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Liberalizing Agricultural Trade and Developing Countries

By David Orden, Rashid S. Kaukab, and Eugenio Diaz-Bonilla

SUMMARY

A diverse group of development and trade liberalization advocates agree that reduction of agricultural protection and subsidization in the world's wealthy countries is necessary to strengthen both international growth opportunities and the global trade regime. According to the consensus reached among participants attending a conference cosponsored by the Carnegie Endowment for International Peace and the Cordell Hull Institute, WTO Doha Round negotiations on agriculture should compel policy change in industrialized countries to limit trade-distorting domestic subsidies for agricultural products, lower tariffs, increase market access, and eliminate export subsidies. In response to temporary hardships caused by an overall reduction in agriculture support, governments should have the flexibility to adopt temporary or limited domestic, and perhaps international, compensatory policies. Significant differences in perspective and policy prescriptions were expressed by conference participants about the appropriate speed and scope of agricultural liberalization in developing countries, especially if progress is not made toward reduced support for agriculture in developed countries.

Agriculture is at the heart of the new "Doha Round" of multilateral trade negotiations that were launched by the World Trade Organization (WTO) at its ministerial conference in November 2001. But governments are as far apart as they were at the end of the Uruguay Round negotiations in 1994 when, after a struggle of epic proportions, agreement was reached on an overall framework within which to pursue the liberalization of agricultural trade.

Agriculture has been treated as an exception to the rules, as a "special case" outside the

negotiations, significant progress was made in liberalizing the border protection and nontariff measures within borders on industrial products traded among developed economies, but little impact was made on the rising trend of support and protection afforded to their farmers. Nor was much done to liberalize trade in agricultural and industrial products of export interest to developing economies.

Agricultural policies in developed countries are based on price-support measures and

subsidies of various kinds sustained by heavily restricting imports from lower-cost producers in other developed and developing countries. Over the decades, these policies have resulted in massive distortions of production, consumption, and trade in the agricultural sector. The detrimental effects have been significant. Subsidies to farm production and exports in industrial countries have depressed commodity prices in “world” markets, closing off trade opportunities and imposing other costs on countries at the periphery of the world economy, many of them very poor. Recent studies put the resulting loss of income among developing countries as high as \$60 billion annually. Protection and subsidization in developed countries has also pushed domestic agricultural producers to adopt intensive-farming methods that have been damaging to the environment through increased water pollution, soil degradation, and loss of biodiversity.

It was not until the Uruguay Round negotiations of 1986–1994 that governments started to address these distortions by bringing the agricultural sector of the world economy into the multilateral trade-liberalizing process. In those efforts, the European Union, along with Japan, Norway, and Switzerland, opposed reductions in domestic support or border protection for agriculture, while the United States and the newly formed Cairns Group of smaller agriculture-exporting countries favored fundamental reforms.

For developed countries, the 1994 WTO Agreement on Agriculture (AoA) provided for a (i) reduction of some forms of domestic supports by 20 percent, relative to a 1986–88 base-period average, (ii) reduction of tariffs of 36 percent from a 1986–88 base-period average, and (iii) reduction of export subsidies of 36 percent in value terms, and 21 percent in volume terms, from a 1986–90 base-period average. While the AoA achieved only modest accomplishments in terms of actual reductions in support and protection, a framework for negotiating liberalization and

reform—as well as rules to guide the application of sanitary, phytosanitary, and other technical measures affecting agricultural trade—was established.

Since the AoA came into effect, farm lobbies in the European Union, Japan, the United States, and some smaller developed countries have continued to resist any reduction in the support measures and border protection that benefit their members. Achieving substantial further reforms in the Doha Round will require a concerted effort by the governments of the Cairns Group countries and other developing countries that are seriously affected by protectionist agricultural policies, and by the United States, which has been a force for multilateral liberalization but has recently enacted legislation that increased its own subsidies. Reform proposals of these governments in the WTO will require support from development, environmental, and consumer groups, as well as trade-policy specialists in think tanks and other scholarly circles.

There are good conceptual reasons for a broad coalition of development and trade advocates in pursuit of agricultural liberalization. Subsidies and border protection of the industrialized countries have so distorted world agriculture that the opportunities for growth in developing countries in which low-cost agricultural production is a large part of the economy have been severely limited or destroyed. Economic theory suggests that wealth is created when trade is less hampered by tariff and other market distortions. Comparative advantage in agricultural production among countries is held in many developing nations, and freer trade provides greater opportunity to realize the benefits. The efficient use of resources is also supportive of objectives of global environmental protection and conservation.

There are good political economy reasons as well for a coalition of development proponents and agricultural trade reformers. In the corridors of power of the developed

countries, neither of these groups has wielded the same clout as domestic farm lobbies seeking government assistance.

On September 11, 2002, the Carnegie Endowment for International Peace and Cordell Hull Institute sponsored a meeting in Washington, D.C. on liberalizing agricultural trade and the interests of developing countries. Participants in the September 11 meeting came from two broad perspectives: (i) those primarily concerned with economic development, poverty alleviation, and countering hunger and malnutrition, along with (ii) those primarily concerned with opening markets and strengthening the multilateral trade system. The first group emphasizes trade as a possible avenue for raising standards of living in relatively poor countries, but has been critical of the WTO, which they perceive to be tilted against the poor. The second group emphasizes that global welfare, development, and poverty alleviation are best served by liberalizing trade and trade-related investment in a stable, or rules-based, institutional environment.

The conference aired a diversity of views and identified common ground among the proponents of agricultural liberalization. Here we highlight areas where there is broad agreement and note other areas in which views differ. One overview statement merits highlighting at the outset, lest any disagreement about the appropriate stance of policy seem to loom too large. There is strong agreement that progress in reducing agricultural support and protection among the world's wealthy countries would be an important accomplishment for development and the strengthening of the global trade regime.

Areas of Agreement

The protection of agriculture, together with much of the subsidization within developed countries, has the effect of closing off trade-based growth and development, causing

environmental damage and weakening global integration. There is consensus that progress towards reducing this trade-distorting protection and subsidization is a high priority. This objective should be pursued aggressively in the Doha Round negotiations.

Consensus in favor of reduced agricultural support and protection in developed countries is based upon our conclusion that developing countries, where agriculture represents large percentages of total production, employment, and exports, will reap tremendous gains. Numerous empirical studies show net gains in export revenues and national incomes for developing countries from agricultural trade liberalization. From this follows agreement on the merits of achieving the complicated task of reforming trade-distorting domestic support for agriculture in the developed world, lowering tariffs to increase market access, and eliminating export subsidies. To respond to temporary hardships caused by an overall reduction in agriculture support, governments may need flexibility to adopt temporary or limited domestic, and perhaps international, compensatory policies. This may be the case for some farmers in developed countries, for low-income countries whose trade preferences are eroded by trade liberalization in industrialized countries, and for some extremely poor developing countries that are net food importers.

1. Domestic Subsidies

Development advocates are suspicious of subsidies to farmers in developed countries. These suspicions are well grounded. Subsidies stimulate domestic production not only through direct price effects but also through the indirect effects arising from reduced risk, an enhanced cash flow, or increased producer wealth. Under the various AoA provisions, the EU, Japan, United States, and other wealthy countries spend \$200–\$300 billion annually to support agriculture. These subsidies are an order of magnitude equal to world agricultural trade!

No wonder developing countries, with less fiscal resources, see the WTO rules for agriculture as unfair.

Among the price-support, income-support, and other subsidy policies utilized in developed countries, some create a more trade-distorting stimulus to production than others, while a few restrain output. Development and trade liberalization advocates need to tread carefully among these domestic subsidies when seeking reforms. Under the AoA, subsidies have come to be characterized as falling into different “colored boxes.” “Amber-box” policies are directly trade-distorting and these expenditures, aggregated across all commodities, are subject to limitation commitments by countries. “Green-box” policies are presumed not to directly affect trade, or to have offsetting social benefits, and are exempt from AoA expenditure disciplines, although they often have indirect production stimulating effects. A compromise accord between the United States and EU reached at the conclusion of the Uruguay Round also established a “blue box” of policies that combine potentially trade-distorting support with some supply-constraining provisions, which again are not subject to AoA expenditure limits. There are also “loophole” provisions regarding *de minimis*, allowing additional amber-box subsidies up to a certain percentage of the value of total agricultural production (5 percent for developed and 10 percent for developing countries).

Subsidy expenditures are high in the EU, and are largely in the amber and blue boxes, providing incentives for increased production that affects trade. Since 1996, U.S. subsidies have been in the amber and green boxes. The 2002 U.S. Farm Act sharply increased amber- and green-box price and income subsidy authorizations for the next six years, stimulating production without imposing supply-control eligibility criteria on U.S. farmers. Yet domestic support is a complex area. The EU blue-box policies require farmers to take some land out of

production annually. The new U.S. farm bill, along with increased price-support and income subsidies, simultaneously continued long-term idling of land under the Conservation Reserve Program (CRP). Authority for the CRP (a green-box policy) was increased to nearly 40 million acres – more than 10 percent of the U.S. agricultural land base.

A second area of complexity about domestic subsidy policy concerns public research and extension expenditures that enhance agricultural productivity. Subsidies in this area again fall in the green box. Higher productivity raises output and causes prices to fall, but does not impoverish farmers because the productivity gains also lower their costs of production. Productivity-induced reductions in production costs make possible a low-priced world food supply. This is of enormous benefit in long-term perspective, particularly to the poor. Development and trade liberalization advocates agree on the importance of public policies for stimulating improvements in agricultural productivity that will, over time, raise income and food consumption among low-income people. We agree on the need to provide adequate funding in developing countries for agricultural research and extension, and for productive and social infrastructure in rural areas, which require, among other things, additional commitments by international financial institutions and donors.

A third complex area of domestic support arises over what have been called “nontrade” or “multifunctionality” concerns, such as protection of the environment or maintenance of a picturesque rural landscape. Both development and trade liberalization advocates are wary of using these concerns to rationalize policies that either increase agricultural production in developed countries or limit the access of developing countries. Important goals related to the environment, for example, are better achieved by policies that do not restrict

trade. The subsidy policies in developed countries are themselves a cause of environmental degradation because of the intensive-farming methods they stimulate. Constraining the production-stimulating and trade-distorting subsidies of developed countries is best achieved by negotiating effective limits on the amber-box policies, including *de minimis* expenditures that are tied to production or prices. In addition, countries should eliminate the blue box entirely, and ensure that supposedly trade-neutral policies under the green box do not bring production-increasing resources into farm production. In all three cases, progress would require both clear language and vigilant observation backed by the WTO dispute-settlement process and accumulation of adjudicated outcomes that secure adherence to negotiated agreements.

2. Market Access and Tariffs

The WTO rules for agriculture remain quite special compared to other goods. Agricultural trade is restricted by nearly 1,400 tariff-rate quotas (TRQs) that limit the quantities of commodities imported tariff free or subject to low tariff rates. Tariffs on “overquota” quantities are usually prohibitive, so the TRQs under the AoA are not much different from the older quantity-based import quotas they replaced. Both developed and developing countries utilize TRQs (43 countries in all, including 21 developing countries), but those imposed by developed countries create the most substantial barriers to global trade. Trade in those agricultural products that are not limited by TRQs is subject to an average tariff level that is high compared with industrial products. In key cases, agricultural trade is severely constrained or precluded by tariff “peaks” on particular commodities in which developing countries have an advantage in production.

Market access should be expanded in the Doha Round negotiations to provide greater agricultural export opportunities for developing countries. Expanding the shares

of markets open to trade requires more than increases in the absolute quantities of trade under TRQs—it requires that TRQs expand as a percentage of domestic consumption. As long as overquota tariffs are prohibitive, this is the only way to ensure greater international competition within the most restricted agricultural markets. Tariffs must be brought down broadly on agriculture products, including those for which overquota and other high tariffs now preclude trade. Widespread tariff reduction with a maximum tariff of less than 50 percent on any agricultural product is a worthy goal for the Doha Round negotiations.

Technical measures used by countries with regard to food safety and quality, and to protection of plant and animal health are increasingly at issue. Development and trade-liberalization advocates agree that safety, quality, and health measures will differ among countries, but that unnecessary technical trade barriers should be avoided. The WTO agreements on sanitary, phytosanitary, and other technical barriers to trade and the WTO dispute-settlement procedures provide a basis for disciplining misuse of technical measures. Developing countries will need to receive assistance in meeting the standards set by developed-country importers for food products, to ensure their own domestic standards are met when there is increased agricultural trade, and to participate fully in global standard-setting and dispute-settlement processes.

3. Export Subsidies

Developing-country agriculture is at the greatest disadvantage when explicit export subsidies are utilized. In these cases, the *prima facie* evidence confirms that farmers in the subsidizing country are receiving higher prices for their output. The subsidized products then enter world markets and choke off sales by countries that do not subsidize. Export subsidies, more than 90 percent of which are deployed by the

European Union, should be eliminated within a reasonable period of time—within five years or sooner. Other forms of “export competition,” notably export credits and food aid, also need to be disciplined.

4. Reform Compensation Policies

Reductions in subsidies and border protection that are desirable overall can negatively effect the incomes of traditional producers. Policy makers may have to address these impacts to create the political space for longer-term reforms. Within the developed countries, compensation often comes through domestic institutions, but developing countries have less capacity to address redistributive issues.

An illustrative case arises under the new U.S. farm bill. Until 2002, peanut production for the U.S. domestic edible market was constrained by internal marketing quotas and import TRQs. The domestic price was kept at about double the world price, so domestic and foreign suppliers with access rights were benefited at a cost to domestic consumers. With the 2002 farm legislation, the U.S. market price of peanuts is allowed to fall, with the marketing quotas replaced by direct government payments to domestic peanut producers, even if they switch to growing other crops. This is a desirable change in policy because it reduces a consumer distortion, creates planting flexibility, and makes it easier for the United States to eliminate use of its peanut TRQs. But foreign producers (including those in Argentina, China, and Mexico) bear a cost. The access to a high-priced market that they attained in the AoA and the North American Free Trade Agreement rose from 1 percent to nearly 10 percent of U.S. peanut consumption. This access loses value with the 2002 Farm Act, since foreign producers are not compensated for lower prices under the new law.

The recent change of U.S. peanut policy points out the desirability of broader, possibly international, compensation measures when beneficial changes to domestic or trade policies in developed countries have substantial negative effects on domestic or foreign producers. Other such cases arise—for example, to liberalize sugar trade may require some offsetting compensation payments. Both development and trade-liberalization advocates are sensitive to these circumstances in order to achieve policy reform.

Difference in Perspectives

Significant differences in perspective and policy prescriptions arise, however, about the appropriate speed and scope of agricultural liberalization in developing countries, especially if marked progress is not achieved among developed countries. These difference emerge from different perspectives on the advisability of policies that would “tilt the balance” explicitly toward protection of agriculture among the developing countries or would restrict world commodity supplies to raise market prices. Such interventions have been proposed by some development advocates, either as self-justified policy steps or for the strategic purpose of offsetting the effects of developed-country agricultural policies. Trade liberalization advocates are suspicious of policies that involve substantial interventions away from a trade-oriented norm, even those aimed toward developing countries. They point out that agricultural trade among developing countries amounts to more than \$50 billion in 1998-2000, and is projected to increase in the next decades, compared to exports to developed countries of around \$75 billion (see Table 1). To trade liberalization advocates, this suggests caution over recommendations for protection of agriculture within developing countries, as well the need for greater trade opportunities with the developed world.

1. Protection of Agriculture

The AoA requires less tariff and subsidy reductions by developing countries than by developed countries. Development advocates particularly favor this and other WTO “special and differential treatment” that allows less or slower trade liberalization to occur in developing countries. They object to unilateral agricultural trade liberalization sometimes associated with lending by the International Monetary Fund and the World Bank. This has led to calls for higher tariffs or other trade barriers for basic food crops produced by developing countries in order to protect developing country agriculture and particularly small farmers from low-priced or subsidized imports and to induce more domestic production. Development advocates often argue these measures are justified in developing countries that suffer from chronic balance-of-payments deficits and where large agrarian populations depend on local production for food and other needs.

In contrast, most trade liberalization advocates believe that proposals for higher protection in developing countries have a net negative effect, including on nonfarm (landless rural and urban) poor in the countries that might resort to such policies. Widespread use of consumer subsidies for basic foods to offset producer protection is a costly fiscal approach that developing-country governments can ill afford. Trade advocates are also concerned that increasing the protection of agriculture by developing countries (where most of the future market growth is expected) will undermine the limited support for agricultural trade liberalization that can be energized in developed countries. There may be some scope for short-term, simplified “safeguards” for poor countries in a limited number of products, when import surges or dramatic price declines affect the livelihood of a substantial number of low-income farmers. However, trade-liberalization advocates would exercise great caution in letting such policies escalate into too much protection for agriculture.

2. Development Box

Calls for special and differential treatment have coalesced around creation of a new “development box” that would apply to developing countries only. Some provisions of the development box reiterate the need for wealthy countries to open their markets to agricultural products from developing countries. Other provisions of the development box are designed to give developing countries room to pursue policies aimed at reducing poverty and achieving sustainable rural development, particularly focused on low-income farmers and on ensuring food security.

Proponents of the development box recognize a risk that the “food-security” argument can be used for protectionist purposes in wealthy countries—as in Japan or when U.S. President George W. Bush claims support for agriculture is part of his national security mix. Therefore they have been careful to keep the development box proposal quite separate from the nontrade and multifunctionality concerns of the developed countries.

Trade liberalization advocates are wary of protectionist policies justified by food security arguments. They note that existing AoA amber-box rules already give developing countries much latitude to achieve their objectives. To the extent that development policies do not go too far towards creating trade distortions, there is room for further measures to be adopted under the existing green box. Developing countries may lack the fiscal resources to utilize the existing green box or any additional expenditure opportunities allowed under a new development box. Trade liberalization advocates further caution against too loose an interpretation of the green box or any new such provisions to subsidize production, even by developing countries.

3. Commodity Markets

A large number of low-income developing countries are heavily dependent on raw agricultural products or other nonfuel commodities for their export revenues. These countries have suffered from a decline in commodity prices (the price index of commodities declined by 47 percent between 1982 and 2001) as well as from relatively high year-to-year price volatility for these commodities. The GATT and WTO agreements acknowledge the problems of low-income countries that are dependent on exports of basic commodities, and the importance of open market access for these products.

Development advocates assert that the WTO should address the problems faced by commodity-dependent developing countries in the context of Doha Round agriculture negotiations. They point out that actions such as removal of tariff peaks, tariff escalation, and other nontariff barriers, and provision of technology to facilitate predictable market access for processed agriculture exports from developing countries, are desirable. Some development advocates argue further for strengthened international commodity agreements—along the lines of market-sharing cartels—to restrict supply and raise world prices of basic agricultural commodities that are of importance to developing countries. This latter recommendation is directed specifically against the trend toward decline of real prices of basic commodities that has occurred. Development advocates have also proposed that agricultural prices be supported based on costs of production.

Trade liberalization advocates look askance at proposals for international commodity agreements. These agreements are viewed as misguided attempts to intervene against fundamental economic forces with government-orchestrated market power. Trade liberalization advocates are sometimes more sympathetic to price-stabilization efforts, but historically it has been nearly impossible to separate price-stabilization programs from price support.

They would allow market forces to determine commodity prices by directing resources into or out of production until prices cover costs.

4. Biotechnology and Competition Policy

Notwithstanding basic agreement on the desirability of cost-reducing technological innovations in food production, there are disagreements about the benefits of recent biotechnology-based crops. One group of development advocates perceives this new technology as having the potential to provide a quantum leap forward in worldwide human nutritional status, resulting in far fewer malnourished people. Other development advocates oppose the technology for its potential environmental risks or cultural implications, and due to the licensing fees required to gain access to it.

Trade liberalization advocates, adhering to the standard of science-based risk assessment incorporated in the WTO agreement on sanitary and phytosanitary measures, are also divided on biotechnology. As with other new technologies, the resolution of conflict lies in specificity. The case for or against specific biotechnology innovations needs to proceed on the basis of scientific risk assessments and economic benefit/cost analysis.

Development and trade liberalization advocates also share concerns about private monopolies and the imperfect operation of markets that work to the disadvantage of small farmers, low-income consumers, and poor countries. A common assertion among development advocates is that further liberalization of agricultural trade may reinforce the power of already dominant input and processing firms in agricultural and food markets, to the detriment of farmers and consumers. By contrast, trade-liberalization advocates consider trade protectionism, not trade liberalization, as the recipe for reinforcing the power of entrenched interests. In their view, discretionary government interventions or private-firm behavior not restrained by

international competition or law will most likely end up benefiting the powerful against the vulnerable.

Conclusion

There are substantial grounds for agreement about agriculture between advocates of international development, poverty alleviation, and food security and those who broadly advocate strengthened global trade opportunities and institutions. Agriculture has been a special case in which trade liberalization has not progressed since World War II. Subsidization and protection of agriculture remain the norm in developed countries. There is broad agreement that the current global regime of support and protection in developed countries, with less support and often less protection in developing countries, is not desirable for global economic development, the environment, or the integrity of the global trade system. For these reasons, there is agreement that agricultural trade liberalization should be pressed forward in the Doha Round negotiations.

Where disagreements arise can be characterized as occurring over whether agricultural products should be brought increasingly under multilateral, trade-liberalizing WTO rules similar to those imposed on most manufactured goods in all countries, or should agricultural products continue to be treated as special but with more policies introduced that favor agriculture in developing countries. Agriculture, and policies toward it, remain diverse and complex worldwide and there are a host of related questions that warrant further discussion. While pursuing agricultural trade liberalization to reduce trade-distorting subsidization and protection among developed countries, both development and trade liberalization advocates will be best served by thoughtful discourse with a relatively toned-down rhetoric. ■

Table 1. Trade Patterns in Agricultural Products, in billion US dollars, 1998-2000

Exporters	Importers		
	Developed Countries	Developing and Transition Countries	Total
Developed Countries	199	93	292
Developing and Transition Countries	76	54	130
Total	275	147	422

Sources: World Trade Organization; UN Food and Agriculture Organization

About the Authors

David Orden is Professor of Agricultural and Applied Economics at Virginia Polytechnic Institute and State University in Blacksburg, Virginia. Rashid S. Kaukab is Director of the Trade Unit at the South Centre in Geneva, Switzerland. Eugenio Diaz-Bonilla is Senior Research Fellow at the International Food Policy Research Institute in Washington, D.C.

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CARNEGIE ENDOWMENT FOR
INTERNATIONAL PEACE
1779 Massachusetts Avenue, NW
Washington, DC 20036
Phone 202-483-7600
Fax 202-483-1840
www.ceip.org

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