Update on the WTO Trade Negotiations: Implications for the 2007 Farm Bill

Robert L. Thompson

Gardner Endowed Chair in Agricultural Policy
University of Illinois at Urbana-Champaign

June 13, 2007 - USDA Economists Group

Uruguay Round Agreement on Agriculture: Accomplishments

- Increased minimum market access as % of consumption
- Bound and reduced export subsidies (value & volume)
- Acknowledged that domestic supports linked to production of *specific* commodities can distort trade and capped those that do
- Converted all non-tariff barriers to tariffs and reduced them
- Required scientific basis for all sanitary & phyto-sanitary (SPS) barriers to trade
- Created a more iron-clad dispute settlement system.
- Negotiations on agriculture and services would resume by a date certain

Domestic Supports Categorized by Degree of Trade Distortion

- “Green box” = non-trade-distorting support: investments in public goods and decoupled income transfers (no cap)
- “Blue box” = trade-distorting, but production-inducing effect offset by prod’n controls or set-asides (no cap)
- “Amber box” = trade-distorting, i.e. linked to production of *specific* commodities
  - Trade-distorting support allowed up to 5% (*de minimis)* each of aggregate value of all ag production and of production of individual commodities
  - Beyond that, the Aggregate Measure of Support (AMS) was capped in each country.

The WTO Cotton Case: Brazil's Allegations

- U.S. policies in 2002 Farm Bill stimulated larger production and exports of cotton than would otherwise have been the case.
- This depressed the world price of cotton, reducing the earning potential of Brazilian cotton growers.
- The U.S. cotton program violates the Uruguay Round Ag Agreement (of which the U.S. was a principal author).
- The U.S. should change those policies or pay compensation.

WTO Cotton Decision

- Marketing loans, LDPs, and counter-cyclical payments have induced larger production and exports that “suppressed” world price of cotton.
- U.S. direct payments are not decoupled (“green box”) since recipients are precluded from growing fruits and vegetables on land receiving payments.
- Export credit guarantees and “step 2” payments are banned export subsidies.

More Cases Possible

- Canada corn already
- Uruguay rice
- Soybeans?
- Dairy?

Doha Round Ag Negotiations: Progression

- Missed deadline for restarting ag negotiations
- 1999 -- Seattle fiasco
- 2001 -- Doha Ministerial declaration
- Individual country/region proposals, but no real negotiations (posturing; talking past one another)
- 2003 -- Cancun Ministerial, the original deadline for completion, failed; G-20 became 3rd force
- July 31, 2004 -- Framework Agreement
- Oct. 10, 2005 -- U.S. Proposal
- Dec. 2005 – Hong Kong Ministerial
- 2007? -- Completion of Doha Round

Why the Development Focus in the Doha Round?

- It's in our economic self-interest: They are the only potential growth markets for agricultural products, but only if and when they can afford to eat meat, fruits, vegetables; edible oils.
- Trade is a more powerful engine of growth than aid.
- Persistent poverty can have adverse geopolitical effects (Doha was 2 months after 9/11) and cause illegal immigration
- With half the world's population living on less than $2 per day, it's the right thing to do.
- Developing countries are now the majority of WTO members; there will be no agreement until they perceive something of value in it to them (unlike the past).

Key Players in Doha Round Agricultural Negotiations

- United States
- European Union (now EU-27!)
- G-20 (Brazil, India, China, S. Africa+)
- G-10 (Japan, Korea, Norway, Switzerland+)
- Various groupings of developing countries, (with heterogeneous interests); G-33 most active, under India’s leadership
- Cairns Group

Developing Country Concerns

- OECD countries tend to be most protectionist in products in which low income countries have a comparative advantage at this stage in their development
  - E.g., textiles, footwear, sugar, rice; cotton.
- OECD ag subsidies induce larger production and exports of their most subsidized commodities, driving down the world market price from which developing country farmers get their entire incomes
  - E.g. sugar, rice, cotton, and peanuts

Overall Domestic Support

- URAA categorizes all support policies in one of three boxes, with amber box total (AMS) and 2 *de minimis* categories each capped. No cap on "overall" domestic support.
- U.S. proposed (October 10, 2005):
  - Cap blue box, product-specific/non-product specific *de minimis* at 2.5% of value of production of the commodity/national output (i.e. reduce each by half).
  - Cap & reduce the sum of amber box + blue box + product-specific *de minimis* + non-product-specific *de minimis*.
  - US offered to cut its by 53% to $22 billion. G-20 proposes US cut 75% to $12 billion; EU says more than 70%.
- Falconer: US cut must be somewhere in range between $19 bill and low teens; perhaps 68% cut to $15 billion. EU > 70%, perhaps 75-80%.

Amber Box

- Framework Agreement said “Substantial reduction in trade-distorting support from bound levels”
- U.S. proposed
  - Full phase out over 15 years: 60% in first 5 years; rest in last 5 years, with higher/lower % reductions in countries where higher/lower AMS (e.g. 83% in EU).
  - Product-specific caps
- Hong Kong: Categorize countries in 3 bands, with highest to be cut the most.
  - EU in highest band; US and Japan in second.
- Status: US offer still a 60% cut from higher 1999-2001 base period; EU & ROW want 70% cut from lower 1995-2000 base period.

Blue Box

- Present: Trade-distorting policies that have measures that offset their production-inducing effect, e.g. set-aside or quota on production or sales. No cap at present.
- Framework Agreement:
  - Broaden to include “direct payments that do not require production,” e.g. counter-cyclical payments [no link to current production, but per unit payment is based on current market price; therefore, not green box].
- U.S. proposal: Redefine blue box as above and cap at 2.5% of total value of all national ag production (including non-program crops).

Green Box

- Present: No cap.
- Doha Round is about shifting as much support as possible from amber to green box payments.
- Brazil cotton case affirmed that direct payments are "green" only if there are no constraints whatsoever on what can be grown on land receiving payments.
  - U.S. must either delete fruit & vegetable exclusion or include direct payments in amber box
- No expectation that Doha Round will cap or tighten definition of "minimally trade-distorting."

Market Access

- Framework Agreement said:
  - Substantial increase in market access though tariff cuts or tariff rate quota (TRQ) expansion
    - But make cuts from bound rates.
  - Categorize all tariffs into “bands,” each with a different reduction formula; highest tariffs to be cut the most.
  - Allow each country to designate an “appropriate number” of (politically) “sensitive products” on which smaller cuts can be made.
  - Increase tariff-rate quotas (TRQs) on “sensitive products” on which tariffs are cut less than formula would otherwise require.
  - Allow developing countries to make smaller cuts over a longer period, designate some products as “special” for reasons of food security or rural livelihoods, and use a “special safeguard” against import surges.

Market Access (cont'd.)

- U.S. proposal would
  - Reduce tariffs by 55-90% (highest tariffs cut the most)
  - Cap tariffs at 75% in high income countries (a little higher cap elsewhere)
  - Limit "sensitive products" to less than 1% of tariff lines "with full compensation" via TRQ expansion
  - Allow "developing countries" Special Safeguard and Special Products
  - Internationally competitive developing countries must provide meaningful increase in access to their markets

Market Access (cont'd.)

- Status:
  - Proposed average cuts: US, 66%; G-20, >75%; G-10, <40%; EU has offered 39%, although 50% or a little more is likely doable if EU achieves other objectives.
  - 4 bands, with proposed cut in highest band: US, 85%; EU, 60%; G-20, >75%.
  - Developing country cuts to be 2/3 of high income countries.
  - Tariff cuts on sensitive products to be 1/3 to 2/3 of std. cuts, with increase in TRQ required; Number allowed: >1% and <5% of tariff lines.
  - Special products: 5-8% of ag tariff lines likely, although G-33 demanding 20%.
  - Least developed countries would have no required cuts.

Export Subsidies

- Present: Cap on volume and value of export subsidies on agricultural policies.
- U.S. proposed elimination of all direct agricultural export subsidies by 2010; EU called for cash-only food aid.
- WTO Cotton Case mandated that the U.S. must eliminate subsidy component in export credits and export credit guarantees
- Hong Kong:
  - Eliminate direct export subsidies by 2013.
  - Export credit programs to be self-financing; term less than 180 days.
  - Food aid: discipline to preclude commercial displacement
  - Discipline mode of operation of state-trading enterprises (STEs) to preclude indirect subsidization of exports; nothing on eliminating monopoly state traders.

US Proposal Misunderstood by Many American Farmers

- Very little real reduction in domestic support has been offered
- The proposed 60% cut is from the *cap* on, not actual, trade-distorting payments
- An “overall” reduction commitment is from a very high number, so reduction percent would have to be very large to have any impact on the actual farm program payments they receive.
- Any real cut in trade-distorting support can be made up fully via larger green box payments.

Status of WTO Negotiations

- Negotiations suspended in summer 2006; "restarted" after U.S. election.
  - Too late? Will Congress extend TPA?
- Three key disagreements:
  - U.S. demands *real* increases in market access.
  - E.U. & developing countries demand *real* reductions in U.S. trade-distorting ag supports
  - Brazil and India are asked to offer more market access for ag, services and non-ag mfg. goods
- Main issues: depth of *real* cuts in tariffs and in trade-distorting domestic support and how many exceptions.

Current Ag Trade Negotiations: What Is Possible?

- Much has already been agreed:
  - Eliminate all ag export subsidies
  - Reduce trade-distorting domestic subsidies (highest the most, but exceptions possible)
    - Redefine blue box to include counter-cyclical payments
  - Reduce tariffs (highest the most, but exceptions allowed if increase tariff-rate quota)
  - Give the least developed countries open access to high income country markets for most goods.
- The issue is NOT to get rid of ag subsidies, but to replace those linked to production of specific commodities.
  - Any disciplining of green box supports won't come until the next round of WTO trade negotiations.

Ethanol Has Changed the Markets, but Negotiators Haven't Noticed

- Expansion of the ethanol industry has driven up the price of corn, other grains and oilseeds, so the expected impact of present U.S. crop support programs will be negligible in the next few years.
  - U.S. corn exports will drop, as will most other grains and oilseeds.
  - Higher prices will induce South America & others to expand production and supply the exports the U.S. has been supplying.
  - Animal agriculture and low-income net-food-importing countries, which have to pay more for grain and oilseeds, likely to complain, as will ethanol exporters.

Prospects for Doha Round

- U.S. farm organizations say they will support a Doha Round Agreement that significantly reduces trade-distorting domestic subsidies *only* if the Agreement includes significant increases in market access.
- They put too much emphasis
  - on increasing access into shrinking markets of the past and not enough on growing the total size of the world market.
  - Protecting current farm program structure with commodity-specific benefits
- If the Doha Round fails now, it will not be completed during the Bush Presidency.

Remember

- The Uruguay Round Agreement on Agriculture will continue to set the rules of the road for international agricultural trade until some future round of negotiations changes them.
- If this rounds fails or is delayed, expect more cases to be files with WTO against OECD agricultural supports (No Peace Clause)
  - Row crops (LDPs, CCPs, etc. as in cotton case)
  - Dairy (e.g. marketing orders and classified pricing)
- The round is not so much about reducing farm subsidies as it is about moving them from trade-distorting to non-trade-distorting mechanisms.

USDA’s Farm Bill Proposal
Jan. 31, 2007

- Increase budget authority $5 billion over baseline.
- Change trigger for counter-cyclical payments from price to revenue (price times yield)
- Re marketing loans, reduce loan rates to 85% of moving average market price (safety net)
- Create an option for farmers to opt out from commodity programs and instead receive stepped-up direct payments with strong conservation cross-compliance requirement

USDA Farm Bill Proposal - 2

- Increase reliance on decoupled direct payments; i.e. delink payments from production or price of *specific* commodities (Use for cotton buy-out.)
- New crop insurance option: supplemental coverage to cover growers' deductible (to be triggered by county/area losses)
- Repeal fruit & vegetable exclusion as a condition for receiving direct payments
- $5 billion for specialty crops research, promotion and product purchase for feeding programs

USDA Farm Bill Proposal - 3

- Repeal export enhancement program, “fix” ag export credits; increase MAP funding
- Little change in sugar & dairy programs (the “Peterson effect”)
- Big increase in support for conservation (the “Harkin effect”); tougher “sodbuster” rules; streamline conservation programs.
- Increase support for research on ethanol from cellulosic (not corn) feedstocks and for pilot plants that apply the new technologies.

USDA Farm Bill Proposal - 4

- Introduce payment cut-off at $200K AGI, and eliminate 3-entity rule
- Big increase in assistance to beginning & disadvantaged farmers
- Lose payments on land sold for non-ag development or bought in 1031 exchange
- In rural development, more support for rural hospitals; sewer & water systems
- Stimulate trading of carbon credits from ag
- Streamline & rename “food stamps”