

World Agriculture & Trade



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WTO Negotiations: Potential Gains from Ag Policy Reform

The World Trade Organization (WTO) opened global trade negotiations on agriculture in Geneva in March 2000. The negotiations are expected to address national agricultural policies related to market access limits (tariffs, tariff-rate quotas, and other trade barriers), domestic support to agricultural producers, and export subsidies.

Agricultural trade barriers and producer subsidies inflict real costs, both on the countries that use these policies and on their trade partners. Trade barriers help keep inefficient domestic producers in operation, result in forgone opportunities for more efficient allocation of national resources, and lower demand for trade partners' products. Trade-distorting domestic subsidies can induce an oversupply of agricultural products and keep resources in agriculture that could be employed more profitably elsewhere.

Oversupply of agricultural commodities leads to low prices and increased competition for producers in other countries and can create the need for export subsidies to dispose of excess domestic production. Consumers are harmed not just by the direct effect of tariffs in raising the cost of imports, but also by inefficiencies in their economy that result from tariffs and sub-

sidies. When an economy is performing below its potential, consumers' income and welfare are reduced.

New negotiations present an opportunity to achieve further reductions in global trade-distorting agricultural policies. Under terms of the Uruguay Round Agreement on Agriculture (URAA), negotiations will include some "built-in" agenda items—i.e., member countries' experiences with implementation of Uruguay Round commitments; effects of URAA reduction commitments on world trade in agriculture; nontrade issues such as environmental protection and food security; and provisions for special and differential treatment of developing countries.

Gains of URAA Have Proven Fragile

The Uruguay Round of the General Agreement on Tariffs and Trade (GATT) ended in 1993 having fundamentally altered the treatment of national agricultural policies under multilateral rules of global trade. In the Agreement on Agriculture, members determined that trade-distorting agricultural policies should be disciplined or constrained, so that market forces rather than government

intervention can increasingly drive agricultural markets.

In committing to greater market access, members agreed to reduce tariffs by 36 percent, on average, (24 percent for developing countries) and to convert most non-tariff barriers to tariffs or to a two-tier tariff system called tariff-rate quotas (TRQ's). TRQ's allow a limited quantity of imports to enter a country at a relatively low tariff, with higher tariffs imposed on over-quota imports.

Member countries also agreed to reduce their aggregate levels of trade-distorting domestic support to agriculture by 20 percent (13 percent for developing countries). In addition, both the value and volume of subsidized exports were placed under limits scheduled to decline through the end of the URAA implementation period. Developed countries implemented URAA reform commitments during 1995-2000, and less developed countries will continue the process through 2004.

The experience to date from implementation of the URAA has demonstrated that policy reform is difficult to achieve. Global agricultural tariffs remain high, and there is substantial disparity in tariffs among countries and across commodities. For example, the average U.S. agricultural tariff is relatively low (12 percent) compared with 21 percent for the European Union, 24 percent for Canada, 33 percent for Japan, and 152 percent for Norway. The global average rate is 62 percent. High import tariffs imposed by U.S. trade partners are a significant impediment to U.S. agricultural export growth.

Disparities across commodities within countries' tariff codes can intensify the distorting effects of tariffs. For example, escalation of a country's tariffs between bulk commodities and processed agricultural products—i.e., a higher effective rate of tariff protection on the final product than on inputs—can significantly affect trade in processed products, a fast growing but price-sensitive component of global agricultural trade. And while tariff-rate quotas have replaced many nontrade barriers, some have complicated import regimes, often with rules that are not easy to understand, and many have very high upper tier rates.

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World Trade Organization Negotiations on Agriculture: Process and Objectives

Venue	Special sessions of WTO Committee on Agriculture, Geneva, Switzerland
Objectives	Continue the process of reform begun in the Uruguay Round Agreement on Agriculture (URAA), taking into account experiences with URAA trade barrier reductions, effects of the URAA on world agricultural trade, nontrade issues such as environment and rural development, special and differential treatment of less developed countries, and other concerns.
Scheduled meetings	Phase I meetings: 2000 — March, June, September, and November 2001 — February, March, June, September, and November
Country proposals	To be submitted to the WTO by December 2000 (with some flexibility through March 2001). Proposals are available at www.WTO.org

Source: WTO Secretariat.

Economic Research Service, USDA

Domestic farm support levels declined early in the implementation period, helped by strong world prices. Also, many countries chose to adopt less distorting types of domestic subsidies that are exempt from URAA limits. For example, some countries have reduced their reliance on subsidies that are directly linked to the production of specific crops, and instead provide payments that are not dependent on farmers' current decisions about which crop or how much to produce. The shift toward less distorting (exempt) programs has been influenced at least in part by URAA principles. However, since 1998, global expenditures on trade-distorting types of domestic support have increased in response to low world prices.

The URAA placed limits on export subsidies for individual commodities, but allowed for some flexibility. Lower usage levels early in the URAA implementation period, when prices were high, enabled some members to bring forward unused levels and recently apply the subsidies when prices were low and ceilings had been reached.

Calculating the Benefits Of Ag Policy Reform

Despite gains made by the URAA, remaining global agricultural policy distortions impose substantial costs on the world economy. Agricultural tariffs, domestic support, and export subsidies

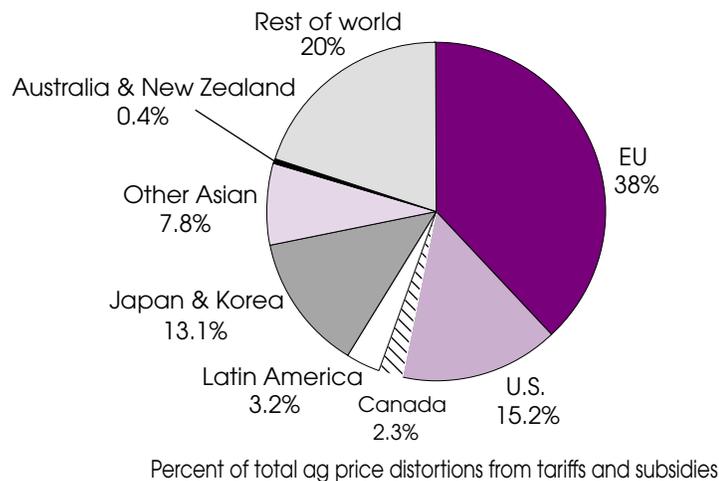
push world agricultural prices to about 12 percent below what they would otherwise be, according to recent analysis by USDA's Economic Research Service. Studies show that over the long term (about 10-15 years) trade-distorting policies will result in a reduction in world welfare (loss in consumer purchasing power) of \$56 billion annually, which represents about 0.2 percent of global GDP.

Most of the agricultural market distortions, as measured by world price effects, are attributed to a small number of countries. Developed economies account for nearly 80 percent of world price distortions. The European Union (EU) accounts for 38 percent, the U.S. 15 percent, Japan plus Korea 13 percent, and Canada 2 percent. These countries typically employ different mixes of price-distorting policies. For example, export subsidies are an integral part of the EU's domestic price support system. As a result, the EU alone accounts for more than 90 percent of global export subsidy expenditures.

The EU and the U.S. together account for most of the global distortions related to domestic producer support. Most other countries rely mainly on tariffs to support their farm sectors. Particularly in developing countries, tariffs are a more practical farm support policy because they raise government revenue, while domestic programs entail government expenditure. But tariffs are a potentially more distorting type of farm support than domestic producer subsidies, because they directly affect consumers as well as producers.

There are two dimensions in calculating potential welfare gains to an economy from further policy reform. The first

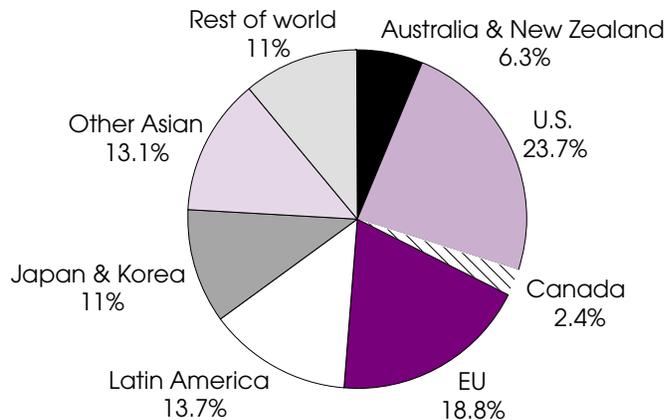
Economies Around the World Contribute to Ag Price Distortions from Tariffs and Subsidies



Note: Distortions from agricultural tariffs, domestic support, and export subsidies cause world agricultural prices to be 12 percent below the level they would otherwise be.

Economic Research Service, USDA

Many Countries Would Share Consumer Purchasing Power Gains From Elimination of Ag Tariffs and Subsidies



Estimated annual gain in consumer purchasing power = \$56 billion

Economic Research Service, USDA

relates to removing distortions in consumption and production decisions. These are the “static” gains in welfare (purchasing power) that accrue after producers and consumers fully adjust to changes in prices when tariffs and subsidies are removed. Despite higher world food prices, consumers in most countries would benefit from static gains because tariff elimination lowers consumer prices of imported foods and because policy reforms increase overall economic efficiency. Static welfare gains worth about \$31 billion annually to the world economy would accrue over time and reflect increases in income (wages and return on investment) relative to expenditure.

Most static gains from trade liberalization would accrue to countries with the largest initial policy distortions. Developed countries receive most of the global static welfare gains from full policy reform (\$28.5 billion annually), compared with potential welfare gains for developing countries of about \$2.6 billion. Some agricultural importing countries that face higher world prices but have few domestic policy distortions would realize static welfare losses from full trade liberalization.

The second dimension in calculating benefits of global policy reform involves dynamic gains—i.e., long-term effects of increased investment and the opportunities for increased productivity that are linked

to more open economies. All countries can benefit from the potential dynamic gains of global policy reform. Reforms lead to greater investment by increasing potential returns, and additional investment increases the productive capacity of economies. Developing countries in particular, which have substantial potential for productivity gains from technological change, stand to benefit directly from more openness to the rest of the world.

If developing countries eliminate their own agricultural import barriers and are thereby more exposed to products and competition from more advanced economies, they can increase their economy-wide productivity by accelerating their rate of learning new skills and by adopting more advanced technologies that are embodied in imports from more developed countries. Reflecting their greater dynamic potential for growth, these economies are expected to draw increased global investment, increasing their resource availability and realizing static and dynamic gains totaling \$21.3 billion. Developed countries will benefit by enhanced investment opportunities. Dynamic gains—investment and productivity growth—due to policy reform account for about 45 percent of total benefits from full trade liberalization.

Over the long term, full elimination of agricultural price distortions would lead

to an increase in world welfare, or consumer purchasing power, of \$56 billion annually, with nearly one-fourth accruing to the U.S. Because U.S. tariffs, domestic support, and export subsidies are relatively low, most of the benefit for the U.S. would come from policy reforms in U.S. trade partners.

Because of its technological maturity, the U.S. will not enjoy substantial direct benefits from dynamic gains. But U.S. agriculture will benefit from dynamic gains in developing countries that import U.S. farm products as growth in demand increases in those economies. In the long run, full policy reform could lead to higher world prices for U.S. farm exports, the real value of U.S. agricultural exports could be 19 percent higher each year, and U.S. agricultural imports could be up 9 percent.

Movement toward a more market-oriented and orderly global agricultural trading system is important for the U.S. because of the large and increasing role of trade in U.S. agricultural production and food consumption. As technological advances and increased productivity lead to higher levels of production, expanding export markets provide an outlet for U.S. food and agricultural products. For consumers, trade rules help to ensure access to a safe, varied, and abundant year-round supply of food.

Global policies that distort agricultural trade impose substantial long-term costs on U.S. producers, consumers, and the world economy. U.S. agricultural tariffs and subsidies are relatively low, suggesting that U.S. domestic adjustments to its own reform commitments are likely to be small relative to the potentially large benefits of global reform. Furthermore, reforms of U.S. policies within a global framework can help to ensure the overall, long-term competitiveness of the U.S. farm sector in world markets. **AO**

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