production *per se*: indeed, if anything, the farmer’s obligation is *not* to undertake agricultural production on these areas. For the purposes of paragraph 6(b) of Annex 2, this limitation relates eligibility for the payment to the volume of production, although the link to production of specific crops is not as obvious in this context as, for example, in the case of crop diversification.

In its examination of United States’ Production Flexibility Contract payments and direct payments in the *US – Upland Cotton* dispute, the Appellate Body took the view that, when the availability of a payment to a farmer was made contingent on a total ban on agricultural production, this prohibition should be more appropriately considered under paragraph 6(e) as opposed to paragraph 6(b), as the former provides that ‘[n]o production shall be required in order to receive such payments’.¹¹⁰ Only partial exclusions from production fall to be

interpretation of ‘based on’ in Article 5 (1) of the Agreement on Sanitary and Phytosanitary Measures may be useful to determine when payment will be ‘based on’ the type or volume of production.

¹⁰⁶ Direct Payment Regulation, (above n 61) Article 43(2).

¹⁰⁷ Respectively, Council Directive 92/43/EEC on the conservation of natural habitats and of wild fauna and flora, [1992] OJ L206/7; and Directive 2009/147/EC of the European Parliament and of the Council on the conservation of wild birds, [2009] OJ L20/7.

¹⁰⁸ Direct Payment Regulation, (above n 61) Article 45(1).

¹⁰⁹ *Ibid*, Article 4(1)(h) Direct Payments Regulation. At least one form of ‘agricultural activity must be carried on in the permanent grassland for the farmer to be eligible for payment: Commission Delegated Regulation (EU) No 639/2014 (above n 68), Article 5. Such a link to production may be problematic under paragraph 6(b) of Annex 2 AoA. See discussion *infra*.

¹¹⁰ WT/DS267/AB/R, (above n 62) paras. 322 and 326-327.

considered under paragraph 6(b) therefore. As Article 45(1) of the Direct Payments Regulation envisages a complete ban on production on the designated areas for the ‘active farmer’ to claim payment, this appears to fall firmly within the scope of paragraph 6(e), a point returned to below.

The final agricultural practice beneficial for climate and preservation of the environment is that farmers who have an arable land holding covering more than 15 hectares shall turn over at least 5 per cent of that land for an ecological focus area (EFA) as from January 1 2015.¹¹¹ The EFA must be located on the arable land itself or, exceptionally, adjacent to it.¹¹² And it is for each Member State to designate one or more of ten possible categories listed in Article 45(2) to be an EFA for the purposes of their farmers’ eligibility under this provision. Two options that a Member State may select for these purposes are ‘areas with short rotation coppice with no use of mineral fertilizer and/or plant protection products’ and ‘areas with nitrogen-fixing crops’.¹¹³

Specifying that a crop (in this case, ‘short rotation coppice’) should be produced without recourse to mineral fertilizer and/or plant protection products creates a link between the crop produced and the inputs into that crop. This may generate issues as to whether the link is one which relates to the ‘factors of production’ so as to cause the ‘greening’ component to violate paragraph 6(d). The Appellate Body has not yet interpreted paragraph 6(d), so it is unclear whether such issues would fall to be considered under this category. However, if paragraph 6(d) can bear a wider interpretation, then nitrogen-fixing crops are problematic, notwithstanding that there are several varieties. As argued above in the context of crop diversification, to form a link to the type or volume production in violation of paragraph 6(b), the link does not necessarily need to be to one specific crop: instead, it can be looser than that, provided that the payment influences the farmer’s production decision.¹¹⁴ If a farmer changes his/her production decisions and plants those crops designated as ‘nitrogen-fixing’ in order to obtain the ‘greening’ component, the payment is certainly influencing his/her production decision even though the choice of which specific nitrogen-fixing crop to grow to fall within this category remains that of the farmer. That said, in *US – Upland Cotton*, the crops ineligible for the payment were narrowly defined in type and variety, whereas a ‘nitrogen-fixing crop’ is not only defined more broadly, but is defined too in terms of its positive pro-environmental characteristics.¹¹⁵ Given the focus of paragraph 6 of Annex 2 is to remove market distortions, it is legitimate to question whether incentivizing a farmer to change production to a crop that has more positive environmental properties is the same type of problematic link to production that was envisaged by the drafter’s of the AoA. This issue is explored below in the context of the ‘greening’ component’s potential violation of the ‘fundamental requirement’ in paragraph 1 of Annex 2 to the AoA.

c. Paragraph 6(e) of Annex 2- Linkage to production after the base year and the ‘active farmer’ requirement

As has been noted throughout the preceding discussion, certain aspects of the ‘greening’ component may be incompatible with paragraph 6(e) of Annex 2 AoA because they link the farmer’s eligibility for the payment to production. For example, channelling arable farmers’

¹¹¹ Direct Payment Regulation, (above n 61) Article 46(1). The Regulation envisages this percentage could rise to 7% in further legislation.

¹¹² Ibid, Article 46(2): the exceptions relate to certain landscape features (para. (c)) and buffer strips (para. (d)).

¹¹³ Ibid, Articles 46(2)(g) and (j).

¹¹⁴ WT/DS267/AB/R, (above n 62) para. 325.

¹¹⁵ Ibid.

planting choices towards the production of certain crops for the purposes of crop diversification,¹¹⁶ and allowing farmers to graze cattle on permanent grassland, are both aspects of agricultural production to which payment to the farmer is linked.¹¹⁷ Yet, in addition to these problems, paragraph 6(e) has the potential to cause significant systemic problems for the direct payments reforms as a whole. These problems coalesce around the ‘active farmer’ requirement.

To be eligible for *any* direct payments (including the ‘greening’ component), the farmer must be ‘active’ within the definition in Article 9(1) of the Direct Payments Regulation, which states that no direct payments may be granted to those whose agricultural areas are mainly areas ‘naturally kept in a state suitable for grazing or cultivation’ and who do not undertake the requisite ‘minimum level of activity’.¹¹⁸ Certain activities are also automatically excluded from this definition (the ‘negative’ list), notably operating real estate services, permanent sport and recreational services,¹¹⁹ but otherwise, the range of activities deemed to be ‘agricultural’ for the purposes of determining whether a farmer is in fact ‘active’, is left to the discretion of each Member State.¹¹⁹ For example, the UK government plans to target payments only to those farmers in England who take the ‘commercial risk’ of farming i.e. ‘the person doing the job should be the one who receives the direct support,’¹²⁰ thereby excluding former tenant farmers offered other arrangements like ‘share farming, contract farming or grazing licences’ so that the landlord can still claim the direct payment.¹²¹ Business activities where agriculture is ‘not a significant activity’ are also to be excluded, although some flexibility is planned for farmers ‘who have responded to the [UK] Government’s [earlier] call to diversify by...providing private water supplies or renting out real estate to supplement their farm income’.¹²²

The ‘active farmer’ definition in Article 9(1) Direct Payment Regulation would seem to comprise two dimensions therefore: first, that the ‘natural or legal person or group of natural/legal persons’ carry out a level of agricultural husbandry beyond merely readying the land for cultivation and/or livestock production; and, second, that farmers carry out the required level of production as part of a commercial venture to the extent that this is defined by the Member State. So in England, for example, a venture will be sufficiently ‘commercial’ for this purpose when the ‘person/group of persons’ also bears the commercial risk of the farming venture.¹²³ As the Appellate Body made clear in *US-Upland Cotton*, linking the ‘positive obligation’ to engage in a farming activity to the receipt of payment, rather than to the commercial nature of the venture per se, means a measure is outside the protection of paragraph 6(e) of Annex 2 AoA.¹²⁴ As *any* form of Direct Payment following implementation of the CAP reform is predicated on the farmer fulfilling this ‘active farmer’ test in Article 9(1) of the Direct Payments Regulation, this means *all* direct payments fall outside the scope of the protection of paragraph 6(e) of Annex 2 AoA.

¹¹⁶ Articles 44(1) and 44(1) Direct Payments Regulation (above n 61).

¹¹⁷ Articles 45(1) and 4(1)(h) *ibid*.

¹¹⁸ Emphasis added. Note this exclusion also extends to farmers who produce, rear or grow agricultural products and keep animals ‘for agricultural purposes’ on such land under Article 4(1)(c)(i) Direct Payment Regulation: Article 10(2) Delegated Regulation 639/2014 (above n 68); Article 13 Delegated Regulation 639/2104 sets out the criteria a Member State may use to determine whether ‘agricultural activities are not insignificant’ for the purposes of Article 9 Direct Payments Regulation (above n 61).

¹¹⁹ *Ibid*, Article 9(1) Direct Payments Regulation.

¹²⁰ UK House of Common Environment, Food and Rural Affairs Committee, *Implementation of the Common Agricultural Policy in England 2014-2020*, Seventh Report of Session 2013-14, Volume I, 26 November 2013, HC 745, para 31.

¹²¹ *Ibid*, para 32.

¹²² *ibid*, para 30.

¹²³ *Ibid*, para 30.

¹²⁴ WT/DS267/AB/R (above n 62), para 326.

Whether the fact the ‘active farmer’ requirement falls outside the protection of paragraph 6(e) of Annex 2 AoA also means the entire Direct Payments is not decoupled income support *at all* for the purposes of paragraph 6 of Annex 2 AoA remains unclear as interesting questions remain as to what the relationship is between paragraph 6(a) of Annex 2 AoA that *permits* Members to link payments to a specific production level in a ‘defined and fixed base period’ and paragraph 6(e) that *prohibits* such a link between a positive obligation to produce and payment. Whilst one interpretation might be that paragraph 6(a) goes to the payment eligibility criteria *per se* and paragraph 6(e) goes to whether the farmer has an *on-going* entitlement to the payment *in fact*, this interpretation is by no means inevitable. A further discussion of this issue is beyond the scope of this paper, but it should be noted that the Panel made it clear in *US-Upland Cotton* that each paragraph of paragraph 6 of Annex 2 must be given effect, an issue not revisited by the Appellate Body.¹²⁵

d. The Fundamental Requirement

The Green Box permits Members to adopt domestic support measures that incentivize the provision of public goods, or ‘non-trade concerns’ in the terminology of the AoA. As its preamble states, any reductions in support required by the AoA must be balanced against the need to ‘have regard to’ non-trade concerns including food security and the protection of the environment.¹²⁶ This is because public goods are apprehended not to distort agricultural markets. As again indicated, they are non-excludable for the reason that, when they are made available to one person, others cannot be excluded from enjoying the product at the same time; and they are non-rival, because enjoyment of the product does not diminish the amount of the product available to another person.¹²⁷ Moreover, the market will not provide them, as there is no economic return for doing so; public goods must instead be provided by state intervention through financial incentives.¹²⁸ It follows that, if such financial support is given to the farmer to incentivize him/her to produce public goods, then there is no incompatibility with world trade rules: rather, it might be contended that the support is *rebalancing* the market and correcting market failure. To determine whether the measures are in fact supporting public goods is an assessment of the measures’ nature. This is a *qualitative* assessment together with a *quantitative* assessment.

For domestic support to be exempt from a Member’s reduction commitment in the AoA, it may be reiterated that it must also conform to the so-called ‘fundamental requirement’ in paragraph 1 of Annex 2: that is, the support must have no, or at most minimal, trade-distorting effects or effects on production. The measure in question must conform to the two basic criteria: that the support is provided through a publicly funded government programme, not involving transfers from consumers; and that the support cannot have the effect of providing price support to producers. The Appellate Body considered the scope of the fundamental requirement in *US-Upland Cotton*. After finding the United States’ Production Flexibility Contract payments and

¹²⁵ WT/DS267/R (above n 71), para 7.368.

¹²⁶ Paragraph 6 of the Preamble AoA.

¹²⁷ Cooper at al, (above n 19) v.

¹²⁸ This theory is not uncontroversial, with some authors argue it is not easy to predict what will ensure a rural community thrives; incentivising more agricultural production to generate this type of public good will not necessarily be successful: F. Sinabell: ‘To what Extent is Rural Development a Joint Product of Agriculture? Overview and Policy Implications,’ in *Multifunctionality in Agriculture: Evaluating the Degree of Jointness, Policy Implications* (above n 18), 24.

direct payments violated paragraph 6(b) of Annex 2 on the grounds that they were not decoupled from production, the Appellate Body stated:¹²⁹

However one reads the “fundamental requirement” in paragraph 1 of Annex 2, given the factual findings of the Panel, the facts of this case do not present a situation in which the planting flexibility limitations demonstrably have “no, or at most minimal” trade-distorting effects or effects on production.

In *US-Upland Cotton* this statement was interpreted to mean that an adverse finding of the policy-specific criteria in paragraphs 2-13 of Annex 2 automatically leads to a violation of the fundamental requirement.¹³⁰ This is because the policy-specific criteria are said to recognise only those forms of support which are not protectionist; that is, the policy-specific criteria weed out forms of domestic support that insulate the farmer from the true price they can obtain on the market, with the consequence that the farmer will always make their production decisions based on the market price and not on the availability of the subsidy. On this view, once violation of the policy-specific criteria is shown, the fundamental requirement must be violated too because *any* link back to the production decision of the farmer not addressed by the terms of the policy-specific criteria *must* have an effect on production and/or have a ‘trade-distorting’ effect. In essence, this interpretation of the fundamental requirement suggests violation is based on a *quantitative* test.

The Appellate Body’s findings in *US-Upland Cotton* do not make that interpretation inevitable. The Appellate Body stated ‘however one reads’ the fundamental requirement, suggesting there may be more to the test than a simple quantitative assessment. This opens up the possibility that the test also may have a *qualitative* dimension; in other words, there must also be a normative evaluation of the *nature* as well as the *scale* of the domestic support’s effects on the market, rather than simply whether it has *any* effects at all. This reimagining of the interpretation of the fundamental requirement has implications for the way the ‘greening component’ of the EU’s revised direct payments scheme is assessed for the purposes of determining violation of paragraph 1 of Annex 2 of the AoA.¹³¹

How the farmer becomes eligible for the ‘greening’ component of the direct payment is set out in the preceding discussion, so this analysis is confined to showing whether the ‘greening’ component is compatible with the fundamental requirement in paragraph 1 of Annex 2 should a qualitative dimension to the test be adopted. Under the revised interpretation, the way that the ‘greening’ component is tied to the farmer’s production decisions together with a determination whether alternative measures exist that better meet the specific non-trade concern are important to determining if the greening component is compatible with the fundamental requirement.

As a starting point, it must be noted that support given directly to farmers that corrects market failure alone, must, by its very nature, improve and not distort agricultural markets. It follows therefore that if the ‘greening’ component simply corrects market failure, it must be compatible with the fundamental requirement because, as has been noted earlier, in this instance the greening component would not provide the kind of support regarded by the multilateral trade negotiators as harmful to international agricultural trade.

¹²⁹ WT/DS267/AB/R, (above n 62) para. 334 (emphasis added).

¹³⁰ *ibid*, para 333.

¹³¹ *Multifunctionality: The Policy Implications* (above n 18), 29-32.

The OECD showed in its work on multifunctionality that all agricultural production jointly produces both commodity and non-commodity outputs.¹³² So, for example, crop production (the commodity output) is inextricably linked to potential environmental damage when the farmer makes excessive use of fertiliser (the negative non-commodity output), and to the maintenance of an attractive rural landscape (the positive non-commodity output). Through extensive empirical studies, the OECD also found that domestic agricultural policies must not incentivise commodity production per se because market forces must be left to govern the farmer's planting decisions and livestock production choices.¹³³ Incentivising commodity production alone would, according to the OECD, distort rather than rebalance markets.

Yet the OECD showed that incentives given to the production of positive non-commodity outputs, not otherwise provided by improvements in technology or farming techniques so as to guarantee the 'quantity, composition and quality' of such outputs demanded by society, would not distort markets.¹³⁴ Targeting policy measures to produce these positive non-commodity outputs was necessary because the market will not incentivise the farmer to produce one non-commodity output over another in every case. And, more importantly, the market will not compensate the farmer for producing only positive non-commodity outputs because such outputs often have the characteristic of being 'public goods'.¹³⁵ Instead, the market may incentivise production of negative non-commodity outputs like, for example, soil erosion and biodiversity loss, when the farmer has maximised crop yields by excessive fertilizer usage in response to an increase in demand.¹³⁶ Providing targeted incentives to the farmer to produce positive non-commodity outputs would not violate the fundamental requirement because such measures rebalance markets and address market failure, unlike those aimed solely at commodity outputs.

Following the OECD's methodology therefore the 'greening' component of the EU's revised direct payments scheme is a measure that corrects market failure in a way that complies with the fundamental requirement if it satisfies three requirements: first, that the measure impacts only on production where the pro-environmental effects (i.e. the non-commodity output) and the required crop and livestock production are inextricably bound together, such that the effects cannot be separated out and provided by other actors rather than the farmer.¹³⁷ If the pro-environmental effects cannot (and should not) be separated out in this way, the production is 'joint,' for the purposes of this first criteria. As indicated by the OECD, the inextricable link between crop and livestock production and adverse environmental effects is indicated in many studies, and as such, proving the requisite 'joint' character of production for the purposes of the 'greening' component's compatibility with this first criteria is unlikely to be problematic.¹³⁸

¹³² Ibid, 8; OECD, *Multifunctionality: Towards an Analytical Framework*, (above n 18), 13. Note the OECD found that multifunctionality was a characteristic of non-agricultural products too, but analysis seemed particularly developed in agriculture: OECD, *Multifunctionality: The Policy Implications*, (above 18), Box 1, 10.

¹³³ OECD, *Multifunctionality in Agriculture: Evaluating the Degree of Jointness, Policy Implications*, ibid, 86.

¹³⁴ ibid, 8 & 11.

¹³⁵ OECD, *Multifunctionality: Towards an Analytical Framework*, (above n 18), 12.

¹³⁶ E.g. the increase in demand for corn in the United States causing soil erosion and loss of biodiversity is described by Michael Pollan in his controversial book: M. Pollan, *The Omnivore's Dilemma*, (2006) Bloomsbury Press, ch.2.

¹³⁷ OECD, *Multifunctionality: The Policy Implications* (above n 18), 39.

¹³⁸ Ibid.

If the production is ‘joint’, the EU must go on to show, as a second step, that the *market* does not provide the requisite pro-environmental effects in the absence of the ‘greening’ component as a *matter of fact*; in other words, the EU must establish that there is a need to incentivise the farmer to produce the non-commodity output, for without that incentive there would be a market failure.¹³⁹ This second requirement may be problematic in the case of organic crops. Organic production automatically entitles the farmer to receive the ‘greening’ component without the need for him/her to comply with the specific pro-environmental ‘agricultural practices,’ listed in the Direct Payments Regulation, namely crop diversification, permanent grassland and the provision of an ecological focus area.¹⁴⁰ Yet consumers may be willing to pay the price premium that results from the farmer internalizing the higher costs of organic production.¹⁴¹ Where this is the case, the *market* provides the incentive to the farmer to switch to such practices because it is the consumer who pays for the cost of production; there is no market failure so the farmer need not be incentivized through the ‘greening’ component to adopt the organic farming practices, contrary to the current Direct Payments Regulation. Likewise in the case of negative non-commodity outputs like soil erosion caused by monocropping, incentivising the farmer to diversify their planting through the provision of the ‘greening’ component is problematic if there are other ways in which the problem might be resolved.¹⁴² For example, the OECD points to the possibility of improving technology, including inputs like fertilizers, to limit adverse effects of such production techniques.¹⁴³ In both these cases, albeit for different reasons, there is no need to incentivize the farmer to produce, so the ‘greening’ component, in its current form, may be found to distort the market and thus violate the fundamental requirement.

It is therefore only in the case of joint production where the pro-environmental effects cannot be provided by other means, that the ‘greening’ component is a legitimate incentive to farmers for the purposes of the fundamental requirement, as it is only in this case that there is true market failure that justifies such direct policy intervention by the EU. The OECD found true market failure only exists where the non-commodity output also *in fact* exhibits the characteristics of being public goods, as the market will never provide such goods.¹⁴⁴ The OECD goes on to set out complex methodological calculations to determine precisely when non-commodity outputs have the nature of public goods. A detailed exposition of how this works in the context of the greening component is beyond the scope of this paper and the expertise of the author, but it is sufficient to state at this stage, that this methodology could be used to determine whether the ‘greening’ component does in fact incentivise the production of public goods and is therefore compatible with a reimagined interpretation of the fundamental requirement using a qualitative and quantitative test.

4. Conclusion

Whilst a close textual interpretation of the eligibility criteria for the ‘greening’ component under paragraphs 6 and 1 of Annex 2 reveals problems, in some respects these problems are

¹³⁹ Ibid, 40.

¹⁴⁰ Note under Article 43(11) Direct Payments Regulation (above n 61) organic production is automatically regarded as eligible for the greening component.

¹⁴¹ OECD, *Multifunctionality: The Policy Implications* (above n 18), *ibid*, 36.

¹⁴² See Article 44 Direct Payments Regulation (above n 61), which specifies compulsory crop diversification as one of the compulsory agricultural practices for the purposes of determining eligibility for the greening payment.

¹⁴³ OECD, *Multifunctionality: The Policy Implications* (above n 18), *ibid*, 34.

¹⁴⁴ *ibid*, 37.

the consequence of a difficult political dynamic between the European Commission, the European Parliament and the Council and its inevitable translation into the final legislation.¹⁴⁵ As such, some of the problems may be resolved with consequential revisions of that legislation (although whether there will be sufficient political consensus on such revisions remains uncertain). The bigger question is whether the finding of a violation of the policy-specific criteria in the AoA equally defeats the aim of the legislation to recognise the link between agricultural production, climate and the environment and thereby ameliorate some of the negative effects of that production by incentivizing certain practices.

In some respects, it is easy to argue that, where domestic support has positive impact on the environment, it must at its heart be protectionist: in other words, to be effective, such support must be targeted on the type and volume of agricultural production so as to steer the farmer away from practices that harm the environment and biodiversity or exacerbates climate change. The allegation that such measures are protectionist and in violation of the AoA is an important one which must be taken seriously, especially given the scale of the harm caused by protectionism of agricultural markets prior to 1995. However, always to reject as protectionist any attempts to move forward and address contemporary problems of climate change, loss of biodiversity and food insecurity is to diminish the fact that these problems are real and that new and innovative policy solutions must be undertaken to address them.

Rather than seeing the ‘greening’ component as yet another protectionist move within Europe to protect inefficient farmers from unforgiving international agricultural markets, perhaps the better way is to regard it as a tentative step in the progress towards addressing contemporary problems of agricultural production.¹⁴⁶ After all, progress towards a ‘fair and market-oriented’ trading system¹⁴⁷ that allows for the sustainable use of the world’s resources whilst recognising the needs of all countries at different levels of economic development, is not linear, but is instead messy and unpredictable.

¹⁴⁵ See Matthews, (above n 3) on the history of the ‘greening’ component and, in particular, the disagreements between the European Commission and the European Parliament.

¹⁴⁶ F. Fukuyama, *The End of History and the Last Man* (Penguin, 1992) 11.

¹⁴⁷ Marrakesh Agreement Establishing the World Trade Organisation, para 1.