ANALYSIS OF TRENDS FOR AGRICULTURAL TRADE LIBERALIZATION

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Abstract. World Bank research has shown that agricultural subsidies of about $300 billion a year in rich countries distort world prices and undermine developing countries' exports. Trade barriers in agriculture reduce economic efficiency and disrupt international markets at the expense of competitive suppliers. Furthermore, these policies often fail to achieve their objectives, in particular that of effectively supporting low-income farmers. OECD ministers have recognized the need for fundamental reform, but only modest progress has been made.

In this paper, I shall argue that agricultural trade liberalization measures should be undertaken in order to maximize the global welfare and eliminate the current distortions in agricultural trade. These measures should include deep cuts to all tariffs as well as elimination of all trade-distorting domestic and export subsidies.

1. Introduction

Many countries have kept their programs of support for agriculture outside the General Agreement of Tariffs and Trade (GATT) rules. In 1955, the United States negotiated a special waiver that states it can utilize import quotas to support domestic farm prices. This is a common policy in many countries. For example, the European Community supports its farmers with its "Common Agricultural Policy", which relies on a series of variable tariffs that act much like quotas, to maintain uniformly high prices throughout the region. Both the United States and the European Community have followed a policy of subsidizing exports of their grains for some time. Indeed, trade in agricultural commodities, textiles and apparel has been largely exempt from GATT disciplines for decades [GATT, 2007].

Finally, it is permissible, for instance, to exclude imports of foods that are thought to have been produced in an unsafe manner, provided that the exclusion is based on adequate scientific testing. The result of these policies is that developing countries, whose share of world industrial exports had been increasing steadily, have not managed to increase their share of agricultural exports.

It is extremely difficult to separate macroeconomic, market or policy factors in explaining these trends in agricultural trade. OECD research suggests that much deeper cuts in tariffs, or larger increases in the volumes admitted at lower tariffs, would be needed to improve developing countries market access significantly [OECD, 2007].

2. Historical Background - The Uruguay Round Agreement on Agriculture

As World Trade Organization members undertake further trade negotiations in order to correct and prevent "restrictions and distortions in world agricultural markets" [Stern, 2002], lessons can be learned from the implementation of the Uruguay Round Agreement on Agriculture (1995-2000).

Prior to the Uruguay Round Agreement on Agriculture (URAA), GATT rules on trade in agricultural products were limited and often ineffective. A number of provisions exempted agricultural products from most of the regulations applying to manufactured goods. As a result, countries often resorted to measures such as export subsidies - which are not permitted in other sectors - as well as a multitude of non-tariff barriers that restricted agricultural trade [Hathaway, 1987].

The URAA was a turning point in the reform of the agricultural trade system. Countries agreed to reduce agricultural support and protection substantially by establishing disciplines and rules on market access, export competition and trade distorting domestic policies. The URAA has produced several positive results. For instance non-tariff barriers were converted to tariffs, which are subject to reduction commitments (the so-called "tariffication".) Export subsidies on agricultural products are for the first time subject to discipline, as part of the effort of establishing regulations for domestic policies that affect trade of agricultural products.

These are important policy changes from the pre-URAA period. However, the URAA achieved only limited reduction in agricultural protection. It is widely accepted that tariffication was the main achievement under the market access discipline. Yet, in practice, agricultural tariffs remain high. Recent estimates indicate that average agricultural tariffs are in the neighborhood of 60% compared to industrial tariffs that rarely exceed 10% (WTO statistic data). Protection actually increased for a number of agricultural products, particularly those perceived as being the most politically sensitive. There is evidence to suggest that market access in agricultural products improved little over the implementation period from 1995-2000. Moreover, the Special Safeguard (which permits import restrictions under certain conditions) has proved relatively easy to invoke.

3. Detrimental role of agricultural export subsidies

It is almost exclusively a small number of OECD countries that use agricultural export subsidies. Yet, once imposed, export subsidies become an issue for non-OECD countries also, because they affect world prices and international market conditions. For potential agricultural exporting countries, export subsidies in OECD countries reduce welfare by reducing world prices. For importers in OECD countries, subsidies can bring short-term benefits in terms of lower import prices. However, in the longer run, export subsidies are detrimental to agricultural development both for importers and exporters. Yet, many countries continue to apply large amounts of export subsidies and subsidized exports do account for an important share of world trade for certain commodities (such as dairy products). The considerable latitude exercised by countries in the interpretation and implementation of their commitments limited the impact of the URAA on the elimination of agricultural subsidies. Many agricultural commodity markets continue to be dominated by trade among OECD countries, with limited access opportunities for non-OECD economies, particularly for developing countries.

A new World Bank study [Stern, 2002] found that full elimination of agricultural protection and production subsidies in rich countries would increase global trade in agriculture by 17 percent, with agricultural and food exports from low and middle-income countries rising by 24 percent. Total annual rural income in these countries would rise by about $60 billion, or roughly 6 percent. As Stern asserts, "European subsidies and barriers are, in general, much higher than those in the United States," which leads to some bizarre results. For instance sugar beets are grown in Finland, where the climate is hardly suitable for them, while poor sugar cane producers in the tropics struggle to make a living. Another astounding finding of Stern's study is that the average European cow receives $2.50 per day in government subsidies and the average Japanese cow receives $7.50 in subsidies, while 75 percent of people in Africa live on less than $2 per day [WB, 2007].

Other barriers to developing country exports that Stern mentioned are protectionist anti-dumping actions, bureaucratic applications of safety and sanitation standards, and textile tariffs and quotas. A Chilean tomato exporter faces a U.S. tariff of 2.2% on fresh tomato exports but nearly 12% if tomatoes are processed into sauce. Escalating tariffs help confine Ghana and Cote D'Ivoire to the export of unprocessed cocoa beans; Uganda and Kenya to the export of raw coffee beans; and Mali and Burkina Faso to the export of raw cotton. As Stern puts it, "These are taxes on development."

Yet, the negative effects of rich-country trade barriers and protective subsidies are not limited to developing countries. Trade barriers waste rich countries' financial resources and raise the domestic prices of food. Equally important, they encourage environmental degradation through increased use of capital-intensive farming, fertilizers and pesticides.

Several formulae could be applied to achieve more significant tariff and export subsidies reductions. Ongoing work in OECD [Fischer, 1998] suggests that seemingly non-trade-distorting subsidies (such as measures that provide support that is not based on current production or factors of production), may nonetheless have production and trade effects. This occurs because such payments may change the level of risk experienced by producers, or affect expectations that governments will continue to provide them in response to falls in market prices. This is why the desirable approach to improved agricultural trade is to adopt liberalizing rules, such as those in effect among the CAIRNS countries.

4. CAIRNS – Example of Successful Regional Agricultural Trade

The Cairns Group is a coalition of 17 agricultural exporting countries who account for one-third of the world's agricultural exports. Since it formed in 1986, the Cairns Group has succeeded in putting agriculture on the multilateral trade agenda. It was largely as a result of the group's efforts that a framework for reform in agricultural trade was established in the Uruguay Round and agriculture was for the first time subject to trade liberalizing rules.

The Cairns Group is a good example of successful coalition-building in the agricultural trade area. By acting collectively, it has had more influence and impact on the agriculture negotiations than any individual members could have had independently. Members of the group are: Argentina, Australia, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Guatemala, Indonesia, Malaysia, New Zealand, Paraguay, the Philippines, South Africa, Thailand and Uruguay [Fischer, 1998]. Since the conclusion of the Uruguay Round, the Cairns Group has worked successfully in Geneva for early implementation of the World Trade Organization agreements relating to agriculture [Markusen, 1995].

The Cairns Group's objectives for agriculture negotiations include deep cuts to all tariffs and removal of tariff escalation as well as the elimination of all trade-distorting domestic subsidies. Furthermore, they argue for the elimination of export subsidies and clear rules to prevent circumvention of export subsidy commitments. The long-term Cairns Group goal is to ensure that the current WTO agriculture negotiations will place trade in agricultural goods on the same basis as trade in other goods.

The example of Cairns trade policy illustrates best the issues raised by regionalism.

Regional trading blocks and a certain amount of unilateralism in trade policy have become inevitable supplements to the multilateral approach to trade. Regionalism can be a positive force. It can be used to promote and build more open and complementary markets and thereby strengthen the multilateral system. Nevertheless, it is a second-best solution. As the Cairns members themselves acknowledge, the optimal solution for agricultural trade lies in an acceleration of multilateral liberalization, not in a resort to preferential treatment for smaller groups of countries.

5. International agreement for movement towards liberalization

Despite all obstacles against agricultural trade liberalization, and the many problems within the developed and developing countries, at the United Nations in the autumn of 2000 there was an international consensus on the Millennium Development Goals (MDGs). The goals represent specific targets for improvements in income poverty, health, education, the status of women and girls, the environment, and international development cooperation for the period from 1990 to 2015.

In Doha, Quatar, in November 2001 the international community agreed upon a new round of trade negotiations that placed the interests of developing countries at the top of the agenda. In Monterrey, Mexico, in March 2001, rich countries and developing countries reaffirmed their commitment to the MDGs. And the Johannesburg Summit in August 2001 looked further ahead to address the challenges of achieving sustainable development and protecting the environment.

A number of agricultural products importing countries, such as Japan, expressed fears that their food supplies could be disrupted if exporting countries restrict or tax exports. They proposed disciplines on export restrictions, for example converting them to taxes that would then be reduced (similar to “tariffication” of import restrictions).

Some countries are proposing the total elimination of all forms of export subsidies, in some cases with a deep reductions right at the start of the next period as a “down payment”. Others are prepared to negotiate progressive reductions without going so far as the subsidies’ complete elimination, and without any “down payment”.

While initially “India’s insulation from world markets stemmed from a long standing distrust of markets and international trade in general” [Srinivasan, 2002], lately, in the wake of increasing globalization, India proposes additional flexibility for developing countries. India thinks that in order to spur agricultural expansion in developing countries it is desirable to allow subsidies on agricultural products to increase when subsidies on other products are reduced.

Several developing countries complain that the rules are unequal. They object in particular to the fact that developed countries are allowed to continue to spend large amounts on export subsidies while developing countries cannot because they lack the funds, and because only those countries that originally subsidized exports were allowed to continue subsidizing — although at reduced levels. One group of developing countries compares the effect of various types of export subsidies with “dumping” that harms their farmers. As a result of all of these concerns, some proposals envisage sharply different terms for developing countries. India, for example, proposes the removal of all developed countries’ export subsidies while allowing developing countries to subsidize for specific purposes such as marketing. Furthermore, some developing countries claim that they should be allowed to retain high tariff barriers or to adjust their current tariff limits, in order to protect their farmers — unless export subsidies in rich countries are substantially reduced. Some other developing countries counter that the barriers would also hurt developing countries that want to export to fellow-developing countries.

6. Conclusion

The concept of “distortion” is used a lot when agricultural trade is discussed. Agricultural trade is oftentimes distorted since prices are either higher or lower than normal, and quantities produced, bought, and sold are higher or lower than the levels that would usually exist in a competitive market. Import barriers and domestic subsidies raise crop prices on a country’s internal market. The higher prices encourage over-production, and if the surplus is sold on world markets, where prices are lower, then export subsidies have to be paid ultimately by consumers. When some countries subsidize and others do not, the result is that the subsidizing countries are producing considerably more than they normally would. Governments invoke various reasons for supporting and protecting their farmers, even if this distorts agricultural trade. They want to make sure that enough food is produced to meet the country’s needs. Furthermore, they want to shield farmers from the effects of the weather and swings in world prices. Last, but not least, governments want to preserve rural society.

The subsidizing policies have often been expensive, and they have encouraged surpluses leading to export subsidy wars. Countries with less money for subsidies have suffered. In negotiations, some countries have argued that trying to trade in these conditions is counter-productive. Others have attempted to find ways of subsidizing agriculture without distorting trade too much.

Trade liberalization promises aggregate gains, but it does not guarantee that everyone will be better off. Within countries, there will be both winners and losers. Among countries there may be some losers, at least in the short term and especially from a narrow agreement. In particular, the food importing countries and those of exporters who depend on few commodities are at the highest risk for losses from dramatic changes in the prices of agricultural products.

Yet, such caveats do not compromise the case for further agricultural trade reform. In countries where the agricultural sector is characterized by high levels of protection adjustment assistance could be provided, as well as targeted intervention to correct market failures. The most important take-home message from the analysis of the current agricultural trade issues is that poorly functioning markets, whether in developed or in developing countries, result in economic losses to all nations.

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