

Will There Be A Global Trade Pact to Reduce Tariffs, Quotas, Subsidies, and Trade Barriers That Limit Access of Agricultural Products of Less Developed Countries to Developed Country Markets?

Anna J. Schwartz
National Bureau of Economic Research

The stalemate in global trade negotiations that must be concluded by the end of this year (section 1). The unresolved issues in the world at large and specifically in the United States (section 2). Why agricultural trade subsidies have become entrenched in both rich and poor countries although the farm population has been declining (section 3). Section 4 concludes.

1. Present Status of Doha Global Trade Negotiations

It is uncertain at this juncture whether the trade reform that the Doha Development Agenda was intended to achieve will materialize this year. The agenda addressed both the complaints of low-income countries that they are excluded from agricultural markets of high-income countries by the tariffs and farm subsidies of those countries as well as the desire of the latter to export banking and insurance services, pharmaceuticals, and industrial products that are barred by restrictive trade practices. Trade expansion would follow from satisfaction of the interests of both sets of the countries.

The problem centers largely on the reluctance of the European Union to offer greater access to their protected farm markets, but grievances against others also abound. Developing countries refuse to discuss opening their markets to services unless the United States and Europe open their markets to low-income countries' farm crops.

There are so many unsettled issues as the date for the Hong Kong negotiations approaches that World Trade Organization officials are playing down the prospects for substantial progress there. The United States is pressing China, which has hitherto made no comment on the wrangling among the country groups in preliminary meetings in London and Geneva, to use its influence in Europe to win greater cooperation there for the effort to dismantle agricultural subsidies and help with the trade talks in Hong Kong

Negotiations have been ongoing for four years. They were to be consummated when trade ministers from 148 countries and customs territories gather in Hong Kong on December 13 for a week-long meeting, with the hope that a deal can be reached despite hitherto unsuccessful attempts to resolve contentious agricultural trade issues. It would be a pity were the Hong Kong gathering to end with no substantive result. A World Bank study released on November 9 estimates that if tariffs, subsidies, and domestic support programs were eliminated, the gain in world income would be close to \$300 billion per year by 2015, and that developing countries would obtain 45% of that gain, provided merchandise trade were completely free. The study focuses on agricultural reform because agriculture is the most distorted of all sectors.

For the United States there is a time constraint. The authority Congress has granted the Bush administration to negotiate trade pacts expires June 30, 2007. If a deal is reached in Hong Kong, it will take three months for the administration to express the terms of the pact in legal language, and another three months to lobby Congress to enact the agreement. By mid-2007, however, the next presidential campaign will be under way, and Congress may not then be receptive to ratifying a trade deal because of negative political ramifications. Members of the House who voted for CAFTA, whether Democrats or Republicans, are facing a backlash from opponents of free trade who are raising funds to defeat these members in the 2006 House elections. All in all, there are reasons to doubt a successful outcome to the Doha Development Agenda.

2. Controversial Trade Issues

In this section, I discuss general controversial trade issues, and then the issues confronting the United States

The member countries are arrayed in different groupings with conflicting interests. A group of twenty developing countries, including Brazil, China, and India contend that it is incumbent on industrialized countries more than on developing countries to reduce trade barriers. The European Union counters that developing countries like Brazil are unwilling to make sharp cuts in tariffs on imported industrial goods. China, ironically, has just introduced farm subsidies at the provincial government level to assist tea exporters. It encourages protection for its farmers, whose incomes haven't matched increases in those of industrial workers.

Another grouping, known as the Cairns Group of 17 food-exporting countries, includes Australia. A group of ten countries including Japan, South Korea, and Switzerland have benefited from free trade in industrial products but apply stringent restrictions on food imports, particularly agricultural products.

The United States and the European Union are at the center of a controversy on the size of the reduction in subsidies and tariffs that each is willing to undertake, each asserting that the concessions of the other are inadequate. The U.S. offered to reduce farm tariffs over five years by 55% for the lowest tariffs and 90% for the highest. The E. U. Trade Negotiator proposed a cut of the bloc's highest farm tariffs by 60 %, with a reduction of average farm tariffs from 23 to 12% that some member countries regard as excessive. The United States has objected that 8% of agricultural products were excluded by the EU as "sensitive." whereas it limited "sensitive" products to just 1%. Sensitive products would be exempt from tariff cuts or subject to only minimal cuts. France has been particularly obdurate, insisting that it will agree only to past proposed changes in domestic subsidies for the European farm program that never were adopted. Only modest reductions in tariffs on farm products, such as beef, sugar, dairy products, and fruit, are on offer. The European Union further stipulates that, for a deal to be acceptable, other countries must agree to abide by a list of rules it has devised, among which is a limit on U.S. large shipments of food as aid to poor countries.

The U.S. offer to cut tariffs and subsidies was based on the expectation that the European Union would reciprocate. As just noted, it has not so far done so. In the Uruguay round of trade negotiations, moreover, the U.S. reductions, which took effect in 1986, did not elicit a

comparable reduction by the European Union. The current negotiations therefore are colored by U.S. resentment of European past behavior.

The U.S. trade negotiator and Congress do not sing from the same hymn book. Congress has authorized the administration to negotiate trade pacts, on one hand, on the other, a bill now before the Senate would extend the farm subsidy program for four years beyond 2007, and extend the milk subsidy program that was supposed to expire this year.

The position of France is anomalous. If the European Union is truly a joint political enterprise, with trade authority centered in Brussels, then individual countries should not be disputing the central authority in defense of their separate interests.

In short, at the country level, the overall objective of the Doha round to promote the prosperity of less developed countries by opening markets in the developed world to the crops of the less developed is absent. The individual countries, developed or not, seek only their own partisan interests. The offer to free trade each proposes is contingent on reciprocal actions to free trade by others. Word of Bhagwati's (2002) advocacy of relaxing reciprocity, in favor of unilateral freeing of trade, has not reached the members of the World Trade Organization, and most certainly, not the United States.

3. Why are Agricultural Subsidies Difficult to Abolish?

Government regulation of agriculture can be traced to the beginnings of recorded history. Perhaps the British corn laws that were in existence from 1463 until their elimination in 1846 are the best known example. It is probably also the best known example of unilateral trade liberalization.

Regulation was motivated by the variability of farm prices and incomes, a result of low price elasticity of demand and low elasticity of short-run supply. No allowance has since been made for the fact that farm households nowadays earn income from salaries or wage employment from other business. These income inflows reduce the variability of farm household income.

In addition, the returns to labor and capital resources invested in farming were assumed to be too low. Governments adopted price and income policies to raise the level of return to resources engaged in agriculture. The measures had additional effects: on resources and output, costs to consumers and taxpayers, and international trade, the particular concern of the Doha round.

The price and income policies of industrial nations limited the export opportunities of underdeveloped areas. They did so by reducing consumption of farm products by industrial nation consumers due to higher prices induced by the programs, and by increasing farm output, thanks both to higher prices and subsidies. Not all farm production of industrial nations competes with that of underdeveloped areas, especially tropical farm products, but in rice, fats and oils, they do compete. Moreover, subsidized food exports of industrial nations, in the form of foreign aid, reduce the market for grains, for example, from domestically produced food products, in the recipient areas.

In the United States the modern form of regulation of agriculture dates from 1933, when the Agricultural Adjustment Act was passed, restricting production and compensating farmers' loss of their production rights by payments to restore their prices to parity with the price level from 1910-1914. The parity price payment principle, now known as subsidies, was formulated into its present form in the farm bill of 1949. The 1949 farm parity formulas are the underlying law of subsidies to which all subsequent farm bills are exceptions, just as the Smoot Hawley tariff of 1930 is the underlying law of tariffs, current tariffs being enacted as exceptions to Smoot Hawley. The present farm bill that took effect in 2002, as an exception to the 1949 farm legislation will expire in September 2007.¹

The government subsidy program induces farmers to produce more than buyers want, depressing prices, so that subsidy payments rise. In effect, the program pays farmers both for producing too much and for low crop prices. Subsidy payments in 2000 were at a record high of \$229 billion, when exports to Asia fell because of financial crises there. Subsidies may set a new record this year because of a bumper crop of corn for which there is no storage space in corn elevators, and grain transportation is a bottleneck. Higher costs for energy and hauling grain have led farmers to sell corn at fire sale prices, but at no loss to them. The government provides guaranteed loan deficiency payments. The lower the price at which corn sells, the bigger the loan deficiency payments.

Farm subsidies in other countries may be variants of those in the United States.. They include output control, government purchase, financing of storage, deficiency payments, import controls, and export subsidies. One problem with the programs is that they encourage additional investments in improving land and in inputs to maximize output, contrary to government techniques to induce withdrawal of land from cultivation.

The Common Agricultural Policy to which EU members are subject intervenes in the market for farm products by buying them, subsidizing exports, taxing imports, restricting quantities, .such as milk quotas, benefiting mostly larger producers and land owners. In 2005 a Single Payment scheme was introduced to replace commodity specific subsidies. The hope is that agriculture will become more market oriented.

The disadvantages of farm subsidy programs are that they raise prices for consumers, impose substantial outlays on the government budget and increase farm output. Even if they succeed in narrowing the gap between farm and non-farm incomes, they may benefit large farm growers more than small ones. In addition, they injure the possibilities for economic growth in underdeveloped countries.

Farm subsidies are an entitlement that farm operators have come to believe is their right. A policy to reduce gradually or fully eliminate them will be resisted not only by the recipients but also by incumbent legislators who will vote against such a policy change. They know that if they did not, they would bear the onus of depriving their constituents of incomes from government that in one form or another they have come to expect. Legislators prize re-election more than they do support of a change that would contribute to domestic and international welfare. That is why the Doha Agenda may not be destined to triumph.

¹ I am indebted to a private communication from Walker Todd for this paragraph.

4. Concluding Remarks

Later this month we will learn whether it is possible to convince individual countries and guardians of individual sectors in each of their economies that reducing long-standing protectionist defenses of agricultural products and barriers to trade in industrial products even if short-term transitional losses are incurred, will result in the overall expansion of trade that will permit economic growth to flourish worldwide.

References

Going Alone: The Case for Relaxed Reciprocity in Freeing Trade 2002. Edited by Jagdish Bhagwati. Cambridge, MA. MIT Press.

Johnson, D. Gale. 1968. "Agriculture: Price and Income Policies." In *International Encyclopedia of the Social Sciences*. New York: Macmillan and the Free Press: 250-256.

New York Times November 23, 2005. "Another Day of Trade Talks, But Same Old Impasse." (Tom Wright, p. C-7).

November 25, 2005. "WTO Chief Won't Count on Consensus"
(Keith Bradsher)

November 9, 2005. "Mountains of Corn and a Sea of Farm Subsidies"
(Alexei Barrionuevo).

Wall Street Journal October 21, 2005. "Just Saying 'Non'" (Review and Outlook, p. A14).

November 8, 2005. "Clock is Ticking on Trade Talks"
(Scott Miller. p. A14).

November 10, 2005. "Ministers to Take a New Tack for Next Round of Trade Talks" (Scott Miller and Juliane Von Reppert Bismarck, p. A2).