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Trade brief on...

Trade in agriculture

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Trade in agriculture, the WTO and developing countries[1]

The Uruguay Round's Agreement on Agriculture (URAA) completed in 1994 was a comprehensive exercise to lower trade barriers – tariff as well as nontariff – and subsidies to producers in both developed and developing countries under the jurisdiction of the World Trade Organization (WTO). Agricultural trade negotiations started again in 2000 as part of the built in agenda of the URAA but the recent Cancun Ministerial (September 2003) failed to have countries agree on a set of modalities to proceed on liberalising agricultural trade. This briefing note examines the major issues important to developing countries and suggests reforms to maximise benefits from trade liberalisation.

Why is the Doha Development Agenda for agriculture so important?

Agriculture and food is important to the world's poor but agricultural policies have heavily distorted agricultural performance in both developed and developing countries.[2] Rich countries have high rates of protection and producer subsidies whereas developing countries, up to the 1990s, generally taxed agriculture. This frustrated economic development. Success in the Doha Round requires substantial reductions in agricultural protection where developing countries, as weaker players in the trading system, have a larger stake. A strengthened rules-based global trading system for agriculture will liberalise trade and increase economic growth. Multilateral agreements also help developing countries undertake and lock-in their own trade and domestic policy reforms needed to advance their development objectives. Reciprocal trade agreements requires adherence to rules under the auspices of the WTO, making it easier to overcome the resistance of domestic lobbies for protection of agriculture, with built-in mechanisms that prevent policy reversals and backsliding. The resulting credibility of the policy reform process enhances investment and supply response. Finally, trade liberalisation will almost certainly reduce the volatility of world prices to which producers and consumers in poor countries

1 This note was written by Harry de Gorter, Cornell University, November 2003.

2 OECD (2003a).

are especially vulnerable. Tariffs, non-tariff barriers and subsidies break the link between domestic and world prices, thereby making supply and demand less sensitive to world price changes, and so exacerbating world price swings with any shock to world markets.[3]

Why is a vibrant agricultural sector so crucial?

Agricultural sector growth is crucial for achieving the development goals of economic growth, poverty reduction and food security.[4] Agriculture is one of the most important sources of overall economic growth in low-income countries, owing to its relative size and its important growth linkages to the rest of the economy.[5] Agriculture is the largest employer in low-income countries, accounting for about 60 percent of the labour force and producing about 25 percent of GDP. Even in middle-income countries, where agriculture's share of GDP is only about 15 percent, the sector still accounts for more than 25 percent of employment. When coupled with agro-related industries and food related services, its share, even among middle income countries, is typically 25 to 40 percent of GDP. Growth in agriculture has a proportionately larger effect on poverty reduction because about 73 percent of the poor in developing countries live in rural areas.

Increased agricultural productivity also provides lower priced food, which makes up a large share of expenditures of poor households. A modernising agriculture creates jobs directly, through greater production and exports, and indirectly, in agricultural processing and marketing, input supply, consumer products and services, and for those leaving the farm. One study showed that a 1 percent increase in agricultural GDP per capita created a 1.61 percent gain in the per capita incomes of the poorest 20 percent of the population.[6]

What are the major policy interventions affecting trade in agriculture?

Industrial countries support their agricultural sectors through domestic subsidies to producers, export subsidies, high tariffs, and non tariff measures such as import restrictions and quotas (For a summary of polices and issues facing the fisheries products sector, see Box 1). Up until the 1990s, governments in developing country levied export taxes on agricultural products in an effort to generate public revenues while protecting manufacturing through high import tariffs and other import restrictions. Even for agricultural products that were not exported, price controls, exchange rate policies and other restrictions kept prices low for urban consumption. In the last decade, developing countries shifted from taxing agriculture to protecting it. Import restrictions on manufactured products have declined dramatically, exchange rates have been devalued and export taxes have effectively disappeared. Meanwhile, reforms in most

3 Tyers and Anderson (1992) show that the coefficient of variation in world food prices would be reduced by two-thirds if all countries ceased to insulate their domestic markets.

4 World Bank (2003a).

5 Mellor (2000).

6 Timmer (1997).

industrial countries, including many of the successful middle-income countries, have been modest – despite the inclusion of agriculture under the WTO in the URAA.

Border protection in rich countries continues to be high, non transparent, and antidevelopment.[7] Average agricultural tariffs in industrial countries are 2–4 times higher than manufacturing tariffs. In addition, about 28 percent of domestic production in countries belonging to the Organization for Economic Co-operation and Development (OECD) is protected by tariff rate quotas. More than 40 percent of the tariff lines in the European Union (EU) and United States (U.S.) contain specific duties, which make it difficult to calculate average tariffs and obscure actual levels of protection.[8] Tariff peaks as high as 500 percent sometimes confront imports from developing countries. Tariffs also increase by degree of processing, creating a highly escalating tariff structure that limits access and hence incentives for processed food production in developing countries. Preferences do not compensate for these high levels. For example, only 34 percent of agricultural imports from countries to the U.S. covered by the General System of Preferences (GSP) were eligible for preferences, and 26 percent of imports received them. Developing countries, too, have maintained high border protection and, on average, have higher agricultural tariffs than industrial countries.

Within OECD countries, treasury subsidies, and subsidies from consumers (from high tariffs and quantitative restrictions on domestic production of selected commodities) amounted to about USD 250 billion in 1999–2001. This protection decreased from 62 percent of farm revenues in 1986–88 to 49 percent in 1999–2001 — still a very high percentage. Of this support, 63 percent came from consumers via higher prices associated with border protection and 27 percent from domestic subsidies.[9] In developing countries, almost all support is generated by border barriers. A silver lining to this dark cloud is that some developed-country subsidies have been at least partially delinked from levels of production (so-called decoupled subsidies), lowering the incentive to overproduce. These partially decoupled subsidies increased from 9 percent in 1996–98 to more than 20 percent of the USD 250 billion in 1999–01.

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7 IATRC (2001a) and World Bank (2003b).

8 World Bank (2003a).

9 OECD (2003a).

Box 1. Government policies affect fisheries products trade and developing countries

OECD country governments provide subsidies to the fish harvesting industry that protect local fishing companies at the expense of fishing communities in developing countries. Rich countries also implement price supports, in conjunction with import tariffs, to ensure price stability. Import tariffs in both developed and developing countries inhibit the ability of developing countries to export fisheries products and can increase the profitability of foreign fishing in developing country waters. Import tariffs increase with the degree of processing, thereby discouraging the development of labour intensive processing industries in developing countries.

In addition, there are several technical barriers to imports in OECD countries from developing countries: health and environmental standards; restricted access to ports of foreign vessels; and restrictions on foreign investment in fishing vessels. Nevertheless, exports of fish and fish products by developing countries have grown dramatically in the past two decades, accounting for the largest share of all their agricultural and food product exports, and half of OECD fisheries products imports. Meanwhile, fisheries suffer from poor resource management in developing countries, with the significant growth in exports from developing countries masking overexploitation of fish resources by local and foreign vessels. Subsidised OECD vessels practice largely unsupervised fishing in developing country waters, with very low license fees that are not related to the catch nor to prices.

But tariff liberalisation of seafood products may not have a big impact on exports as most fish resources are near full exploitation. In the absence of proper management, tariff reduction could result in even more overexploitation of fish resources among exporters. Nevertheless, optimal polices to manage the fish catch in developing countries like quotas are still superior to tariffs by importing countries in resolving overexploitation of fish stocks.

Source: OECD (2003b).

What are the trade patterns in agriculture?

Growth in agricultural trade is lagging that of other sectors, partly because of the many trade and subsidy programs in both developed and developing country agriculture. This has resulted in overproduction and price declines in many commodities, reducing opportunities for many developing countries to expand exports and penalising the world's poor. Most of the developing countries generated the bulk of their agricultural GDP in lower efficiency production for the domestic market, supplying the world market with tropical commodities that could not easily be produced in the industrial countries. In products for which they competed with industrial countries, such as sugar and beef, some countries could export limited amounts under preferential-access programs.

Consequently, while developing countries have almost doubled their share of world trade in manufacturing over the last two decades, their share in agricultural trade has been stuck at around 30 percent.[10] During the 1990s, the growth of developing country agricultural exports to industrial countries slowed while exports to other developing countries accelerated. During this period, 56

[10] World Bank (2003a).

percent of the growth of developing country agricultural trade was accounted for by sales to other developing countries and 44 percent by sales to industrial countries. The middle-income countries have managed to increase global market share, principally by entering into other developing countries' markets and by aggressively diversifying into non-traditional exports, such as seafood products, fruits, vegetables, and cut flowers, and processed foods. Growth of these non-traditional exports has outpaced growth of traditional commodities by 3 to 1. Meanwhile, many low-income countries, except for China, have had less success – their share of world agricultural trade has declined.

How will trade liberalisation help?

There is a preponderance of evidence in many countries that economy-wide trade liberalisation and integration with the world economy promotes growth and reduces poverty. World Bank research shows that the potential gains for developing countries are large. The likely results from full removal of all barriers would yield global welfare gains of USD 400–900 billion, more than half of which would go to developing countries. If all trade barriers were dismantled, agriculture and food would account for 70 percent of these gains.[11] A major share – 60 percent – would derive from reforms in developing countries. The largest gains are from tariff reforms in agriculture undertaken in a context of a global reform program.

With liberalization, agricultural production would marginally shift from North to South as beef, sugar and grain imports by developed countries increase. The currently highly depressed world prices for many commodities would increase because current import barriers, export subsidies and production subsidies all increase domestic production in industrial countries and sometimes reduce demand, resulting in depressed world prices. The impact of these price changes on low-income net importers would be small and manageable because they too have import tariffs. In those cases were consumer prices do go up, farmers will be better off as will the rest of the economy due to higher prices for non-staple output and exports.

In addition to exploiting comparative advantage with higher prices for sales and lower prices for inputs, increased trade can generate scale economies internal to the industry (e.g., improved labour skills and technology). Free trade also helps ensure competition (including upstream and downstream industries), improves product variety and quality, and encourages product differentiation and two-way trade. Trade can be a major source of foreign exchange that is necessary to finance imports and development and provides domestic food security in improving the country's capacity to finance food imports.

What is the current state of play in the trade negotiations?

Because many of the proposals designed to elicit consensus on agricultural reform leading up to

[11] World Bank (2003a).

the Cancun Ministerial in September 2003 were modest, no agreement was reached on the modalities of how the trade talks on agriculture should proceed.

A first order of business is to create a more transparent and simpler trade regime in all countries by converting specific tariffs to ad valorem tariffs[12], eliminating minimum price regulations, capping peak tariffs[13], changing the structure of tariff-rate quotas[14] so they increase over time, and introducing a transparent system of reallocation to more efficient producers. The URAA provisions on market access had only a modest impact on trade liberalisation, mainly because tariff reductions were based on average reduction in tariffs, rather than a reduction in the average tariff, and because of the high tariff base year upon which reductions were made. Rich countries should phase out both domestic producer and export subsidies that encourage overproduction, both of which are directly prejudicial to poor farmers around the world. And a serious agreement to reduce border protections significantly would produce benefits for the world's poor that far exceed those that can be anticipated from present levels of development assistance.

Individual product tariffs need to be reduced because unweighted average tariff reduction commitments currently allow countries to have larger tariff reductions on commodities with low tariffs, are of little importance to exporters, and are politically less sensitive domestically. A faster reduction in high tariffs should also be required to lower the degree of tariff dispersion across commodities and countries and in tariffs on processed foods to reduce tariff escalation. Limiting the application of special safeguard, anti-dumping and countervailing duties and other contingent measures should also be encouraged to prevent unfair restrictions on market access. Product regulations need to be rationalised (such as sanitary and phyto-sanitary (SPS) conventions, labelling laws, etc.) so they cannot be formulated as non-tariff barriers. Rules will need to be devised for special and differential treatment for developing countries that provide greater benefits from a more liberalised trading environment, perhaps including a limited set of safeguards for politically sensitive commodities in developing countries.

The importance of disciplines on domestic support

Domestic subsidies to farmers have increased substantially since 1986-88, but there is evidence that high levels of direct payments to farmers like those in the U.S. and EU do in fact distort trade.[15] In addition, countries have taken advantage of the complex set of rules outlined in Box 2 by repackaging subsidy programs and using loopholes to meet their support commitments. Therefore, the URAA has not properly defined, quantified, and hence has not reduced trade-distorting domestic support measures in many instances.

[12] An ad valorem tariff is a customs duty levied as a fixed percentage of an item's value, while a specific tariff is a customs duty based on weight, quantity, or physical characteristics of imported items.

[13] Tariff "peaks" are defined as those exceeding three times the overall simple average MFN (most favoured nation) rate.

[14] A tariff rate quota is a tariff that has a lower rate until the end of a specific period or until a specified amount of commodity has been imported. At that point the tariff rate increases.

[15] IATRC (2001c) and World Bank (2003c).

Box 2. Domestic support reduction commitments

Domestic agricultural support was classified in the URAA with a complex system of "boxes" that ranked programs according to their effect on trade. Policies deemed as trade distorting were put in the "amber box", as measured by the "Aggregate Measurement of Support" (AMS), which consisted of direct subsidies and support due to the gap between a fixed world reference price and domestic support prices. The latter gap is a poor measure of actual border support (because actual world and domestic prices are not used), rendering the AMS as a flawed measure of domestic support.

There are four major exemptions from reduction commitments: the blue and green boxes, *de minimis*, and special treatment for developing countries. The blue box are for subsidies with domestic supply controls while the green box is for subsidies deemed to be non-trade distorting. Amber box subsidies that were below a *de minimis* standard — 5 (10)% of value of production in developed (developing) countries — were exempt in two separate categories: non-product-specific and product-specific subsidies. If either was over 5% in developed countries, for example, then the subsidy was counted in the amber box. For developing countries, a wider list of policies were exempt and all least-developed countries were exempt from any subsidy reduction commitments at all.

The aggregation of all policies and commodity sectors (including sector wide policies) into a single Aggregate Measurement of Support (AMS) has limited the effectiveness of amber box policy reduction commitments. Countries have flexibility not to reduce support in some sectors and even offset reductions in some sectors by increasing support in others. Furthermore, the baseline AMS is overestimated because it includes blue box support but this support is not measured in the AMS reduction requirements.

What is left to be done on export subsidies?

Although export subsidies account for a small percentage of total government interventions, their effect on selected markets are large and there are several loopholes.[16] There is no rule that directly constrains officially supported export credit programs, even though it was recognised in the URAA that they provide a subsidy element. The WTO members were instructed to work with the OECD but failed to resolve the issue, leaving it to be solved in the Doha Round agricultural negotiations. Given the potential adverse impacts on domestic producers from food aid that is poorly targeted, efforts could be made to encourage the use of cash aid in place of food aid to minimise adverse effects on markets caused by mismanaged food aid distribution efforts.

Stronger disciplines on state trading enterprises (STEs) are needed. These must include increased notification and transparency requirements to prevent disguised export subsidies. Rules are needed to constrain indirect export subsidies through price discrimination and revenue pooling arrangements for farmers. Finally, export taxes should be constrained and eventually phased out. For any developing countries that still depend on these taxes as an important source of government revenue, the phase out period could be prolonged.

[16] IATRC (2001b) and World Bank (2003d).

The Expiration of the Peace Clause

The ”Peace Clause” precludes most WTO dispute settlement challenges against a country in compliance with the URAA, but ends after 2003. Many agricultural subsidies, which have hitherto been sheltered from the application of several WTO provisions on subsidies, will then be vulnerable to legal challenge under the WTO. All countries including non-subsidising developing countries will then be able to bargain using dispute settlement panels (or direct negotiations) to contest the compatibility of domestic farm policies with these stricter disciplines. These options are already used for these purposes in non-agricultural sectors in the WTO. The remedy would require compensation, elimination of the subsidy or reduction of its adverse effects.

Special and Differential Treatment (S&DT)

S&DT generally refers to exceptions to the rules to benefit developing countries (longer implementation periods and lower reduction commitments) and to positive actions like preferential access (lower tariffs and special import quota allocations) and the provision of technical assistance to permit developing countries to meet their WTO obligations. For agriculture, S&DT basically comes under three texts: the URAA, the SPS Agreement and the decision on ”Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries” adopted by the Ministerial conference in Marrakesh in 1994 that concluded the Uruguay Round.

The latter was in response to least developed and net food importing countries concerns with the increased cost of food after trade liberalisation. A regular review of food aid commitments and flows was therefore provided for, along with the adoption of guidelines to ensure that food aid is given in grant form or on appropriate concessional terms. It was proposed that some form of counter cyclical subsidy mechanism be implemented whereby food and financial aid are automatically triggered by commodity price increases owing to agricultural trade liberalisation. If the negative effects of trade liberalisation is not offset by benefits from trade, then the optimal measures to ameliorate the impact of shocks that threaten food security could include commodity price risk management measures (like hedging in the futures market), food aid or subsidised credit.

The SPS Agreement is to address the issue of human and animal health and plant protection. Developing countries are particularly vulnerable because of the costs of information, compliance, standards and transparency issues. This has been further complicated by the emergence of trade in biotechnology products which is not covered in either the SPS or Technical Barriers to Trade Agreements. Costs of certification and segregation can be very costly, along with labelling and safety assessments. This puts developing countries at a disadvantage and emphasises the need for technical assistance for developing countries to participate in international standard setting activities.

Needs for Trade Related Technical Assistance and Capacity Building

The previous discussion points to the need for technical assistance to help developing countries comply with international standards and provide food security. But assistance is also required in implementing institutional changes to promote trade-led development.

Many countries will not be able to take advantage of new opportunities from trade liberalisation unless the much needed finance from international agencies and bilateral donors is forthcoming to put in place the infrastructure, transport logistics, and trade-related public institutions necessary to take advantage of those opportunities. Developing countries need the expertise for reducing transport and processing costs in ports with complicated customs-clearance procedures, nontransparent documentation requirements, and uncertainty about the enforceability of legal trade documents. If developing countries can reduce these costs and raise the capacity to trade to halfway that of the global average, international trade could increase by USD 380 billion annually – an increase of about 10 percent.[17]

Trade capacity building activities enhance the ability of developing countries to formulate and implement a trade development strategy, create an enabling environment for increasing the volume and value-added of exports, diversify export products and markets, increase foreign investment to generate jobs and trade, stimulate trade by domestic firms, encourage investment in trade-oriented industries, and participate in and benefit from the institutions, negotiations and processes that shape national trade policy and the rules and practices of international commerce.

Trade capacity building also involves help in formulating and implementing sound trade policy to enhance growth and reduce poverty, managing the adjustment costs of trade reform and participating effectively in international negotiations. Tariff cuts could result in reduced government revenue. The costs of implementing changes to international trade rules may be significant.

Governments will have to design trade reform programs that orchestrate the shift of resources from some activities that are not internationally competitive into areas that provide new opportunities. This may entail new budget outlays. In the short-run this may be for income maintenance or worker retraining, or for new public investments to help bring goods to markets in expanding sectors.

In recent years, the international donors have expanded their assistance to the poorest countries through such programs as the Integrated Framework of the World Bank.[18] More resources will be required for developing countries to promote their competitiveness and help them manage in a post-Doha world.

[17] World Bank (2003).

[18] The World Bank is one of six agencies working with the Integrated Framework. The other agencies are IMF, ITC, UNCTAD, UNDP and WTO.

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Halving poverty by 2015 is one of the greatest challenges of our time, requiring cooperation and sustainability. The partner countries are responsible for their own development. Sida provides resources and develops knowledge and expertise, making the world a richer place.

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