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# POLICY OUTLOOK

Trade, Equity, and Development Project January 2007

# Breaking the Doha Deadlock

## *Congress Could Play a Pivotal Role*

By Sandra Polaski

Negotiations for a new global trade deal at the World Trade Organization have been suspended since July, when the head of the organization concluded that the talks were at an impasse. As the new Congress takes up its responsibilities in Washington, one question it must confront is whether to reshape U.S. trade policy. Because the WTO negotiations represent by far the largest potential deal on the U.S. trade agenda, Congress would do well to evaluate the current state of those talks and the role of U.S. policy in creating the deadlock. If it wants a new deal at the WTO, Congress may have to take an active role in breaking the impasse. This would have the additional advantage of restoring bipartisanship to trade policy making, as it would require cooperation between the Republican administration and the Democratic-controlled Congress.

The WTO talks, named the Doha Round because they were launched in Doha, Qatar, are stalemated over agricultural trade. Most other countries lay the main blame for the impasse on the United States. U.S. negotiators have tabled a proposal that is widely seen as requiring little or no actual policy change by the United States, particularly with respect to trade-distorting subsidies paid to certain U.S. farm sectors, while asking for wide and deep market opening by its trading partners. The majority of countries, including most of the developing world and the European Union, have been unwilling to agree to what they see as maximum concessions by themselves in return for minimal concessions by the United States. More significantly, other countries have refused to make offers to open their markets for services and manufactured goods until they know the outlines of an agricultural deal.

### Where U.S. Interests Lie

The vast majority of both U.S. and world trade is in manufactured goods and services, not in agriculture. Globally, less than 7 percent of world trade is in agricultural products. About 60 percent is in manufactured goods, while about 20 percent is in traded services.


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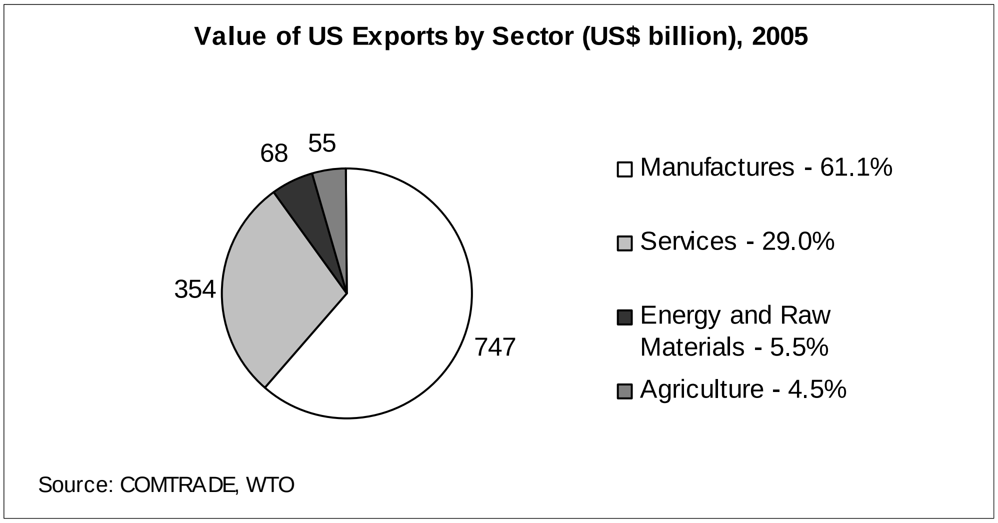
For the United States, the weight of different sectors in trade is even more lopsided: agricultural products make up only 4.5 percent of U.S. exports, while services and manufactured goods together account for over 90 percent.

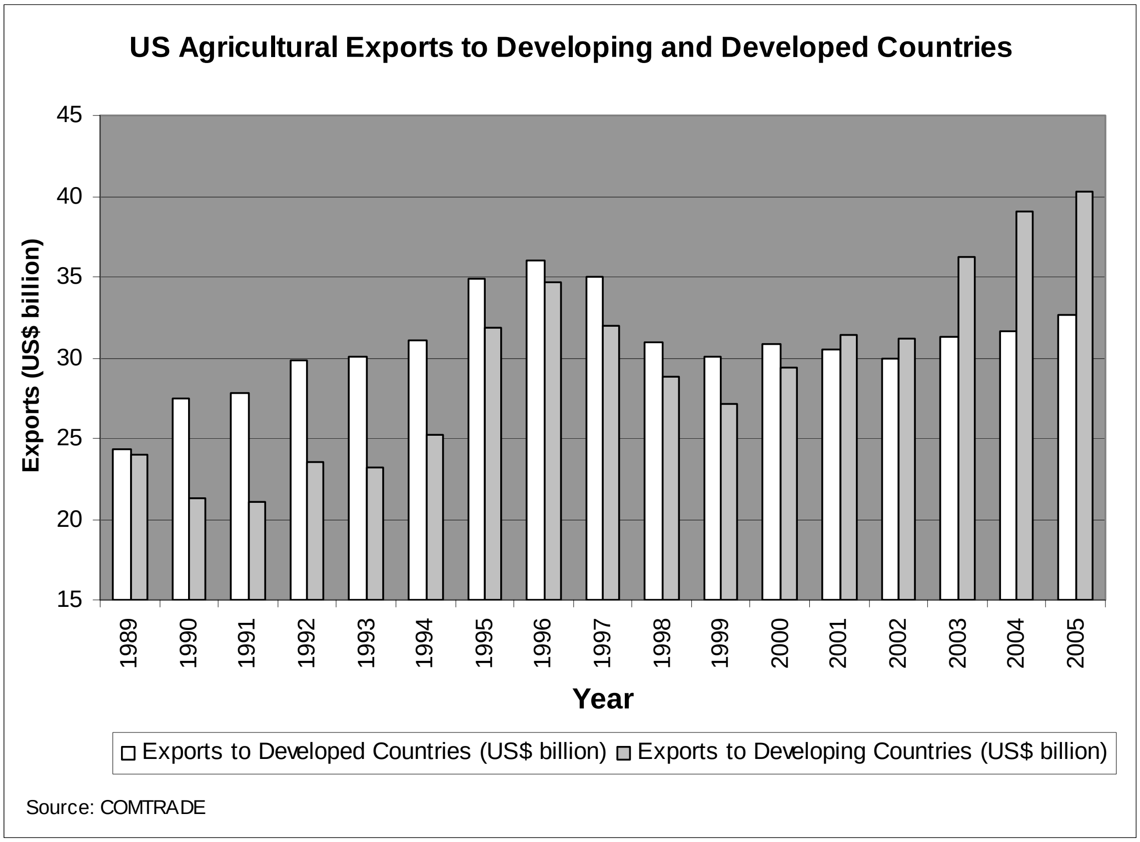



The current U.S. trade proposal, in effect, holds hostage the trade interests of the overwhelming majority of U.S. exporters—and the workers and suppliers who depend on them—to the trade interests of a very small group of agricultural exporters. The agricultural constituency is even smaller than it appears based on the export figures. The domestic farm subsidies that the United States has insisted on protecting go to only half of U.S. farms. Within that group, the overwhelming share goes to very large farms and agricultural corporations. It is hard to defend a bargaining stance that caters to the interests of such a small segment of U.S. firms and households while blocking negotiations on manufacturing and service sectors that offer much wider benefits.

Further, the exaggerated U.S. trade proposal on agriculture is not necessary to advance the interests of U.S. farmers. Prospects for U.S. agricultural exporters are already bright under current global trading rules and would grow still more under offers that other countries have tabled in the Doha Round.

Growth in agricultural exports into the developing world has been particularly strong in recent years, as incomes in China and other countries have risen. In fact, U.S. agricultural exports to China have grown faster than to any other market over the last ten years.

Overall, U.S. agricultural exports to developing countries now exceed those to wealthy countries and are growing at a faster pace, as seen in the figure below. In much of the developing world, countries that were net agricultural exporters a generation or even a few years ago are now net importers. This growth is occurring under current trade rules and current tariff policies of developing country governments. The United States has consistently been the top exporter of agricultural goods to developing countries as a group. In 2005, the United States exported three times as much as Brazil, the next largest exporter, into these countries' markets. The claim that developing country agricultural markets are closed to U.S. exports and must be pried open during the Doha Round is simply not supported by the facts.




## The Interests of the Developing World in Agricultural Trade

Many developing countries' economies are still dominated by the agricultural sector, measured as a share of GDP, employment, or both. For developing countries as a group, agriculture accounts for 55 percent of employment. In very low-income countries, the share rises to 68 percent of employment. Contrasting that huge share of livelihoods dependent on agriculture with the United States, where less than 2 percent of employment is in agriculture, illustrates the critical importance of this sector to the overall economic health of these countries. In particular, it will largely determine their prospects for improving incomes, reducing poverty, and gradually making the transition to modern agriculture and modern economies. They face far more consequential dislocations from agricultural trade liberalization than does the United States. Their concerns deserve to be treated much more seriously.

The interests of developing countries are quite heterogeneous. Some interests may be primarily offensive, with concerns centered on trying to increase agricultural exports and employment; others are primarily defensive, with the vulnerability of poor farmers at the forefront of concerns. The offensive interests come into play for those countries that produce agricultural goods at prices that are competitive on world markets. Many of these products are specific to tropical climates and do not compete with U.S. exports. However, some crops do compete and here the question of farm subsidies by wealthy countries is the primary concern. Subsidies elicit overproduction, which causes world prices to fall.

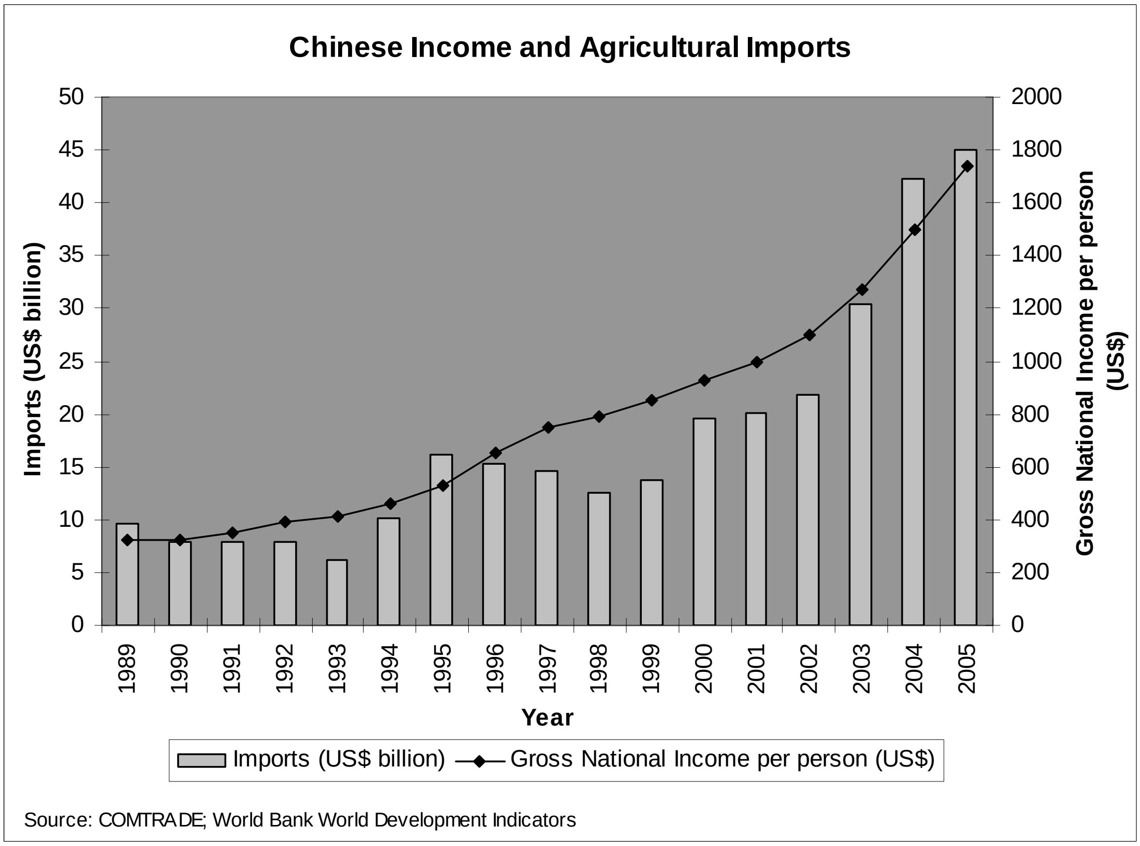
Agricultural exporters ranging from large, middle income countries such as Brazil and Thailand to small and poor countries such as Chad and Mali have insisted that trade-distorting subsidies must be reduced in the Doha Round to lessen the negative impact on world prices.

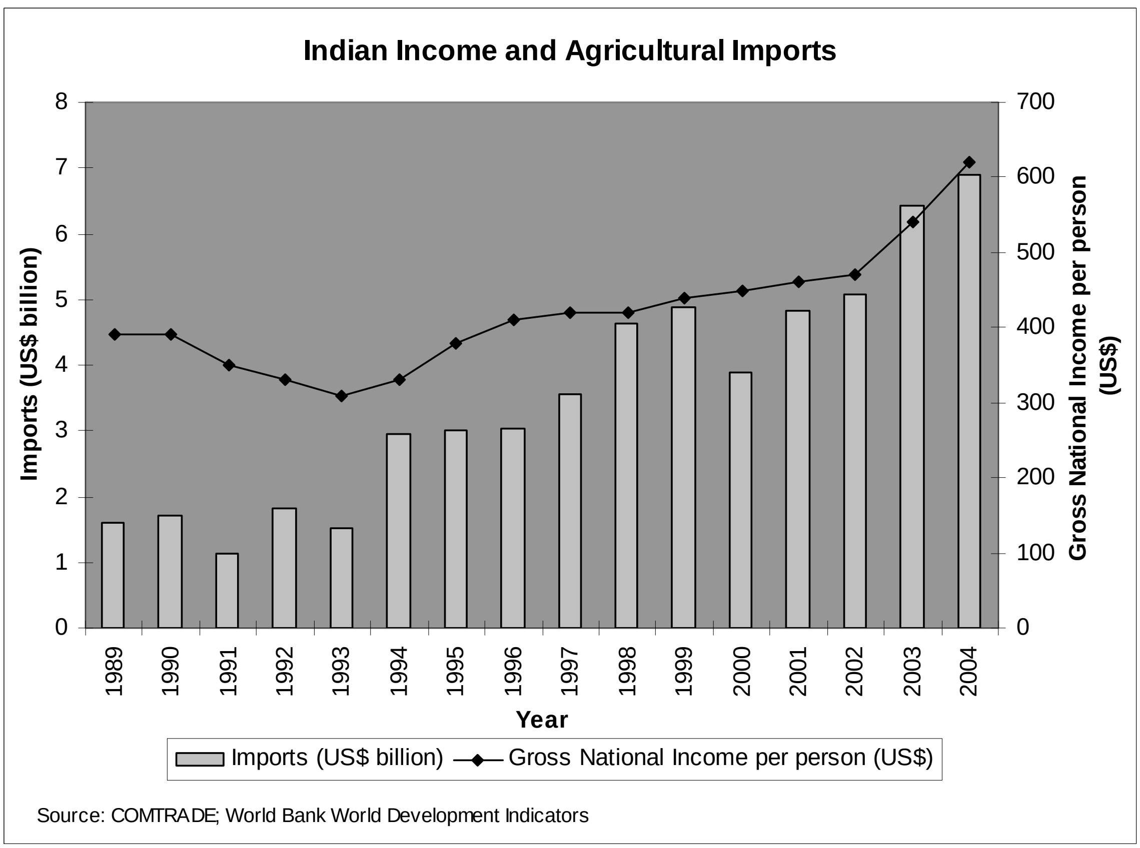
The defensive interests of developing countries have proved particularly nettlesome in the negotiations. A group of countries with large concentrations of households subsisting on small-scale agriculture have joined together as the Group of 33 (G33) to deal with concerns that, if they are forced to open their agricultural markets too quickly, large numbers of poor farmers may be displaced before manufacturing and other jobs can be created for them. They are also concerned about fully opening their economies to the well-known volatility of world agricultural prices, because they lack the fiscal resources to manage the impact of price swings and their poor households are little able to bear the resulting price shocks.

The G33 proposes that they should be allowed to exempt ten percent of their agricultural tariff lines from reductions in the Doha Round for those products that are key to livelihood security, food security, and rural development. They ask that an additional ten percent of agricultural tariff lines be subject to cuts of five to ten percent. These products would be designated as "special products" based on criteria that establish their relevance to poverty and development. The remaining eighty percent of agricultural tariffs would be reduced by an agreed overall formula. The United States has counterproposed that only *five tariff lines* (not five percent of tariff lines) should be eligible for exemption as special products. Given the specificity of tariff lines, that number might not be sufficient to cover even a single product of importance for rural livelihoods. For example, milk is typically covered by dozens of tariff lines depending on fat content and other factors.

## A Mutually Beneficial Solution Hiding in Plain Sight

It is counterproductive for the United States to insist on terms that could *lower* the incomes of poor farmers in developing countries by displacing their production or causing prices to drop for the commodities they produce. Only as large numbers of low-income households grow their way out of poverty will U.S. agricultural exporters see sustained increases in sales to developing countries. For countries with large portions of their populations in farming, which is to say most developing countries, governments must carefully manage policies to allow those farmers to become more productive and other sectors to grow. As incomes rise, both rural and urban households will buy more and better food until their dietary needs are satisfied. This pattern has been consistent over time and is illustrated by the recent experience of China and India. The figure below shows that China's agricultural imports have closely tracked the rise in per capita income there.





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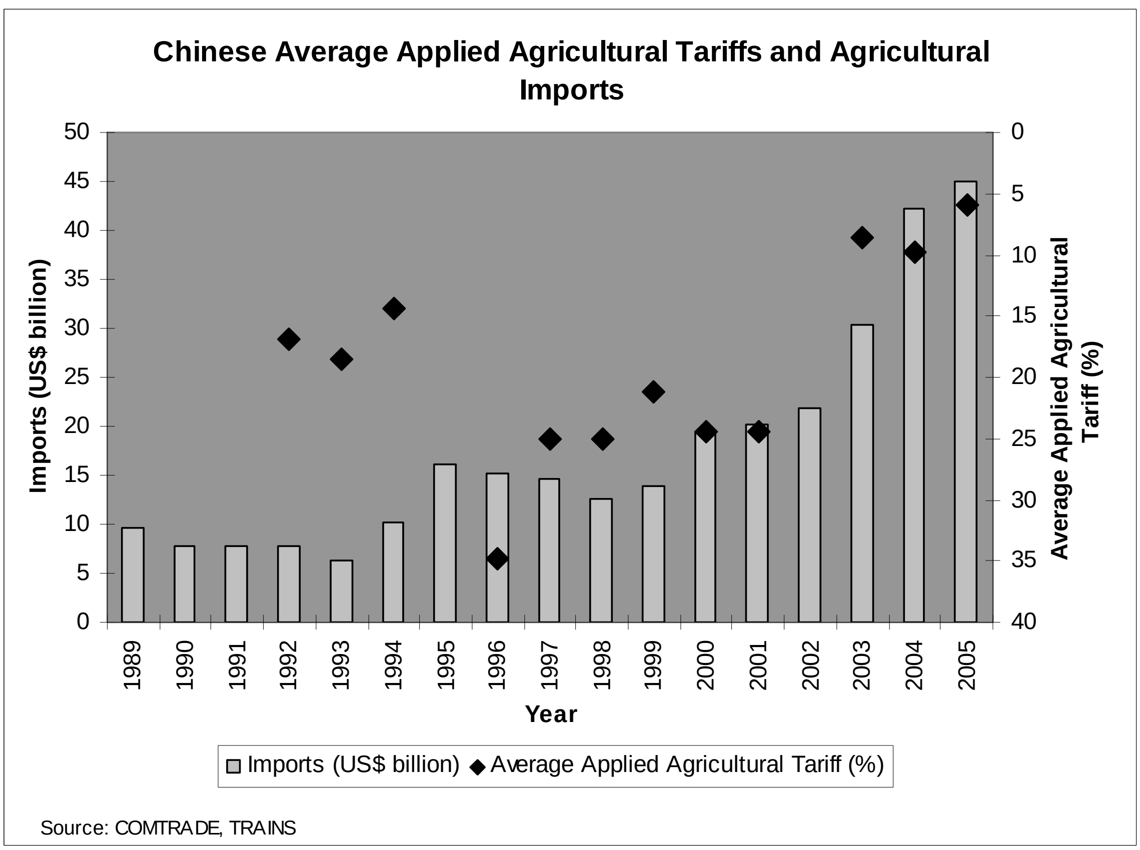
A similar pattern prevails in India, although income levels there are still substantially lower than in China. Indian per capita income is still below the level (about $800 per year, at international exchange rates) at which Chinese imports of agricultural products started to climb sharply. With most households at very low income levels, a country simply cannot afford to buy all the food it needs. Now that Indian incomes are beginning to climb, agricultural imports are certain to grow. As other developing countries manage to achieve higher levels of growth, they will follow a similar pattern.

While agricultural imports are closely correlated with income levels, there is *not* a close relationship between agricultural imports and applied tariff rates. For both China and India, the pattern of imports does not follow changes in agricultural tariffs. The figures below show that high applied tariffs have coexisted with both low *and* high import levels in those countries, and low tariffs have not caused imports to rise when income levels were very low. The recent experience of these two countries is consistent with the well-established historical pattern that the main drivers of agricultural imports are income levels and variations in domestic harvests, not tariff levels.

The United States does not need to achieve maximum tariff reductions to enjoy growth in exports into these markets. However to be able to foster rising income levels, the governments of developing countries *do* need tariff setting flexibility to protect their most vulnerable farmers from global price shocks and to manage the long and difficult transition from an agrarian to a diversified economy. This suggests that the United States should drop its extreme position and accept the G33 proposal on special products, perhaps with additional clarifications to ensure that the flexibility is used to achieve agrarian development and poverty alleviation in the countries that utilize it.





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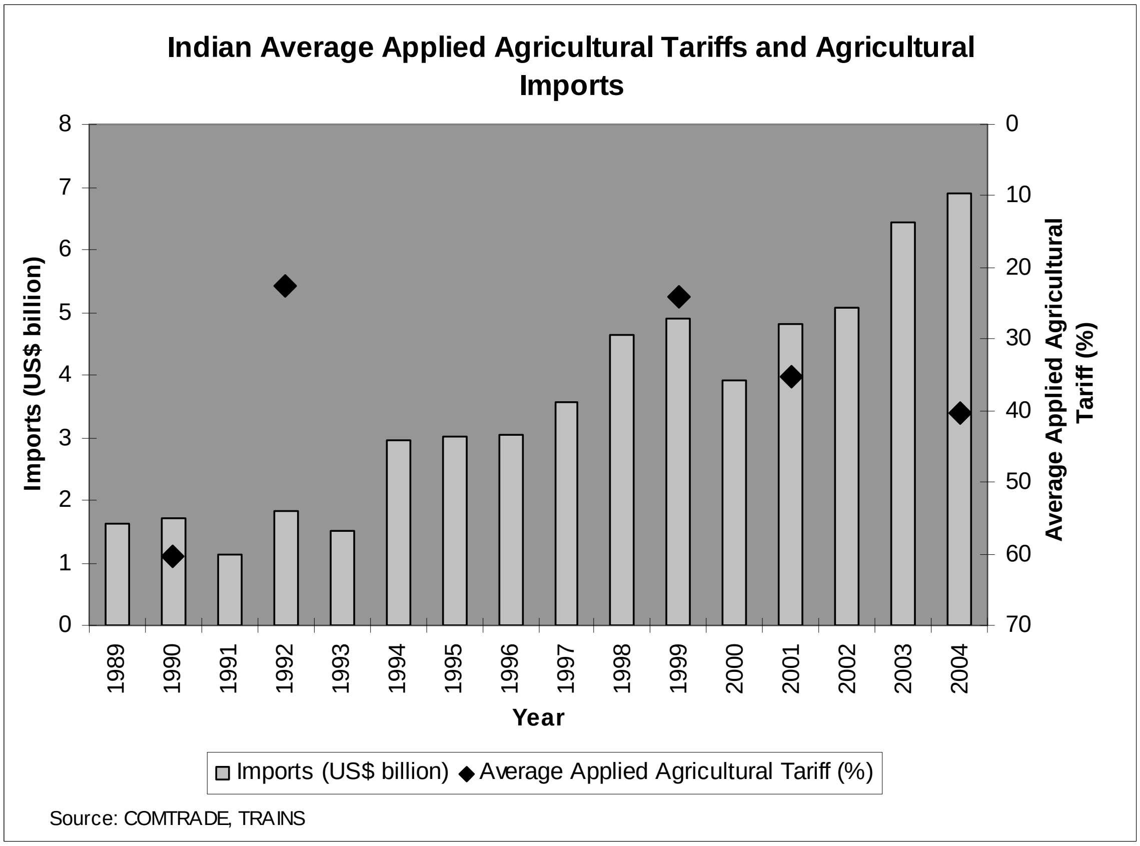


## Restoring Balance to the U.S. Bargaining Stance

The United States has put itself in a corner with its maximalist bargaining proposal on agriculture. Changing its position is the only way out. As it happens, a changed position that meets the key objections of the rest of the world would also be good domestic, trade, and foreign policy for the United States.

On the domestic front, the U.S. farm subsidy program is an inequitable, distorted, and very expensive set of policies that do not serve the objectives of the U.S. government, the interests of U.S. consumers, or even the interests of the majority of U.S. farmers. The deficiencies of the current system are well documented and reform is long overdue. Congress should undertake a sober revision of U.S. farm policy in the farm bill of 2007 because of the yawning fiscal deficit and the inherent inequity of the current program.

On the trade and foreign policy front, revising the U.S. agricultural proposal would allow the United States to make progress on a new agreement at the WTO that enhances opportunities for manufacturing and services, the vast majority of the U.S. economy. U.S. farm exports to the rest of the world would continue to grow, both because of further opening of markets by wealthy countries and due to income growth in developing countries. Current U.S. demands for maximum access to developing country agricultural markets, even at the risk of displacing desperately poor farmers, are not only unseemly from a foreign policy perspective but they are also likely to backfire in the real world, as depressed incomes for the large portion of households dependent on farming force them to buy less, not more U.S. goods.

Although the U.S. proposal has caused the impasse on agriculture—and a moderated U.S. proposal is the only way to break the stalemate—such a move would be quickly reciprocated in the Doha talks. The European Union has signaled that it is prepared to improve its offer to open its agricultural markets from a current proposal of tiered tariff reductions that would produce an overall average cut of 39 percent to a more ambitious formula that would yield an average cut of about 50 percent. This level of cuts by the EU would be unprecedented in world trade negotiations and would put pressure on other wealthy countries to agree to do the same. Developing countries have offered to cut their own tariffs, on average, by about 55 percent of the reductions offered by the developed world. If their legitimate concerns on special products are met, it is quite possible that they would agree to an overall formula of tariff cuts that is somewhat more ambitious.

An agricultural trade package along these lines would be by far the largest liberalization of farm trade in history. Even more significantly, it would allow the bargaining on manufactured goods and services to begin. Those negotiations will not be easy, but it is generally agreed that the other sectors will not be nearly as difficult as the agricultural negotiations.

It is time to recognize that a very favorable, if incremental, deal is available in the Doha Round. Congress can drive progress to achieve that deal by undertaking a sensible reform of agricultural subsidies in the farm bill and by accepting the fact that developing countries need time and policy space to improve their poor farmers' productivity and incomes before they are forced to compete with first world agriculture. Sound and equitable policies on both fronts are also in the interest of the U.S. economy. There is a win-win deal waiting to be grasped.■

**Sandra Polaski** is Director of the Trade, Equity, and Development Project at the Carnegie Endowment for International Peace. Her work focuses on trade, development, and employment policies in the context of globalization. Until April 2002, Ms. Polaski served as the U.S. Secretary of State's Special Representative for International Labor Affairs. Her most recent publication is: *Winners and Losers: Impact of the Doha Round on Developing Countries*, March 2006.



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