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Summary

Agricultural trade barriers and producer subsidies inflict real costs, both on the countries that use these policies and on their trade partners. Trade barriers lower demand for trade partners' products, domestic subsidies can induce an oversupply of agricultural products which depresses world prices, and export subsidies create increased competition for producers in other countries. In 2000, World Trade Organization (WTO) members continued global negotiations on agricultural policy reform. To help policymakers and others realize what is at stake in the global agricultural negotiations, this report quantifies the costs of global agricultural distortions and the potential benefits of their full elimination. It also analyzes the effects on U.S. and world agriculture if only partial reform is achieved in liberalizing tariffs, tariff-rate quotas (limits on imported goods), domestic support, and export subsidies.

Key findings include:

Global agricultural policy distortions impose substantial, long-term costs on the world economy; in the long term, the full elimination of these policy distortions would result in an annual world welfare gain of \$56 billion, about 0.2 percent of global GDP. These projected welfare gains, or increased purchasing power, can be decomposed into the removal of distortions in production and consumption (\$31 billion), the effects of policy reform on global savings and investment (\$5 billion), and increased productivity gains, mainly in emerging and developing countries (\$20 billion). Total, long-term welfare benefits to the United States from eliminating world agricultural policy distortions are \$13.3 billion annually — about 24 percent of global gains. U.S. gains would mainly come from our trade partners' policy reforms.

Elimination of agricultural trade and domestic policy distortions could raise world agricultural prices about 12 percent. Import tariffs lower food demand, and domestic support and export subsidies encourage excess supply — all result in lower world agricultural prices. European Union (EU) agricultural policies account for 38 percent, and Japanese plus Korean policies combined account for 12 percent, of global price distortions. U.S. agricultural policies account for about 16 percent of global price distortions.

Tariffs and tariff-rate quotas account for more market distortions than domestic subsidies and export subsidies. Tariffs and tariff-rate quotas account for most of the agricultural price distortions (52 percent) from agricultural protection and support. Post-Uruguay Round agricultural tariffs remain high, with a global average rate of 62 percent, and an industrial country average of 45 percent. Domestic subsidies (31 percent) and export subsidies (13 percent) have comparatively smaller, direct roles in reducing world prices. The remaining 4 percent measures the interaction effects of the three policies combined.

Continuing the Uruguay Round reductions (an additional 20 percent) in the Aggregate Measurement of Support (AMS) will have less of an impact than leveling domestic support across countries and commodities, an alternative, generic approach to reducing domestic support. An additional 20-percent reduction in the Uruguay Round ceilings on total support expenditure would affect a small number of OECD countries, because many countries' expenditures are already below their AMS limits, based on 1998 policies. Leveling and reducing domestic support on a commodity basis would engage more countries and commodities in the reform process. Commodity impacts would also differ under the two approaches.

Despite their relatively small aggregate price effects, export subsidies play an important role in the reform process. Tariffs and domestic support policies of many countries contribute to distorted global markets. The global effects of export subsidies, however, are mostly attributable to a single region, the EU. Export subsidies significantly affect trade in some markets, create increased competition that strains trade relationships, and are an integral part of related domestic price support programs.

Many trade and domestic policies operate interdependently, and options for reform of some policies are linked. A reduction in tariffs would reduce the problems related to TRQ's by reducing over-quota tariffs. Trade policy reforms can help achieve reforms of domestic market price support, because price support programs generally rely on tariffs and export subsidies to be effective. Greater constraints on export subsidies can help some countries ease their reluctance to reduce their import barriers because of unfairly subsidized competition, and can create pressures for reducing related domestic price support that encourages surplus production.

Emerging and developing countries can benefit from further policy reforms. These countries have diverse, and sometimes divergent, interests in the negotiations. Global policy reform will lead to increased agricultural exports by many emerging and developing countries and improved terms of trade. Most of the potential benefits from policy reform will come from developing countries' reform of their own policies. Their full engagement in a global reform process could increase their welfare by \$21 billion annually. Low-income developing countries' food aid needs will decline 6 percent as their domestic food production expands in response to higher world prices.

Glossary

Agreement on Agriculture. Part of the Uruguay Round agreement covering issues related to agriculture (e.g., market access, export subsidies, and internal support).

AMS (Aggregate Measurement of Support). An index that measures the monetary value of the extent of government support to a sector. The AMS, as defined in the Agreement on Agriculture, includes both budgetary outlays as well as revenue transfers from consumers to producers as a result of policies that distort market prices. The AMS includes actual or calculated amounts of direct payments to producers (such as deficiency payments), input subsidies (on irrigation water, for example), the estimated value of revenue transferred from consumers to producers as a result of policies that distort market prices (market price supports), and interest subsidies on commodity loan programs. The AMS differs from the broader agricultural support measure, the Producer Subsidy Equivalent, by excluding estimated benefits (or costs) of certain noncommodity specific policies (e.g., research and environmental programs), and by using special WTO-defined measures of deficiency payments and market price supports. Furthermore, the final AMS for the WTO implementation period (1995-2000) is adjusted to exclude deficiency payments under WTO special provisions, even though they are included in the WTO base period.

Bound tariff rates. Tariff rates resulting from GATT negotiations or accessions that are incorporated as part of a country's schedule of concessions. Bound rates are enforceable under Article II of GATT. If a GATT contracting party raises a tariff above the bound rate, the affected countries have the right to retaliate against an equivalent value of the offending country's exports or receive compensation, usually in the form of reduced tariffs of other products they export to the offending country.

Cairns group. A group formed in 1986 in Cairns, Australia, that seeks the removal of trade barriers and substantial reductions in subsidies affecting agricultural trade. The group includes Argentina, Australia, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Fiji, Guatemala, Indonesia, Malaysia, New Zealand, Paraguay, the Philippines, Thailand, South Africa, and Uruguay. The Cairns Group was a strong coalition in the Uruguay Round of multilateral trade negotiations.

Ceiling binding. In cases where an existing tariff was not already bound, developing countries were allowed to establish ceiling bindings. These ceiling bindings could result in tariffs that were higher than the existing applied rate. The ceiling bindings took effect on the first day of implementation of the Agreement.

Country schedules. The official schedules of subsidy commitments and tariff bindings as agreed to under GATT for member countries.

De minimis rule. The total AMS includes a specific commodity support only if it equals more than 5 percent of its value of production. The noncommodity-specific support component of the AMS is included in the AMS total only if it exceeds 5 percent of the value of total agricultural output.

EFTA (European Free Trade Association). An international organization with four member countries: Iceland, Liechtenstein, Norway, and Switzerland. The purpose of

EFTA is to monitor and manage relationships among the EFTA States. Iceland, Liechtenstein, and Norway also participate in the EU common market through an Agreement on the European Economic Area (EEA).

EU (European Union). Established by the Treaty of Rome in 1957 and known previously as the European Economic Community and the Common Market. Originally composed of 6 European nations, it has expanded to 15. The EU attempts to unify and integrate member economies by establishing a customs union and common economic policies, including CAP (Common Agricultural Policy). Member nations include Austria, Belgium, Denmark, Germany, Greece, Finland, France, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

GATT (General Agreement on Tariffs and Trade). Originally negotiated in Geneva, Switzerland, in 1947, among 23 countries, including the United States, GATT is an agreement to increase international trade by reducing tariffs and other trade barriers. The agreement provides a code of conduct for international commerce and a framework for periodic multilateral negotiations on trade liberalization and expansion.

In-quota tariff. The tariff applied on imports within the quota. The in-quota tariff is less than the over-quota tariff.

“Like-minded” developing country group. A group of least developed, developing countries that presented a joint proposal at the WTO. The group includes Cuba, Dominican Republic, Honduras, Pakistan, Haiti, Nicaragua, Kenya, Uganda, Zimbabwe, Sri Lanka, and El Salvador.

Market access. The extent to which a country permits imports. A variety of tariff and nontariff trade barriers can be used to limit the entry of foreign products.

Megatariffs. Extremely high tariffs that effectively cut off all imports other than the minimum access amounts granted under the agreement. Some well-known examples of megatariffs resulting from tariffication include the base tariffs calculated for EU tariffs on grains, sugar and dairy products; U.S. sugar, peanuts, and dairy products; Canadian tariffs on dairy products and poultry; and Japanese tariffs on wheat, peanuts, and dairy products.

MERCOSUR. The Common Market of the South (Mercado Común del Sur) created by the Treaty of Asunción signed by Argentina, Brazil, Paraguay, and Uruguay in 1991. Chile and Bolivia became associate members in 1996 and 1997, respectively.

NAFTA (North American Free Trade Agreement). A trade agreement involving Canada, Mexico, and the United States, implemented on January 1, 1994, with a 15-year transition period. The major agricultural provisions of NAFTA include (1) the elimination of nontariff barriers — immediately upon implementation, generally through their conversion to tariff-rate quotas or ordinary quotas; (2) elimination of tariffs — many immediately, most within 10 years, and some sensitive products gradually over 15 years; (3) special safeguard provisions; and (4) country-of-origin rules to ensure that Mexico does not serve as a platform for exports from third countries to the United States.

Nontariff trade barriers. Regulations used by governments to restrict imports from, and exports to, other countries, including embargoes, import quotas, and technical barriers to trade.

Notifications. The annual process by which member countries report to the WTO information on commitments, changes in policies, and other related matters as required by the various agreements.

OECD (Organization for Economic Cooperation and Development). An organization founded in 1961 to promote economic growth, employment, a rising standard of living, and financial stability; to assist the economic expansion of member and nonmember developing countries; and to expand world trade. The member countries are Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States

Over-quota tariff. The tariff applied on imports in excess of the quota volume. The over-quota tariff is greater than the in-quota tariff.

PSE (Producer Subsidy Equivalent). A broadly defined aggregate measure of support to agriculture that combines into one total value aggregate, direct payments to producers financed by budgetary outlays (such as deficiency payments), budgetary outlays for certain other programs assumed to provide benefits to agriculture (such as research and inspection and environmental programs), and the estimated value of revenue transfers from consumers to producers as a result of policies that distort market prices.

Round. Refers to one of a series of multilateral trade negotiations held under the auspices of GATT for the purposes of reducing tariffs or other trade barriers. There have been eight trade negotiating rounds since the adoption of GATT in 1947.

Special and differential treatment. The provision allowing exports from developing countries to receive preferential access to developed markets without having to accord the same treatment in their domestic markets.

Tariff. A tax imposed on commodity imports by a government. A tariff may be either a fixed charge per unit of product imported (specific tariff) or a fixed percentage of value (ad valorem tariff).

Tariff-rate quota. Quantitative limit (quota) on imported goods, above which a higher tariff rate is applied. A lower tariff rate applies to any imports below the quota amount.

Tariffication. The process of converting nontariff trade barriers to bound tariffs. This is done under the UR agreement in order to improve the transparency of existing agricultural trade barriers and facilitate their proposed reduction.

UR (Uruguay Round) agreement. The Uruguay Round of multilateral trade negotiations, conducted under the auspices of the GATT, is a trade agreement designed to open world markets. The Agreement on Agriculture is one of the 29 individual legal texts included in the Final Act under an umbrella agreement establishing the WTO. The negotiation began at Punta del Este, Uruguay, in September 1986 and concluded in Marrakesh, Morocco, in April 1994.

WTO (World Trade Organization). Established on January 1, 1995, as a result of the Uruguay Round, the WTO replaces GATT as the legal and institutional foundation of the multilateral trading system of member countries. It provides the principal contractual obligations determining how governments frame and implement domestic trade legislation and regulations. It is the platform on which trade relations among countries evolve through collective debate, negotiation, and adjudication.