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## **WTO: Key Issues for Freer Agricultural Trade --Developing Country perspectives**

**Dr. Funing Zhong**

### **Abstract**

Contradict to many projections developing countries have not benefited from freer trade in agriculture after completion of the Uruguay Round negotiations. This is largely due to the high level of domestic support in developed countries, and the “green” barriers and other non-tariff measures. The technology advance in GMO and other biotech products may actually put developing countries in unfavorable positions in both production and trade, and the lack of market access for labor-intensive commodities may be even more crucial to agriculture in developing countries.

Developing countries are likely to bring the above issues to the next round of multilateral negotiations on agriculture. However, depending on their economic structures and positions in agricultural trade, developing countries may hold the same stands in some issues, and split in others.

**Key words:** Domestic support “Green” barriers Labor market

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## **WTO: Key Issues for Freer Agricultural Trade ----Developing Country Perspectives**

**Dr. Funing Zhong\***

Almost 8 years have passed since the completion of the Uruguay Round multi-lateral negotiation under the GATT. However, developing countries have not seen nor benefited from freer trade in agriculture as projected by most studies during the negotiation. As most developing countries depends on agricultural production and trade to a large extent, the situation in the world agricultural market may have significant impact on their economic growth, as well as their attitude towards the next round negotiation.

It was predicted that following the completion of the Uruguay Round negotiation and the establishment of the WTO, prices of most farm products in the world market would increase by a big margin due to the cut in domestic price support and export subsidies in developed countries. As a result, developing countries, except the poorest food deficit ones, would benefit significantly from freer trade in agriculture and their GDP growth would be accelerated.

However, it is not the case in reality. The world prices of major farm products keep at low levels while the volumes of trade basically maintain the same. The reason is not new: the levels of domestic support and export subsidy are still high in developed countries, though some have changed their forms. In addition, new barriers to agricultural trade have emerged based on “green” criteria and as other non-tariff measures, and the technology advance in GMO and other biotech products may actually put developing countries in unfavorable positions in both production and trade. At the same time, developing countries do not find any improvement in the market access for their labor-intensive manufactured goods, and can not strengthen competitiveness of their agriculture by absorbing excess laborers from that sector.

As the agricultural sector plays a more important role in the economy of developing countries, such situations may raise a question that how developing countries can really benefit from the world trading system under the WTO? To some developing countries depending on exporting farm products, the low prices at the world market, and the new barriers set by developed countries, have damaged their effort in economic growth. To the importing countries, though consumers may benefit, the agricultural sector and the basic living conditions for a large portion of the population are threatened. Therefore, such issues are likely to be discussed in the next round negotiation.

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## I. Subsidy and Domestic Support in Developed Countries

According to the Uruguay Round Agreement on Agriculture, for developed countries, the average tariff for all agricultural products should be cut by 36%, while the domestic support should be cut by 20% and the export subsidies should be cut by 36% in value and 21% in volume terms, respectively. Such reform in domestic and trade policies is believed to push agricultural prices down significantly by many observers. For example, it is estimated that the world agricultural prices will increase by 11.6% if all distorting policies are eliminated, and that removal of domestic subsidy in OECD members alone will increase world wheat price by 12%<sup>1</sup>.

However, actually the world agricultural prices have continued to decline since the completion of the Uruguay Round, and this is largely due to the domestic support in developed countries. Such support raises the realized revenue per unit of farm product above the market price level, and encourages farmers to produce more than otherwise, resulted in even low market price, especially those at the world market.

It was estimated that the US Commodity Loan Program with Marketing Loan Provisions pushed most agricultural prices not only above the market level, but also above the loan rates<sup>2</sup>. For example, per unit realized average revenue was 12.8% above the average market price and 7.4% above the loan rate for corn, 16% and 12.4% for wheat, 18.3% and 4.6% for soybeans, and 29.5% and 21.5% for rice, respectively, in 1999. As the United States is a major exporter of those commodities, eliminating its domestic support will lead to significant increase in the world prices. Obviously, if other OECD countries such as the EU members eliminate domestic support at the same time, the world prices for those commodities may increase by 10% or even more.

According to the above analysis, total marketing loan benefit in the US rose from US\$ 200 million in 1997 to about 8 billion in 1999, and might continue to be at such a high level in the next a few years. It is said that the marketing loan provision has shifted the Commodity Loan Program from supporting price to supporting income. However, as the marketing loan facilitates the realized per unit revenue to be higher than the loan rate, it raises farmers' expectations for the per unit revenues in next year, and builds into acreage response and results in increased aggregated production. At the same time, as it does not have impact on market price, such provision may further depress market price with increased production. Therefore, not only the magnitude but also the form of the domestic support in developed countries may have significant impact on world price and trade, and hence on the welfare of farmers in developing countries.

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<sup>1</sup> Diao, X., A. Somwar, and T. Roe (2001). "A Global analysis of Agricultural Reform in WTO Member Countries," *Background for Agricultural Policy Reform in WTO: The Road Ahead*. Washington, D.C.: USDA, Economic Research Service, ERS-E01-001.

<sup>2</sup> Westcott, P. C. and J. M. Price (2001). "Analysis of the U.S. Commodity Loan Program with Marketing Loan Provisions," D.C.: USDA, Economic Research Service, Agricultural Economic Report Number 801.

Developing countries suffer from the high domestic support in developed countries and the low prices at the world market in different ways, depending on their position in the trade. Exporting countries may face shrinking market share and diminishing revenue from exports, while importing countries may face increasing challenge to their domestic production. In both the situations, the farmers in developing countries will be big losers, the costs for restructuring the agricultural sector and the whole economy will be very high, and the pressures on social stability and security will be quite heavy.

There is also a question about the role of income support. It has been generally believed that income-supporting measures are less distorting in production and trade and thus more preferable to price-supporting ones. However, the above analysis clearly indicates the opposite. Any support measures that raise farmers' expectation of realized revenue would encourage expansion of production and depress price. Even those have nothing to do with production of any specific commodity, the supporting measures are still likely to encourage more production than otherwise as they have built into exit costs.

## **II. “Green” and Other Non-tariff Barriers**

While the domestic support in developed countries basically affects trade of bulk crop commodities, developing countries are facing “green” and other non-tariff barriers to their imports of animal products, vegetables and fruits, and the like.

Sanitary and phytosanitary (SPS) measures are necessary for protecting human as well as plants and animals. However, it may easily be turned into barriers to trade. A lot of such discussions have taken place in the past, and many disputes have been settled not on purely scientific basis. While this kind of disputes will continue in the future, a new trend has emerged in the name of “clean production,” putting developing countries in more disadvantageous positions.

Unlike the past SPS measures examining the final products, the “clean production” concept requires certain standards to be applied in production process. Such requirements in production standards are usually consistent with ongoing practice in developed countries, and with the resource endowments in those countries. If production of the product concerned is organized everywhere in the “clean” way as in some developed countries, comparative advantage will fully exhibit in those countries given the resource endowments (in a broad sense). However, if the commodity could be produced in its traditional way in developing countries, some of the countries might be able to successfully compete in the world market. As developing countries have to adopt the technology developed by developed countries based on their resource endowments, they are likely to exhibit comparative disadvantage in the production.

It raises a series of questions: To what extent the “clean production” requirement is scientifically sound? To what extent the controls on production process are really necessary despite the traditional PSP measures imposed on final products? How can we distinguish “green” barriers from true protection for people, plants and animals?

Special Safeguard (SSG) measures may become an important barrier to exports of some products from developing countries. The SSG provisions give importing countries the right to protect domestic production if imports of that product increase beyond a certain limit. Such a limit is usually stipulated as a certain percentage of domestic consumption or previous import level, regardless the share of the product in total agricultural GDP.

General speaking, bulk commodities such as grain, cotton and oilseeds are land-intensive products in which many developing countries do not have comparative advantage. On the contrary, most developing countries do have comparative advantage in producing labor-intensive products such as vegetables, fruits, and some animal and aquatic products. In most cases, the land-intensive products account for a very large share in agricultural production, while the labor-intensive products consist of a small portion of the total production. Therefore, when exports of land-intensive products from developed countries force farmers in some developing countries producing and exporting more labor-intensive commodities, they may face the SSG measures to be applied by developed countries.

Due to the huge difference in relative shares, a substantial increase in imports of land-intensive goods may not reach the limit in percentage terms for those goods. However, the resulted adjustment in developing countries may lead to exports of some labor-intensive products exceeding the limits, in percentage terms, set in a developed country, entitling implementation of the SSG measures. This has been revealed by the current dispute between Japan and China over three special products exported from China to Japan. Altogether they count for a very small percentage in either Japanese or Chinese agriculture, but the increases in imports are very significant in the respective markets, leading to initiation of the SSG measures by the Japanese government. Although the dispute is settled this time, but it is likely to happen again and again, and the SSG measures might be used tactically in this regard.

Given the difference in resource endowment and relative shares of various products in agriculture between developed and developing countries, such disputes are likely to increase in the future. The current rules clearly put developing countries in disadvantageous position.

### **III. Bio-technology**

Labeling of GMO products is a hot issue between the US on one side and EU and Japan on the other side. However, developing countries may find themselves being caught between aggressive multinational giants and importing countries with restrictive regulations.

As Justin Lin has pointed out<sup>3</sup>, the development in modern biotechnology, especially GMO products, may benefit developers and big producers to a large extent, while the majority small producers in developing countries may benefit very little. The basic reason is the required big scale of the production in adopting the technology in terms of land, capital, and other modern inputs, and most small producers in some developing countries can not meet the requirement. Therefore, the distribution effect may over-weigh income one in some less-developed areas, and farmers there may suffer from the new technology which is supposed to bring bright future to the poor in developing countries.

Food shortage is a chronic problem in developing countries as a whole, because of being less developed, and also due to distributional factors. GMO and other modern biotechnology may boost food production and provide possible solutions to food security issues worldwide, especially in developing countries. However, the potential benefit may not be evenly distributed among countries. In some developing countries where the above requirement can be met, farmers may face non-tariff barriers such as labeling regulation set by importing countries. They may suffer from such barriers if they depend on exporting. In other countries where farmers are unable to adopt the new technology and food supply is usually in short, producers may suffer from increasing imports produced with the new technology as they are not protected by similar regulations at home.

It is likely that developing countries may split facing GMO and other biotech issues, depending on domestic demand and supply conditions and on their positions in the world market. Unlike in the above issues, their stands in this area may vary in the next round multilateral negotiation.

### **IV. Market Access for Textile and Other Labor-intensive Products**

Economic growth and technology development have dramatically changed the structure of economy in developed countries. After two centuries of industrialization, the share of labor force employed in the agricultural sector has fallen down to 5% of the national total or even less. Developing countries have followed this path in economic development by establishing modern industries and gradually shifting a part of the rural laborers to other sectors. If both internal conditions and external

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<sup>3</sup> Presentation at the Pre-conference Workshop, the 24<sup>th</sup> International Conference of Agricultural Economists, held in Berlin, August 13-20, 2000.

environment are favorable, most developing countries will be able to realize their development goals in several decades.

However, it is not the case in reality. Logically, the first sectors to develop are labor-intensive ones that may absorb the large amount of outgoing rural laborers and generate increasing income to finance capital investment for further development. The expansion of these sectors needs ever-expanding market for their labor-intensive products, which can only be found in developed countries. But, the problems is, while developed countries enjoy comparative advantage in high-tech products, and in some service sectors, their domestic market for labor-intensive products is highly protective, just as their agricultural market. When developing countries are forced to speed up the re-allocation of laborers by freer trade in agriculture, they find it difficult to provide employment opportunity to the excess laborers to be released from agriculture.

There is no doubt that the agricultural sector in developing countries has to be re-structured in accordance with modern technology, resulted in its share in employment declining with that in GDP. However, if this process is to be accelerated by squeezing the agricultural sector with imports, alternative employment opportunity must be provided in a growing manner from outside. Developed countries should open their domestic market for textile and other labor-intensive products wider and quicker, otherwise developing countries may not be able to open their agricultural market to the extent as required by developed countries. Furthermore, without expansion of exports of labor-intensive products, many developing countries may face serious problems in their economic growth, as well as in the welfare of a large portion of their population.

Textile is directly related to agriculture while other labor-intensive may not relate to agriculture as closely. However, due to their crucial role in transferring rural labor force, the negotiation of freer trade in agriculture should be directly linked with that in labor-intensive sectors.

## **V. Major Issues for the Next Round Negotiation**

According to the above analysis, developing countries may hold the same stand in some issues, and split in some others, in the next round of multilateral negotiation on agriculture, depending on their economic structures and their positions in agricultural trade.

The most important common interest among developing countries is to have the domestic support in developed countries substantially cut. This will reduce the heavy pressures on farmers and the agricultural sector in importing countries, while provide more export opportunities for exporting countries. The issues related with “green” and other non-tariff barriers are of importance to exporting countries, especially to producers of the respective commodities. GMO and other biotechnology might be a



big issue to exporting countries facing restrictive regulations set by importing countries, and, to a less extent, to other developing countries as small producers may actually suffer from the distributional effect of the new technology.

As the fundamental problem in developing countries' agriculture is the excess labor, freer trade in textile and other labor-intensive products might be crucial to rural economy in developing countries, and has to be addressed in the future negotiation with top priority. After all, when free access to labor market would be put on table?