The Doha Round, Agriculture, and the Developing Countries[1]

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Introduction

It is an honor and a pleasure to be invited to participate in this important forum on US agricultural policy. I will argue first that deep global trade liberalization could make a major difference to reducing global poverty and so the stakes in the Doha Round are high. Second, I will suggest that the current impasse in Doha can only be broken by a major meaningful reduction in US agricultural subsidies and a corresponding reciprocal move by major developing countries to liberalize their own agriculture as well as their markets in manufactures, as well as a commitment by Europe and Japan to major cuts in agricultural tariffs. Third, I will suggest that it is high time to reduce or eliminate those US agricultural subsidies that boost output, and replace them temporarily with subsidies to ethanol that are in turn subsequently replaced by the indirect incentives from a carbon tax.

The Stakes: Trade Liberalization and Global Poverty

History shows that export opportunities are a key to the potential for economic growth. **FIGURE 1** In the past two decades there was a clear correlation across countries between those that achieved high export growth and those that achieved high growth of GDP. Export opportunities are especially important in world agricultural markets for the poor in developing countries. Seventy-five percent of the 3 billion people

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who are poor at the $2 per day definition live in the rural sector, and their opportunities increase when agricultural export opportunities increase.

In 2004 I wrote a book on *Trade Policy and Global Poverty.* In that study I estimated that a move to global free trade could boost the income of developing countries by $200 billion annually. About half of this was from gains from global free trade in agriculture. Also, about half of the total gains to developing countries would arise from the liberalization of industrial country barriers to their exports. That means that through protection industrial countries currently inflict losses on developing countries that are about twice as much as they give back in the form of development assistance. The bulk of this protection in industrial countries is in agriculture and in textiles and apparel.

In the same study, I estimated that global free trade could reduce the number in poverty globally by about 500 million persons. The underlying economics can be summarized in the following stylized facts. **FIGURE 2** Most models show that the static welfare effects of global free trade would amount to income gains of about 1.5 to 2 percent of GDP for developing countries. Most international economists would agree that total gains including dynamic effects are probably at least twice as large. So as a stylized fact, global free trade could increase developing country incomes by about 4 percent. Basic international trade theory furthermore states that developing countries have a comparative advantage in products that use unskilled labor, because that is their relatively abundant factor. That means that trade liberalization would boost the unskilled wages relevant for those near the poverty line by proportionately more than would be the case for the economy on average. My model estimates showed that the ratio was typically about 2 to 1. So poverty-level wages would tend to rise by 2 times the average

4 percent, or 8 percent. Finally, the broad empirical relationship between poverty and income shows that the "poverty elasticity" – the percent by which the number of poor declines for a 1 percent rise in their income – is about 2. So multiply once again by 2 and you get a total of 16 percent reduction in the number of poor. Apply that to 300 million in poverty and you get about 500 million reduction in global poverty.

The Role of Agriculture

P*rotection in Industrial Countries* -- Agriculture is crucial to this potential. **FIGURE 3** In industrial countries, it is the agricultural sector where protection remains high. Both Canada and the European Union have overall agricultural protection that is the equivalent of a tariff of about 50 percent, and for Japan the tariff equivalent is about 80 percent. This is in part because of enormous "tariff-rate quota" tariffs that apply once an import threshold has been exceeded. Even the United States has overall agricultural protection on the order of a 20 percent tariff equivalent, although in the case of the United States more than half of protection comes from the effect of domestic production subsidies, which push out the supply curve enough to discourage imports by an equivalent of a tariff of about 10 percent.

Protection in Developing Countries -- **FIGURE 4** The developing countries also tend to have high protection in agriculture, only modestly lower at 30 percent than the 36 percent average for industrial countries. As this table shows, industrial countries tend to have still substantial tariff protection in textiles and apparel at about 12 percent, but otherwise their manufactures have low tariffs, averaging only 3 percent. In contrast, developing countries tend to have somewhat higher textile-apparel protection averaging 18 percent, and the difference is even greater in most manufactures – at a 12 percent average applied tariff (and even higher bound rates).

Doha Impasse

The broad outline of a Doha Round deal thus necessarily involves reductions in agricultural protection in the industrial countries and reduction in protection of both agricultural and manufactured goods in developing countries. There are some who argue that because the Doha Round is the "Development Round" the developing countries should not have to liberalize at all but should get a free ride. That would be a tragic mistake for two reasons. First, without making substantial offers to liberalize their own protection , key developing countries such as India and Brazil would be missing a major opportunity to improve the welfare of their own citizens, because protection imposes high costs on consumers and leads to technological stagnation. Second, without a significant contribution of reciprocal liberalization by the major developing countries, the industrial country export interest groups are unlikely to be willing to put pressure on their politicians to ignore the calls for protection by the interest groups representing protected sectors.

FIGURE 5 A Doha bargain thus surely needs to involve deep tariff cuts by industrial countries in agriculture and textiles and apparel. It also should involve either deep cuts in agricultural subsidies or a transformation of these subsidies to truly "Green Box" subsidies that are decoupled from production, such as those for rural infrastructure and research. For their part, the major developing countries should be prepared to cut their tariffs deeply as well, perhaps at least as much as two-thirds the depth of cuts adopted by the industrial countries. The third element of a deal truly designed to help the world's poor would be immediate free entry for all goods from the poorest countries of the world.

Unfortunately, for more than a year now the Doha Round has been at an impasse. Agriculture is the main reason why. The G-20 of major developing countries regard the offers that have been made by the European Union and the United States on agriculture to be inadequate to warrant significant offers in return. Already at Cancun in 2003 the major developing countries showed that in this Round of trade negotiations it would no longer be business as usual as practiced in the GATT deals of the past, which were largely cut behind closed doors by the Quad powers (United States, Canada, EU, and Japan). Consensus voting in the new WTO increased the leverage of the developing countries. The G-20 forced a breakdown at Cancun because of inadequate offers in agriculture, eventually forcing better offers by mid-2004. In many ways they had a right to do so, because aside from the important breakthrough in phaseout of the multifibers arrangement, the Uruguay Round of the 1990s had not done much for them and had even imposed some windfall losses in the area of access to generic pharmaceuticals. Yet Doha is indeed supposed to be a development round, motivated in part by the geopolitical response to the urgency of reducing global poverty as perceived in the aftermath of September 11, 2001. So today's impasse can usefully be seen as Cancun II: another episode in which the larger developing countries are insisting that they will not sign on to a Round that accomplishes no real market opening for the goods that are of importance to them.

A large part of the problem is that although the offers by the European Union and the United States may have sounded generous, they turned out not to be. The offers in the run-up to the Hong Kong ministerial meeting in December 2005 were of this nature. The European Union essentially was insisting on keeping a sizable number of products out of liberalization as "sensitive" products. To its credit, the EU did set the stage for subsidy reform in its 2003 reformulation of the Common Agricultural Policy, which shifted subsidies away from production into decoupled Green Box categories. For the United States, the key offer that all other parties have always been waiting for is a meaningful reduction in production subsidies. But the base level of bound subsidies in the so-called Aggregate Measure of Support (AMS), or "Amber box," was so inflated that supposedly deep percentage cuts left the permissible levels still high, at amounts equal to or greater than what was actually being spent before.

Subsidy Cuts: Phony or Real?

FIGURE 6 The US offer in October 2005 was to cut its bound AMS level by 60 percent, or from a bound level of $19 billion to about $8 billion. A sixty percent cut in subsidies sounds generous. It turns out, however, that the actual level of spending on subsidies would have been unaffected and could even have risen. The bound AMS did not include what was called "de minimis" subsidies. Moreover, it contained about $6 billion of pure fiction, a remarkable concept called "Market Price Support" (MPS). This accounting concept equals the difference between the domestic administered price and the 1986-88 world price. Yes, 1986-88, not today – already a clue that this concept is a fiction. There is no actual taxpayer money paid out for the MPS, it is pure accounting. Japan suddenly cut its reported AMS subsidies by billions of dollars in the late 1990s by eliminating its administered prices, with no change in agricultural protection whatsoever. So the first thing that should be done in Geneva is to redefine the Amber Box AMS to exclude the Market Price Support as part of the calculated bound level. Getting rid of the phony subsidy will make it easier to get rid of phony subsidy cuts.

As you look at the 2005 US offer, what you see is that the new controlled levels would include AMS, the blue box of contingent subsidies, and the deminimis allowance. The actual spending on these three categories, after stripping out the ficticious Market Price Support, would have been a permissible $17 billion annually under the US proposal. That would have been an increase, not a decrease, from the pre-Doha actual range of $16 billion in production related subsidies. Not surprisingly, the offer was not considered enough to bring the G-20 into meaningful counteroffers of reduction in their own protection.

Now we have a new US proposal. In January the Secretary of Agriculture announced proposed changes in the context of the 2007 farm bill. As most of you know, the 2002 farm bill was a major step backwards for trade liberalization, because it essentially reversed the broad decoupling of agricultural subsidies from agricultural production that was contained in the predecessor 1996 farm bill. Now we have another historic opportunity to get agricultural subsidy policy back on track toward decoupling. The question is whether the new offer really does that.

Perhaps the most conspicuous feature of the new proposal is an income ceiling of $200,000 on farmers eligible for subsidies. That is an important step in the right direction because it at least recognizes the problem that US agricultural subsidies have mainly gone to the larger farms and corporations rather than truly supporting the small family farm. Unfortunately, however, from the available evidence it does not appear that the new proposal represents a permanent commitment to major reductions in actual spending on output-related subsidies. Although the announcement emphasized that there would be a reduction in spending by about $3 billion per year over the next 5 years in comparison with average spending on subsidies in 2002-05, that expected reduction was almost wholly driven by the assumption that the recent rise in commodity prices would remain in place, and that there would be no repeat of the various crop disasters of that period. If prices do fall and if there are more disasters, the subsidy numbers would mushroom once again.

Clearly what is needed to achieve a breakthrough at Doha is an iron-clad commitment to reduce the money actually spent on subisidies that affect production along an aggressive timetable. That is called decoupling. In parallel, the EU must have its feet held to the fire to ensure that its subsidies actually do turn from blue to green. The EU must also accept a smaller range of sensitive products so it cannot exempt its tariff cuts through that loophole. If Brazil and other major developing countries, including even India, see forceful movement in these directions by the United States and the European Union, I think they will be prepared to make substantial liberalization offers themselves, including not only in manufactures but also in agricultural goods.

The Energy and Environment Connection

Let me conclude by saying that I think that today American farmers have a rare opportunity to transform US subsidy policy in a radical and positive way. The nation is presently highly conscious of the need to reduce dependence on foreign oil and the need to reduce emissions of carbon dioxide because of the threat of global warming. US agriculture can help on both fronts by producing biomass for production of ethanol, ideally in the form of cellulosic biomass such as switchgrass rather than corn which requires more energy inputs per unit of energy output. So I would argue it is an excellent time to set a firm timetable for the elimination of general agricultural production subsidies, with a conscious shift of any remaining subsidy funds toward ethanol or to rural infrastructure. In the next decade Americans are likely to face huge cuts in medicare and probably even social security because of looming fiscal deficits, and they are likely to be in no mood to spend tens of billions of dollars annually on traditional agricultural subsidies, especially subsidies that are seen to go mainly to high-income farmers. So the alternative to a more productive channeling of subsidies – to biomass and ethanol – may be no subsidies at all.

Over the medium term it would then be highly desirable to shift away from subsidies to ethanol and toward the same stimulus to production accomplished indirectly by implementation of a system of carbon taxes or cap-and-trade permits. Putting a price on carbon emissions would tend to make the production of biomass for ethanol profitable without a subsidy, by boosting the price of oil and coal. The result would also be upward pressure on international agricultural prices, which would boost the prospects of farmers in developing countries and contribute to poverty reduction. My sense is that rural America is more energized today than for a long time, precisely because of the new potential for activity in ethanol production. I think this is very much on the right track. In the Doha context, a US offer of commitments to reform subsidy policy along these lines could achieve a breakthrough, especially if it were coupled with the elimination of the high import duty on ethanol imports, prompting Brazil in particular to sign on to a deal.

Conclusion

In conclusion, global trade liberalization can benefit both American farmers and the 3 billion living in poverty in developing countries. It is essential, however, that the America farm community think boldly about new approaches, if these opportunities are to be realized. In particular, keeping the same old levels of the same old farm production subsidies, even after cosmetic surgery from the new high-income caps, almost certainly would mean that the Doha opportunity would be lost.

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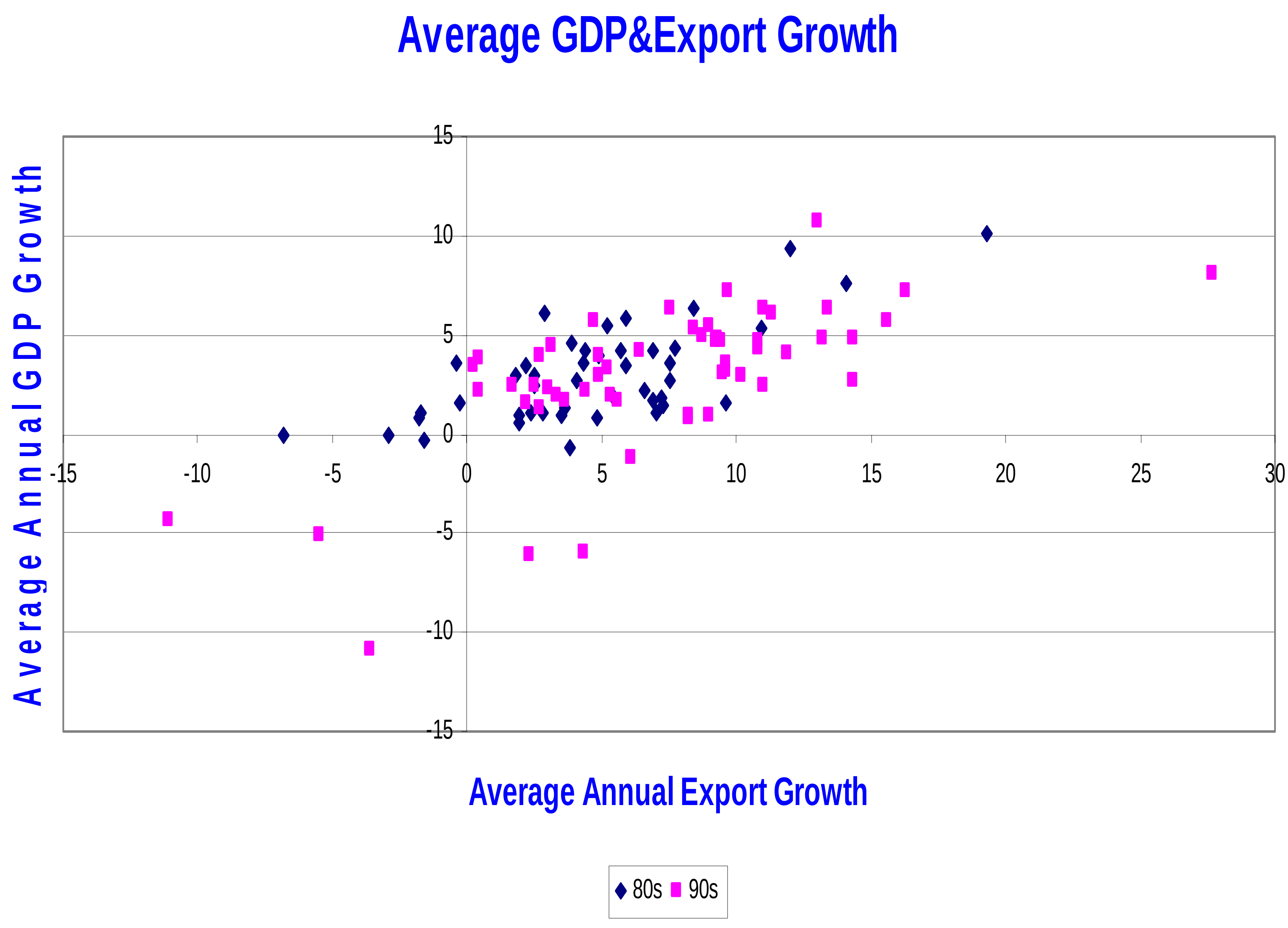

Average GDP&Export Growth
Average Annual GDP Growth
Average Annual Export Growth
15
10
5
0
-5
-10
-15
-15
-10
-5
0
5
10
15
20
25
30
80s
90s

Impact of global free trade on world poverty ($2/ day definition)

- Income gains from free trade (static and dynamic effects): about 4 percent of GDP
- x Ratio of unskilled wage gains to average gains: 2
- x "Poverty elasticity" (percent reduction in number of poor for 1% income gain): 2
- = percent reduction in global number of poor people (16%,or about 500 million)

Agricultural Protection
(tariff-equivalent, percent)

Type	US	CAN	EU	JPN
Tariffs	8.8	30.4	32.6	76.4
Subsidies	10.2	16.8	10.4	3.2
Total	19.9	52.3	46.4	82.1

Applied Tariff protection,1997-98 (%)

	Agriculture	Textiles-Ap	Oth. Manuf.
Industrial Ctrs	35.6	11.6	3.1
Developing Ctrs	30.3	18.2	11.5
Brazil	22.9	17.6	15.4
China pre-entry	29.9	27.9	15.3
India	31.5	31.6	24.6
Indonesia	19.6	19.2	11.5
Korea	50.7	7.9	6.9
South Africa	37.8	19.3	7.8
Thailand	33.3	31.7	16.7

Blueprint for a Doha Deal

- DCs: Phased deep tariff cuts or elimination, including in agriculture, textiles and apparel;
- DCs: Eliminate agricultural subsidies or fully “decouple” from production;
- Middle-income DGCs: cut protection at least 50-60 percent; longer phase-in.
- Second track: immediate free entry from LDCs, HIPCs, SSA; 10-year tax holiday on FDI

Phony Subsidies = phony cuts (US levels and 05 offer, $ billions)

	Bound	Actual	Phony	Real
AMS	19.1	14.4	5.8	8.6
Blue box	…	0	…	0
DeMinimis	…	7.1	…	7.1
total	19.1	21.5	5.8	15.7
US offer Oct 05				
AMS	7.6		5.8	1.8
Blue box	5.0		…	5.0
Deminimis	10.0		…	10.0
total	22.6		5.8	16.8