Agricultural Trade: Time for a New Framework

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Introduction

To the consternation of the U.S. government and the joy of much of the rest of the world, Brazil just won a case at the World Trade Organization (WTO) against U.S. subsidies on upland cotton. The WTO ruled that the U.S. violated its obligations under the Agreement on Agriculture by exceeding its spending limits for cotton. The U.S. will almost certainly appeal the ruling, but no one expects the finding to be overturned. After fifty years of waivers and carefully worded exemptions for agriculture, rich countries may have lost their power to set their agricultural policies without regard for the rest of the world.

In international negotiations on agriculture, whether at the WTO, at the Food and Agriculture Organization, or elsewhere in the multilateral system, spending on domestic agriculture programs in the world's richest countries has been under heavy attack. Leaders such as Kofi Anan at the UN, James Wolfensohn at the World Bank and Rubens Ricupero at UNCTAD have all made much the same speech: tremendous resources for development await if developed countries can be forced or persuaded to eliminate their agricultural subsidies. By eliminating subsidies, these leaders claim, production in the North will slow or cease and developing country farmers will gain access to large and lucrative markets.

Might the Agreement on Agriculture, to date a considerable disappointment to developing countries, be about to come into its own? No. Unfortunately, the ruling on upland cotton subsidies will prove most important as a symbol: rich country spending on agriculture is not unassailable. The symbol is, of course, important. The legitimacy of the multilateral trading system depends on its ability to protect countries that are too small to defend their trade rights on their own. Agriculture has been a glaring example of the system's failure to protect small countries. But even if governments succeed in eliminating all subsidies to U.S. agriculture, world markets will not make the dramatic recovery predicted by such authorities as the World Bank: agricultural dumping and low prices will continue at damaging levels.

The existing multilateral trade rules for agriculture fail to discipline one of the most egregious market distortions: dumping of agricultural products at below cost of production prices. More worryingly, the rules fail to respect the fundamental objectives people have for agriculture, including fulfilment of the right to food and the establishment of a resilient rural sector as a basis for economic development. Agriculture has proven itself a sound basis for broadly based, lasting development of the whole economy. The contribution of agricultural exports to development, however, is far more contentious—exports can make an important contribution, but only if a number of other conditions are met first. Governments have undertaken to eradicate extreme poverty and hunger by 2015, as one of the Millennium Development Goals. Their focus on breaking the deadlock on agriculture at the WTO cannot come at the expense of keeping this promise to the 800 million people who live with hunger every day.

The Agreement on Agriculture has failed developing countries. Indeed, it has failed agriculture around the world. We need new multilateral rules for agriculture, and they must include trade rules. However, those trade rules must be rooted in the world we inhabit, not in assumptions that reflect an ideal, but unreal, world.

Paradoxically, we need regulations to harness the power of the market. To end distortions in world agricultural markets:

- Governments must prohibit agricultural dumping, which means imposing restrictions on supply.
- Governments must restore competition in agricultural markets by reducing the market power of transnational agribusiness.
- Governments must revitalize international commodity agreements, which in turn they must support with sound national commodity policies.

Those policies must take account of scarce, fragile resources; unstable weather patterns; increasing global population; and the persistence of an unacceptable divide between the few people who enjoy enormous wealth and the hundreds of millions of people who live in abject poverty.

The deadlock in agricultural negotiations is above all political. The political fights are not just between the United States and the G20 (Ag)[1] over market access, or just about everyone and the European Union over export subsidy programmes. The important political struggles over agriculture are going on inside WTO Member States. Mexican peasants marched from all over the country to Mexico City on January 1, 2003 to protest at the continued implementation of the North American Free Trade Agreement because of the agreement's exacerbation of the crisis in rural areas. Luis Inacio Lula da Silva (Lula) ran his successful bid for the Presidency of Brazil on a platform to end acute hunger in Brazil in three years. José Bové, the French Roquefort farmer from Larzac, has led rallies of French farmers calling for the WTO to "get out of agriculture," a cry that echoes at peasant rallies around the world. Across the globe, peasant associations are fighting for food sovereignty—for the right of countries to determine their agricultural policies independently of multilateral rules. In Cancún, a Korean peasant committed suicide, to express his despair at the impact of trade liberalization on his livelihood.

To resolve the deadlock in agriculture, G8 leaders—or the leaders of a newly configured G20—do not need to find a perfect formula for tariff reductions or to just accommodate exemptions for developing countries' food security priorities. Resolution will come when the leaders think about global agriculture writ large, and then define a role for trade within that larger canvas—a role that will necessarily differ according to the challenges facing different countries.

[1] G20(Ag) is used to distinguish the G20 in the context of the WTO agriculture negotiations from the G20 proposed as an alternative to the existing G8.

1. Starting Assumptions

The solution to today's *impasse* on agricultural trade rules requires us to re-examine assumptions. Sound agricultural trade policies can only be built on sound foundations. Here are some of the assumptions that underpin the proposals that follow.

1. A properly functioning free market is the collective outcome of millions of self-interested decisions by buyers and sellers, producers and consumers. Without centralized planning or guidance from the state, this market maximizes the common good. It ensures the most efficient use of the productive resources available. The perfect open market mediates between supply and demand through price, providing the best price for producers and consumers alike.

2. Nonetheless, the "free" market does not come without cost. Without clear and enforceable rules there is no "free" market. To work, markets depend on a wide body of law, on impartial implementation of that law, and on constant vigilance. The magic of the invisible hand depends on a lot of visible support: property law, contract law, border administration, and more. A perfect open market depends on perfect competition, yet many markets—agricultural commodity markets are a prime example—tend to oligopoly and therefore require regulation. There is no single way to structure a free market. Societies have enormous choice in deciding how to marshal the powerful forces of competition and self-interest, which—*if properly managed*—stimulate growth.

3. All markets have their failures, but more is at stake when it comes to agriculture. Unemployment is a cruel hardship, but starvation is fatal. That is why food security is protected in international law. UN member states are bound to protect and fulfill the universal human right to food. Governments are also bound by their commitment to ensure food security, defined at the World Food Summit in 1996 as: "Food that is available at all times, that all persons have means of access to it, that it is nutritionally adequate in terms of quantity, quality and variety, and that it is acceptable within the given culture."[2] Governments cannot deprive the country of food the way they might decide to do without cars, or even fuel, if they had to.

4. There is strong empirical evidence to show agricultural development is an effective way to generate employment and reduce poverty.[3] Increasing incomes in rural areas has an immediate and significant positive effect by increasing demand for local goods and services. People living in rural areas without land, together with small land-holders who have to sell their labor part-time to make a living, make up the majority of the extremely poor. They depend on jobs in the local service economy to survive. Interventions to eradicate poverty have to target these groups, and particularly women within them:

[2] FAO, 1996, Rome Declaration on World Food Security.

[3] John W. Mellor, Background Paper: "Reducing Poverty, Buffering Economic Shocks—Agriculture and the Non-tradable Economy", prepared for Experts' Meeting, 19-21 March, 2001, Roles of Agriculture Project, FAO: Rome. On-line at http://www.fao.org/es/esa/roa/roa-e/EMPDF/PROCEED/BG/MELLOR.pdf

women are over-represented among the poorest and are often the most effective agents to combat poverty in the wider community.[4]

5. The market cannot capture all that people value in agricultural production. Agricultural production is a central strategy to combat hunger, both directly and as a livelihood, but it is more than that. Other factors need to be taken into account to understand agriculture's contribution to human welfare. Traditional farmers are caretakers of knowledge gained over millennia in cultivating thousands of crops and animal breeds. In most cultures, that knowledge extends to uncultivated species, such as non-timber forest products (honey, berries, medicinal plants and much more). The globalization of world agricultural production has already undermined this biological and cultural diversity to a shocking extent. With the world's climate changing in ways that are still not clearly predictable, governments have an obligation to protect biological diversity to safeguard food production for the generations to come.

2. Renegotiating the Agreement on Agriculture

Governments identified three primary sources of distortion in world agricultural markets when they designed the Uruguay Round Agreement on Agriculture: export subsidies, domestic support, and market access barriers. The agreement set about reducing all three, and prohibited certain tools (such as variable levies on imports). The actual reductions agreed to did not, in most cases, change existing spending or increase market access in any significant degree. In fact, the categorization of programs was in some ways more profound than any spending limits set. The categorization was important, because it sent a signal as to what kinds of programs would be acceptable in the future, and pressured WTO member states to shape their agricultural programs in a particular way. In practice, the agreement discouraged payments to producers that were tied to output, and blessed decoupled payments, which are based on historic rather than actual production.

In the negotiations to revise the Agreement on Agriculture, the U.S. and E.U. are fighting what is likely to be a losing battle to maintain their export share in world agricultural markets. U.S. and E.U. member state governments are pulled in different directions over the interests they should protect: those of producers, who live, spend and vote in the country, or those of agribusiness, which increasingly operates without regard to international borders. These groups have conflicting interests. Producers' primary interest is in markets—whether local, national or r despite their relatively small numbers. The political stance on trade within E.U. member states and the U.S. can be characterized as the executive branch pushing to expand market access opportunities for firms, which in turn requires acceptance of increased access for imports and disciplines on allowable domestic and export support programs. Meanwhile, increasingly skeptical yet relatively impotent parliamentarians have had to respond to farmers' growing doubts about free trade. Legislators resort to standards (in the case of the U.S., these include evaluations of a country's human rights performance, or its perceived effectiveness in countering the production of illicit drugs), subsidies (for example rewarding processors for purchasing domestic rather than imported commodities), and exceptions (for example, the U.S. conu9ing proces

perverse outcomes of the existing programs, the public is also increasingly worried about nutritional and environmental standards. Far from seeking deregulation, the public in these countries is asking for tougher standards, greater clarity on where its food comes from, and more transparency about what goes into food. The controversy over the introduction of genetically engineered foods reflects public mistrust in food companies. This shift in public attitudes has serious implications for developing country exporters, as much as for the Common Agricultural Policy or U.S. farm legislation.

2. Farmers do not necessarily benefit from increased exports in deregulated markets. The experience in the U.S., Canada and the E.U. has shown exports can increase at the very same time as on-farm income declines. Farmers rarely export directly. They sell their crops to middlemen, supply crops under contract to multinationals, or work as hired labour while maintaining a subsistence plot for the family. Farmers are interested in keeping production costs low and in maximizing the price for which their production can sell. Market choice is good for farmers, but few of them have the capital to participate actively in markets that are thousands of miles away. More often, open markets bring dumped imports that undercut prices on local markets where most producers sell their produce.

3. Open borders are no guarantee of cheap food for consumers. Price transmission in most commodity markets is imperfect. In the United States, food and commodity prices are virtually independent. Food prices reflect prevailing inflation levels, not raw commodity prices. It is not that trade liberalization cannot benefit consumers, but that in practice it often has not. This failure for consumer prices to reflect commodity prices can in large part be attributed to the concentrated market power of food processors and retailers. When commodity prices fall, these companies simply increase their profit margin. Moreover, many of the poorest consumers are also food producers, whose ability to buy the extra food they need depends on what price they can get for their crops. Even poorer, landless labourers depend on a healthy local agricultural economy to earn the money they need to buy food.

4. Countries do not all have the same agricultural priorities. Many developed countries are coping with unprecedented surpluses of production, while a number of developing countries need to increase their production to stimulate economic development. Special and differential treatment is vital, but it has yet to show itself capable of accepting more than slower implementation timetables for less radical reform within a common framework. In practice, countries may find that the best way forward from a developmental perspective will require that governments cut some tariffs, and increase others. Some countries may need to have market access guaranteed, such as exists under GSP schemes. Some situations may warrant export taxes. The bewildering variety of situations that face WTO member states (not to mention the 50 or so countries who are not yet members) make a one-size fits all approach to agricultural reform highly problematic.

Logically, governments should be neutral as to the use of subsidies, tariffs and other instruments to govern agriculture. As with any policy tool, they have costs and benefits that need to be weighed. We know that perfectly competitive markets are in theory welfare-maximizing, but we also know that markets are not perfectly competitive in practice. Some markets are better able to approximate perfect competition than others. Agriculture—like the energy sector—is not a market that is best structured according to the free market. Given these difficulties, how should agricultural markets be structured? Before suggesting what trade rules might work better, it is worth a moment to consider the issue of subsidies, since they dominate the debate on agricultural trade.

4. What About the Subsidies?

The conflation of subsidies with the existence of a price discrepancy between domestic and world markets confuses the debate on how to reform multilateral agricultural trade. A subsidy is payment from the public purse for a normal, usually recurring, cost of doing business. For example, an input (such as fertilizer) is provided at less than cost price: the government pays the difference. Or the government pays part of the cost of shipping grain to port, or of on-farm storage. There are grey areas—is the public provision of infrastructure (roads, grain terminals) an *investment* or a *subsidy*? Either way, taxpayer money is spent on the business of growing, processing and distributing food.

However, the OECD's Producer Support Estimate (PSE) is commonly used as a measure of OECD member state subsidy levels, although it measures much more than just subsidies. In fact, subsidies represent only about one-third of the total PSE for OECD countries. The bulk of the PSE – 70% in 1999-2002 – comes in the form of "Market Price Support" (MPS), which is an estimate of the transfers to producers from consumers (as opposed to taxpayers) due to government policies that result in higher prices[5]. Most common among these policies are tariffs, quotas, and price supports (or administered prices).[6]

Market Price Support is obviously an important measure. But it is not a measure of government subsidies. The conflation of PSE with subsidy exaggerates the importance of subsidies as a source of market distortion. Moreover, domestic and world prices differ for many reasons; these are not all due to government actions. As Tim Wise has shown in his recent working paper on the PSE (cited above), important distortions arise from other sources, not least the preponderance of oligopolistic traders and processors in global commodity markets. Moreover, many developing country economies are not fully integrated into the global economy, and may not want to be. As a number of countries in sub-Saharan Africa and Latin America have learned to their cost, without great care fuller integration under current conditions can result in a process of deindustrialization and massive social and economic dislocation.

A growing number of academics deny that subsidies cause over-production and therefore depress prices. Thus they also deny that eliminating subsidies will reduce production and cause prices to rise. The Agricultural Policy Analysis Center at the University of Tennessee, for example, developed a model to simulate what would happen if subsidies were reduced on five of the most heavily subsidized U.S. commodities: corn (maize), wheat, soy, cotton and rice. Their results suggest that complete elimination of marketing loans, counter-cyclical payments and direct

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[5] OECD (2003). Agricultural Policies in OECD Countries: Monitoring and Evaluation.

[6] Tim Wise, "The Paradox of Agricultural Subsidies: Measurement Issues, Agricultural Dumping, and Policy Reform," Global Development And Environment Institute , Working Paper No. 04-02. Tufts University. USA.

payments would have little impact on production levels and world prices. Elimination of these programs, however, would cause dramatic upheaval to rural America by slashing on-farm income and bankrupting rural banks.[7]

As for decoupled payments, they have given rise to widespread dissatisfaction. They have failed the farmers who get the money, they cost enormous sums of money, and they draw the ire of exporting countries with smaller budgets. As suc

4. The WTO needs stronger rules against agricultural dumping. Article VI of the 1947 General Agreement on Tariffs and Trade tackles the problem by addressing export sales at less than cost of production prices. But Article VI is inadequate. Severe over-production in many commodities has made dumping endemic. Developing countries, unable to protect their producers with subsidies, must be allowed to block dumped imports at the border to protect the livelihoods of their own farmers. Countries must be allowed to make constructive use of tariffs as part of their overall tax policy and as a way to protect against the distortion of under-priced imports. Argentina, the Philippines and some others proposed rules along these lines early in the agricultural negotiations. These ideas need to be revived.

5. To address dumping, the WTO needs access to accurate and complete cost of production numbers for all crops that a country wants to export, including the dollar value of domestic support measures that cover production costs. A minimum threshold level could be established, such that a country would be exempt from this assessment if it provided say three percent or less of the world market. Elements of the PSE provide a useful starting point for this measurement.

6. Countries need diverse models of agricultural management to choose from in deciding how to regulate their agricultural markets. Priority should be given to the development of farmer-owned, value-added cooperatives, where benefits flow to and within the community, where wage-laborers are paid a living wage, where the result is more competition in the local cash market and where good stewardship of natural resources is rewarded through the market.[8] The WTO should not prohibit State-Trading Enterprises either explicitly, or *de facto,* by outlawing policies necessary to the establishment and operation of a single desk seller. State-trading enterprises are a useful response to concentrated export markets. STEs have real costs and are an obvious temptation for corruption. Nonetheless, properly overseen, they offer important benefits in countries where the private sector is weak or under-capitalized. STEs should continue to be subject to disciplines under GATT rules.

7. Governments need to dramatically improve transparency in international commodity markets. UNCTAD had a mandate to monitor this behaviour, but developed countries eliminated this mandate in the 1980s. As a contribution to what will have to be a more broadly based effort, the WTO should extend the transparency measures required of state-trading enterprises to private companies operating in international agricultural markets. This would increase market transparency, improve the efficiency of the market and allow more accurate modeling of the likely results of proposed policy reforms.

8. Trade rules to end market distortions cannot succeed if they focus on government programs alone. Vertical and horizontal concentration in global commodity markets is a central cause of market distortion. Possible policy responses could include an international review mechanism for proposed mergers and acquisitions among agribusiness companies that are present in a number of countries simultaneously. For

[8] Based on a recommendation made by the National Commission on Small Farms to the U.S. government in 1998 (*A Time to Act,* p. 11, U.S. Department of Agriculture: USA.)

example, a proposed merger in a given country might involve two companies that do not have significant market power in that country. However, the merger might significantly diminish competition in a third country, where the two companies share a dominant market position. The third country should have some recourse to protect itself. One of the contradictory outcomes of liberalized trade is that it can increase competition in a local market, as foreign entrants arrive, but it can also consolidate market power, as some firms become global players.[9].

9. Eventually, investment and competition rules will both form a part of the solution to distortions in global agricultural markets. The proposals made by the European Commission and others at the WTO in these areas, however, are not helpful. They focus on deregulating national regimes to encourage increased foreign investment and to allow foreign companies to bid on all contracts in a given country. The evidence strongly suggests that governments must regulate capital if foreign investment is to create employment and contribute to local business expansion. As the WTO itself has observed, lowering trade and investment barriers makes regulation of industry more difficult, creating a trade-off between increased efficiency, which is of particular benefit to the TNCs involved, and strong standards, whether environmental, labor-related or other.[10] Competition and investment need instead to be approached from the perspective of protecting standards and national development objectives. The UN provides a better forum for this discussion than the WTO, while governments explore the implications and trade-offs more thoroughly. The E.U. currently suggests that it will reform its agriculture in exchange f or acceptance of its agenda for investment and competition. The proposal is a lose-lose offer to developing countries and they should roundly reject it.

6. Why Would Governments Sign Up?

The argument presented here suggests that the deadlock over agriculture at the WTO is indicative of a wider *malaise* in international relations. The WTO is in some sense a victim of its own success—it cannot solve all the problems laid at its door. The deadlock on agriculture will not be resolved until world leaders take the problem out of Geneva and build a new basis for a deal that situates trade in the context of development. Increased trade is not a proxy for development and eliminating export subsidies is no substitute for eliminating the distortions that plague world agricultural markets. Multilateral trade rules have an important role to play in the solution, but only if they acknowledge the importance of other aspects of agriculture.

The United States. The U.S. has to face the fact that it is steadily losing its trade surplus in agriculture. The current level of support to its farmers is unsustainable: it is widely expected to fall significantly in the 2005 budget reconciliation process. Decoupled payments, supplemented with emergency relief and various other creative programmes, have cost billions of dollars. At the same time, U.S. farmers have begun to challenge corporate concentration in the courts and have won some important victories. The U.S. has a proud history of busting cartels, and some commentators sense a shift back to a more aggressive stance against oligopoly power. It would be

[9] MacLaren, D. & Josling, T. (1999), "Competition Policy and International Agricultural Trade," p. 2, Working Paper #99-7 for the International Agricultural Trade Research Consortium. On-line at http://www.umn.edu/iatrc
[10] Nordtröm, H. & Vaughan, S., (1999), *Trade and the Environment*, World Trade Organization Special Studies 4, WTO: Switzerland.

G20 (Ag). This group of countries differs from the Cairns Group in two important ways. First, there are no developed country members, giving it a clearer alliance with the South. This makes the group more open to working with the G33 and others to find some accommodation for developing country interests. While primarily exporters, the members of the G20(Ag) all have significant food security concerns and domestic producers that need protection. Secondly, China and India are members of the G20. These two countries, accounting for 25 percent of the world's population and hundreds of millions of farmers between them, are large importers and exporters and provide a more balanced view of agriculture than the export-only perspective that dominates Cairns Group positions.

The emergence of the G20(Ag) can be interpreted as a failure of the Cairns Group—the Group moved too little, too slowly to accommodate its