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**CATPRN**

Canadian Agricultural Trade Policy Research Network

# **WHAT IF THE DOHA ROUND FAILS? IMPLICATIONS FOR CANADIAN AGRICULTURE**

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This paper grew out of a workshop where a group of agricultural trade experts were invited to discuss the consequences of a failed Doha Round for Canadian agriculture. Although every member of the group contributed ideas that are reflected in this report, Mike Gifford, Alex McCalla and Karl Meilke assumed the responsibility for drafting the paper. The other participants in the workshop were: Karen Huff, University of Guelph; William Kerr, University of Saskatchewan; Kurt Klein, University of Lethbridge; James Rude, University of Alberta; and Robert Wolfe, Queens University. Funding for this project was provided by the Canadian Agricultural Trade Policy Research Network (CATPRN). The CATPRN is funded by Agriculture and Agri-Food Canada but the views expressed in this paper are those of the authors and should not be attributed to the funding agency.

## 1.0 INTRODUCTION

Many commentators assume that the WTO Doha Round negotiations have already failed and that this failure will not matter for Canadian agriculture. Neither view is correct. Most countries appear willing to make the effort needed to bring the negotiations to a make or break point in early 2008. If the Doha Round does eventually fail, an important opportunity to make the agricultural trading system significantly less distorted, more open and fair will have been lost.<sup>1</sup> For Canadian agriculture, the failure to move the Doha Development Agenda (DDA) forward has more serious consequences than just missing the chance to improve the rules governing agricultural trade; it could signal a return to increased protectionism, more managed trade, a return to competitive subsidization, and an escalation in the number of trade disputes.

It has been more than six years since the Doha Round was launched. During that period, the negotiations have staggered from crisis to crisis and yet, despite numerous missed deadlines, the main elements of a potential deal in agriculture have slowly emerged. While a number of participants and observers are still convinced that a deal is within reach, others are increasingly pessimistic that there is the necessary political will to conclude the negotiations in 2008. They believe that elections in the US and India will result in a lengthy suspension of the negotiations at best, or a complete breakdown at worst. Compounding the negotiating difficulties is the fact that the US Administration currently does not have Congressional "fast track" Trade Promotion Authority (TPA). This means that if a deal is struck in Geneva in the near future, the other participants run the risk of "double jeopardy"; that is, they could end up having to renegotiate the deal with Congress in order to obtain a Doha specific TPA which would oblige Congress to vote on a Doha implementing bill on an up-or-down basis, without amendments.<sup>2</sup>

Some pessimists go on to argue that the real question now is whether what has been tentatively agreed to, can be frozen until a new US Administration is capable of re-engaging and concluding the negotiations (probably in 2011 at the earliest). If the answer to this question is "no," then the Doha negotiations will have failed and the opportunity to continue and intensify the reform of world agricultural trade, which took its first halting steps in the Uruguay Round, will have slipped through our fingers.

If the Doha Round negotiations are not completed during 2008, a new US Administration will not be able to re-engage and conclude them any earlier than 2011.
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<sup>1</sup> Appendix I discusses why it has been so hard to successfully conclude the Doha Round.

<sup>2</sup> Some observers believe that a Democratic controlled Congress is less likely to block a Doha Round specific request than a request for broader negotiating authority, including bilateral trade deals.

Some question whether the WTO matters now that world agriculture is in the midst of a biofuel boom and the underlying market fundamentals for many commodities are strong. However, similar comments were made in the early 1970s. Experience suggests that in agriculture, it is wise to assume a production response to high prices and that price troughs will continue to follow price peaks. In addition, cost/price squeezes could become more severe in the future if energy and fertilizer costs continue to rise. To the extent that biofuel policies result in continuing strength in grain and oilseed prices, the livestock sector will be made more vulnerable to price downturns and hence more likely than in the past to seek government assistance. When prices weaken and costs continue to rise, governments will be under pressure to increase domestic support, and to find ways to provide additional import protection/export assistance. International commitments provide a shield to fend off such pressures and/or the incentive to provide support in less trade-distorting ways.

Some suggest that the benefits of multilateral trade liberalization have often been overestimated and the political and financial challenges of helping the "losers" to adjust underestimated. Even if these assessments are correct, is there also a tendency for the consequences of a Doha Round failure to be overstated? A "yes" answer could be based on the

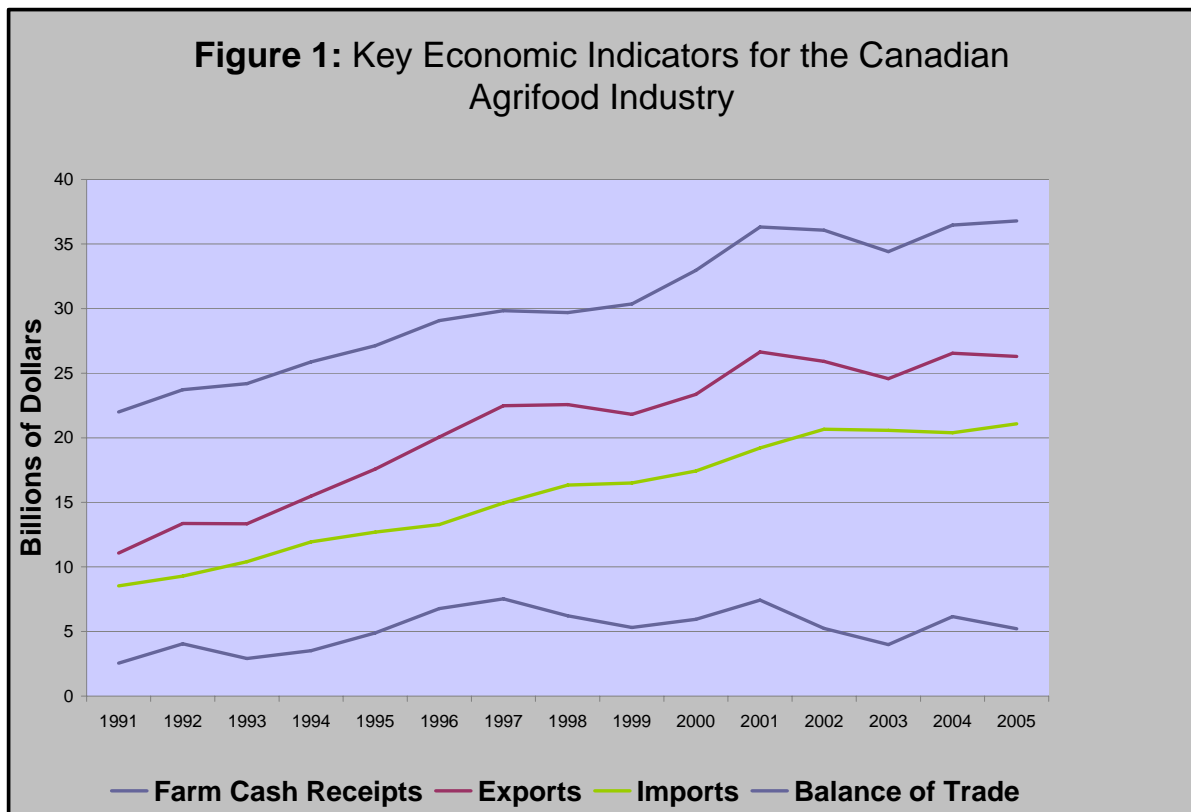
analysis of scenarios involving more trade liberalization than will actually materialize, and a "no" answer on scenarios that ignore services trade liberalization, the creation of new investment opportunities and the dynamic gains from trade. While overstatement is always a risk, it should be noted that a Doha Round failure would mark the first time a multilateral trade negotiation has failed to conclude and it would represent the worst set back for the multilateral trading system since the US Congress failed to ratify a proposed International Trade Organization in the late 1940s.

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Few nations are more trade dependent than Canada and multilateral agricultural trade reform is vitally important for the Canadian agrifood sector, given that its productive capacity far exceeds its relatively small domestic market. As Figure 1 illustrates there is a very close correlation between Canada's farm cash receipts and its export performance. In recent years, agrifood exports have averaged 70 to 75 percent of farm cash receipts and exceeded imports by around \$5 billion per year.

Experience has shown that preferential trade agreements such as NAFTA, while capable of very substantial market access improvements, are incapable of disciplining domestic support and export subsidies. For this to occur, all the major

subsidizers and beneficiaries need to be around the same table, which means a multilateral negotiation is necessary to achieve this rather than a bilateral or regional agreement.



As a major agricultural exporter and importer (table 1), Canada has a vested interest in the WTO continuing to strengthen its trade rules and disciplines, by providing a forum to further reduce or eliminate trade distorting support and protection. Successive rounds of GATT negotiations failed to deal with agriculture in any meaningful way until the trade situation became so corrosive that countries decided in the Uruguay Round that a start had to be made in bringing agricultural trade under the rule of law. While the Uruguay Round was successful in eliminating country-specific exceptions, reducing export subsidies, converting non-tariff barriers into bound tariffs, and laying the foundation to significantly reduce trade-distorting domestic support in future negotiations; it did not make much progress in improving market access. In fact, world agricultural tariffs still average over 60 percent, as compared to less than 30 percent for non-agricultural tariffs (less than five percent in developed countries).

<b>Table 1: Canada's Imports and Exports of Goods, by Product, 2006</b>					
Product	Exports		Imports		Balance of Trade
	billions of \$	percent	billions of \$	percent	billions of \$
Agrifood Products	27.9	6.1	22.4	5.5	5.5
Energy Products	86.8	19.0	34.6	8.6	52.2
Forestry Products	33.3	7.3	3.1	0.8	30.2
Industrial Goods & Materials	94.0	20.6	84.0	20.8	10.0
Machinery & Equipment	94.7	20.8	114.6	28.3	-20.0
Automotive Products	82.5	18.1	79.8	19.7	2.8
Other Consumer Goods	18.0	3.9	52.0	12.9	-34.1
Other Goods	18.6	4.1	13.8	3.5	4.8
Total	455.7	100.0	404.4	100.0	51.3

In order to explore the consequences for Canadian agriculture of a worst case scenario, this paper assumes that the Doha Round negotiations will fail to conclude in 2008 and that no resumption of substantive negotiations will be scheduled. We begin by examining the implications for the global agricultural trading system of failure. Following this, we discuss the general consequences of failure for the Canadian agrifood sector and then examine the implications for export oriented and import sensitive industries. We then outline the potential benefits of a positive Doha Round result and contrast this with the options Canada will face with a breakdown of the multilateral negotiations.

## 2.0 DOES A DOHA ROUND FAILURE REALLY MATTER?

There are two main scenarios for the international trading system following a Doha failure and no planned resumption of negotiations. The first scenario is that a progressive deterioration in the trading system will be so intolerable; it will stimulate countries to start a new round of multilateral trade negotiations within the next three to four years. The second scenario is a death spiral wherein the multilateral trading system begins to unravel and world trade becomes increasingly governed by a growing number of competing preferential trading blocs. The longer the delay in resuming the multilateral trade negotiations, the greater will be the risk of a complete breakdown of the entire system. Some observers believe that before the multilateral trading system implodes, countries will recognize the dangers and return to the multilateral table, probably with a broader agenda than under the Doha Round. Others are not so sanguine.

If implosion of the multilateral trading system is not permitted, then the two scenarios merge into one with the main difference being the amount of time it takes for countries to recognize that the trading system cannot be allowed to regress indefinitely. However, if the more pessimistic observers are correct and the multilateral trading system slowly disintegrates, Canadian agriculture will become more than ever dependent on NAFTA and vulnerable to preferential access competition in an increasing number of offshore markets.<sup>3</sup> As the multilateral system erodes, increased uncertainty would negatively impact investment in and the growth of the Canadian agrifood economy.

For developed and developing country agricultural exporters, a Doha Round result on agriculture along the lines proposed in the Chair's modalities paper would represent incremental but worthwhile progress towards the goal of a more open and less distorted multilateral trading system. It would quicken, reinforce, and

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strengthen a number of trends which are already determining the future of global agriculture. For example, demand for food in most developed countries is saturated. Consumers are demanding more and more value added in terms of convenience but the physical quantity of food consumed is not increasing and in fact, could decline with the impact of low birth rates and an aging population. In contrast, the demand for food will increase substantially in developing countries, particularly those with large numbers of young, increasingly affluent consumers, who as incomes increase, are upgrading their diets to include more protein, fresh fruits and vegetables, and high-value prepared foods.

Some argue that growing import demand in developing countries will continue to drive international markets, irrespective of a Doha Round result. This is true, but the question for exporters such as Canada, is whether it makes sense to make the investments necessary to gear up to service export markets where the applied tariff is well below the bound rate and can be unilaterally increased overnight. Moreover, it must be remembered that agricultural imports in developing countries will depend on their economic growth and for many this will be export led, sometimes in manufacturing, sometimes in agriculture, and sometimes in both. The lack of a Doha Round result will lower the rate of economic growth in many emerging markets, and this in turn will lead to lower agricultural import demand.

While there are a number of examples of unilateral reforms of domestic agricultural policies, there is no doubt that new international rights and obligations

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<sup>3</sup> Preferential access competition involves other countries having access to foreign markets at lower tariffs than Canada.

will help facilitate policy reform and lock in past unilateral reforms which might otherwise erode in the face of a market downturn. For example, in Canada, the Uruguay Round disciplines on export subsidies helped reinforce the arguments of those pressing for the elimination of grain transportation subsidies. A Doha Round result would provide similar opportunities for policy-makers around the world.

Although we find the arguments for completing the Doha Round compelling, there is no guarantee that sensible heads will ultimately prevail in preventing the multilateral system from unraveling. If it does unravel, what would be the main consequences of a Doha Round failure for Canadian agriculture? The likely responses are discussed in detail in the next section but briefly they would entail: 1) increased trade diversion arising from a further proliferation of PTAs; 2) an overburdened dispute settlement system; 3) more pressure to use sanitary and phytosanitary measures and other technical regulations as disguised barriers to trade; and 4) reduced pressure for domestic policy reform.

### **3.0 CONSEQUENCES FOR THE CANADIAN AGRIFOOD SECTOR**

Canada's next generation of domestic agricultural policies is currently under federal/provincial consideration. Any review will need to consider how the external environment is likely to change over the next decade and to what extent the environment will differ if the Doha Round succeeds or fails. In this section, we consider four adverse trends that could gain momentum in the absence of a successful Doha Round.

#### **More Preferential Trade Agreements**

The number of preferential trading agreements has increased significantly since the turn of the century and this trend will likely continue regardless of whether the Doha Round succeeds or fails. The proliferation of PTAs can be attributed to a variety of economic and geopolitical factors (e.g., the breakup of the former Soviet Union). Earlier in the Doha Round, some countries (most notably the US) used the negotiation of PTAs as a "stick" to encourage the conclusion of an ambitious multilateral result. More recently, the perception that the Doha Round negotiations are in serious difficulty and could ultimately fail has led other countries to regard PTAs more favourably. Whether for offensive or defensive reasons, as a "Plan A" priority, or "Plan B" fallback; one can expect there will be greater pressure on governments to pursue PTA negotiations following a failure of the Doha Round.



A substantial Doha Round result on tariffs would reduce the preference margins of existing or new PTAs and moderate to some extent the pressure for regional accords. A Doha Round

failure leaves Canada more vulnerable to being placed at a competitive disadvantage, as other agricultural exporters seek to improve market access opportunities through negotiation of

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bilateral or plurilateral free trade agreements. Currently, Australia is negotiating with China, the US already has trade agreements in North Africa (Morocco), MERCOSUR (Brazil, Argentina, Uruguay, and Paraguay) will resume PTA negotiations with the EU, and the EU will continue to negotiate reciprocal trade agreements with the former colonies of its member states and to expand membership of its customs union.

Even though agriculture will contain a number of exceptions from tariff elimination in most PTAs, the bottom line is that for specific commodities, Canada's competitors will have preferential access, whether this means Australian grains and meat into China, grains, oilseed products, and meat from MERCOSUR into the EU, or processed food exports from the EU into India.

**Table 2: Major Destinations and Sources of Canadian Trade, 2006**

Country or Region	% of total merchandise trade		% of total agrifood trade	
	Exports	Imports	Exports	Imports
United States	81.6	54.9	58.2	58.3
European Union-25	6.6	12.4	6.5	13.9
Japan	2.1	3.9	8.5	0.2
China	1.7	8.7	2.4	1.9
Mexico	1.0	4.0	3.9	3.8
Korea	0.7	1.5	1.6	0.1
Total for six countries	93.7	85.4	81.1	78.2
Other	6.3	14.6	18.9	21.8
Total	100.0	100.0	100.0	100.0

Canada's natural resource industries, including agriculture, are particularly vulnerable to being put at a competitive disadvantage in a world of proliferating PTAs. This is because non-NAFTA markets account for a much larger share of total exports for the natural resource sectors than for the other sectors of the Canadian economy (table 2).

Non-NAFTA markets have the growth potential to reduce Canada's vulnerability of being so reliant on a single export market, namely, the US. The US takes over 80 percent of Canada's total merchandise exports and even in agriculture the US market represents nearly 60 percent of total Canadian exports (table 2). Capitalizing on offshore market growth potential offers considerable market diversification benefits which will be eroded if PTAs favour competitors at Canada's expense.

Canada has already indicated that it intends to pursue PTAs in Latin America, with CARICOM, and with Korea in order to compete more effectively in markets where the US already has or hopes to have preferential access. However, with the exception of Korea, these are relatively small markets compared to the EU, China, or India. While the US may be unable to pursue new PTAs for some time because of a lack of fast track negotiating authority (which a Democratic Congress is less likely to provide, at least for PTAs), there is nothing constraining the EU, MERCOSUR, or other exporters from pursuing PTAs.

While Canada can try and match the PTA activities of others, it takes two to tango and there is no guarantee that the Canadian market will be viewed as sufficiently attractive to capture the interests of the larger, prospective PTA partners, who can pick and choose among a number of potential suitors and must prioritize where to use their negotiating capital. Unfortunately, Canada is big enough to cause import competition concerns in other countries when it comes to agriculture and other natural resource sectors, but may not be regarded as a particularly high priority export market from the perspective of many of its larger non-NAFTA trading partners.

There is no guarantee that the Canadian market will be viewed as sufficiently attractive to capture the interests of any larger, prospective PTA partners.

Thus, from a Canadian perspective, it would be better to be part of a large, plurilateral initiative, such as an Asia Pacific PTA than to try to compete by negotiating a series of bilateral PTAs which import sensitive sectors have a greater chance of blocking. Like a multilateral agreement, but obviously to a lesser extent, a very large plurilateral PTA would tend to reduce the risk of trade diversion for Canada.

One of the major attributes of a multilateral negotiation for medium and small countries is that it enables them to take advantage of the negotiating leverage of much larger players such as the US and the EU. Thus, in agriculture, Canada benefits from the priority the US, the G-20, and the Cairns Group attach to expanding market access. In the case of domestic support, Canada benefits from the priority the EU and the G-20 attach to reducing US trade-distorting domestic support to the maximum extent possible. Similarly, multilateral negotiations provide the opportunity to become part of various negotiating groups, such as the

G-20 and the Cairns Group, which also helps to maximize a smaller country's negotiating leverage.

Outside of a multilateral or a very large plurilateral negotiation, Canada will have few opportunities to avail itself of this "coattail" effect when dealing with prospective preferential

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trading partners who have similar or larger negotiating leverage. As a consequence, it can be expected that most of Canada's prospective preferential trading partners will continue to be smaller rather than larger markets.

### **More Litigation in Agrifood Trade**

If the Doha Round fails, the multilateral agricultural trading system will continue to operate under the existing rules and disciplines of the WTO, and in particular, the Uruguay Round Agreement on Agriculture. One of the major accomplishments of the Uruguay Round was the establishment of a much improved dispute settlement system. Under the GATT, panels were prevented from being established or the results were blocked from being adopted because of the requirement for consensus on every decision. Under the WTO, countries have a right to a panel and the defending country cannot block the adoption of a dispute settlement finding.

If the Doha Round fails, countries can be expected to try and get through litigation, what they could not get through negotiation. Increased recourse to WTO litigation runs the risk that at some point the dispute settlement system may begin to buckle under the pressure as governments become tired of losing panel cases and become more willing to ignore negative panel findings.

Unfortunately, while the existing WTO dispute settlement system provides for authorized retaliation if a country refuses to bring its measures into conformity with a Panel/Appellate Body finding, it is impossible for a smaller country to retaliate without hurting either industries dependent on imported inputs or consumers. Thus, smaller countries would much prefer the implementation of dispute settlement findings.

In short, it is asking too much to expect the existing dispute settlement system to indefinitely shoulder the burden of failed negotiations. Moreover, pressure on governments to use trade remedies (anti-dumping and countervailing duties and emergency import safeguards) will increase as protectionist pressures are encouraged by the vacuum in the multilateral negotiations. Agriculture is particularly vulnerable to the use of constructed costs of production to determine "normal value" in dumping cases, because it is generally a price taker and often

does not cover the full costs of production, including normal profit, when market prices fall as a result of cyclical or weather related events. While the Doha Round is not expected to result in major changes in anti-dumping rules, largely because of the strong opposition of US steel, textile, and clothing interests, some improved disciplines to prevent abuse are expected, since many WTO members attach importance to reform in this area.

A Doha Round failure will encourage exporting countries to make every effort to protect their existing export market access. Thus, for example, a Canadian decision to change the compositional standards for cheese in order to minimize the use of imported, non-traditional dairy ingredients could result in a WTO tariff nullification and impairment challenge under Article II of the GATT and/or under the Technical Barriers to Trade (TBT) Agreement. This would particularly be the case if foreign access to Canada's milk protein market is also curtailed as a result of an Article XXVIII renegotiation.

Experience has demonstrated that Canadian agriculture is particularly vulnerable to US trade remedy actions, especially anti-dumping and countervailing duties. In an environment of increasing trade tensions following a failure of the Doha Round, there would be an increased risk of such actions.

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### **More Abuse of Sanitary and Phytosanitary Measures and Technical Trade Barriers**

A failure of the Doha Round might encourage and reinforce a variety of protectionist pressures, particularly in the area of technical regulations. One of the major accomplishments of the Uruguay Round was the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS) which encouraged governments to base their SPS regulations on science and discouraged their use as disguised barriers to trade. With the major exception of the EU meat hormone case (which reflected a political reaction to consumer perceptions, as well as protectionist pressures), the WTO dispute settlement system has been very successful in policing and enhancing the credibility of the SPS Agreement.

The SPS Agreement is not under negotiation in the Doha Round and by and large, it has provided administrators with an effective shield against pressures to use SPS measures for protectionist rather than legitimate science-based reasons. However, to the extent the overall credibility of the WTO will be undermined by a failure of the Doha Round, there will be an increased risk that

the SPS Agreement's shield will be unable to deflect as many protectionist pressures as it was able to do in the past.

To the extent that a Doha Round failure will erode the credibility of the SPS and TBT Agreements, Canadian agricultural exports will be adversely affected such as, beef and seed potatoes which have a history of SPS problems and are vulnerable to a return to arbitrary "better safe than sorry" SPS decisions as opposed to those based on science and risk assessments.

Canada has benefited from the SPS Agreement immeasurably, particularly in the way it has influenced the US response to the Bovine Spongiform Encephalopathy (BSE or "mad cow") cases in Canada. So far, despite intense pressure to close the cattle and beef border for as long as possible and for as many products as possible, the US has insisted on making decisions on import entry on a scientific basis. A Doha Round failure will run the risk of tipping the scales back in favour of those who want to use technical regulations for protectionist reasons.

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### **More Domestic Policy Reform Challenges**

While many in Europe claim that reform of the Common Agricultural Policy (CAP) is irreversible, others argue that a failure of Doha would have a negative effect on efforts to continue to reform the dairy sector which has so far only been lightly touched. Certainly, if there are no commitments to phase-out export subsidies, the EU Commission will be under pressure to continue to use their WTO export subsidy entitlements in depressed market conditions (as witnessed by the recent reintroduction of EU export subsidies on pork) or to compensate processors for inadequate domestic reforms. That said, many observers argue that the EU is less likely to backslide than the countries of North America which have not undertaken anywhere near the same degree of reform (although arguably starting from a much lower base than Europe and involving fewer commodity sectors).

The reality is that governments in North America are not facing the same degree of budgetary pressures as in the European Union, which must recognize that the CAP of the 1960s with just six member states is simply not sustainable in the current EU of 27 members and growing. However, in the EU, the politics of agriculture are somewhat easier to manage as compared to North America,

because an individual member state negatively affected by reform can blame the majority in the EU and/or the unelected European Commission for its inability to respond to domestic pressures to retain the policy *status quo*. In North America, there is no supra-national body to blame and therefore elected politicians in each country are more exposed to the political backlash arising from farm policy reform, particularly where it involves threats to asset values created by the existing programs. Thus, unilateral reform is arguably more difficult in North America and helps to explain why reform of commodity price support policies is more dependent on external pressure than it is in the EU.

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Canada's ability to unilaterally reform domestic agricultural policies is probably more constrained than in the US because agriculture is a shared responsibility under the Constitution and, unlike most other federal states, Canadian provinces have a long history of operating their own price and income support policies. In order to minimize the potential for policy conflict and incoherence, the federal and provincial governments have developed a number of jointly funded national agricultural income support programs. While these income support programs have undergone a number of changes over the years (e.g., the switch to whole farm rather than commodity specific programs), there have been comparatively fewer changes made to the national supply management systems which have been in place since the 1960s for dairy and the 1970s for poultry and eggs – systems which in addition to federal import protection, rely heavily on the delegation of federal and provincial powers to provincial and/or national marketing boards (e.g., taxation, production quotas, and inter-provincial trade controls). Although the Uruguay Round resulted in the conversion of quantitative import restrictions into two-stage tariffs (tariff rate quotas), the resulting over-quota tariffs were high enough to permit the value of production quotas to nearly quadruple since the end of the Uruguay Round to \$26.2 billion in 2006 (Statistics Canada).

To date there has been only sporadic and limited internal pressure (mainly from processors and institutional users) to adapt supply management to an international agricultural trading system which is becoming progressively more open. Most other stakeholders have been either ambivalent or strongly opposed to any changes to an income support system which does not rely on taxpayer support (although in recent years there have been efforts by some provincial marketing boards to limit the escalation in production quota values).

Given the politics of Canadian agriculture, it is no accident that the greatest reforms of Canada's agricultural policies during the post-WWII period – the development of "whole farm" income support (as opposed to commodity-specific

price support) and the elimination of grain transportation subsidies – were both precipitated by external pressures. In the case of using income support rather than price support for most commodities, the pressure came from US countervailing duty action in the late 1980s against commodity price supports (in particular, for live hogs and pork). In the case of the transportation subsidies, the need to implement the Uruguay Round export subsidy commitments helped break the long-standing impasse between the defenders of the *status quo* and those who believed the subsidies were discouraging livestock and other value-added production in Western Canada.

The main consequences of a Doha Round failure for Canadian agricultural policy-makers would be a substantial reduction in external pressures to adapt Canada's existing agricultural policies so they would be sustainable in a more open and less distorted trading environment. If one accepts that a Doha Round failure would precipitate protectionist pressures which eventually would drive countries to resume multilateral negotiations, and that the long-term trend of the international trading system will be a continued reduction of trade barriers, then it would be dangerous for Canadian agricultural policy-makers to assume otherwise when considering domestic policy changes in either a medium or longer-term context.

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There is no doubt that only a substantial multilateral trade agreement would provide the necessary pressure to force change on the 20 percent of Canadian agriculture based on supply management.<sup>4</sup> Of course a one-quarter reduction in 200-300 percent over-quota tariffs would not mean the end of supply management, nor would a doubling or tripling of the quantity of imports allowed in at low tariffs.<sup>5</sup>

For the 80 percent of Canadian agriculture based on international market prices, a failed Doha Round would reduce the pressures to change federal and provincial policies which are categorized as trade-distorting (i.e., non-green). Because of the large gap between Canada's actual non-green support levels and its Uruguay Round commitments, there was, for a number of years, little pressure on policy-makers to design domestic support policies to exactly meet the WTO

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<sup>4</sup> Although supply managed commodities account for about 20 percent of farm cash receipts, they account for only ten percent of farm operators. In 2006, Canada had 327,055 farm operators, 25,770 engaged in dairy production and 6,770 in poultry and egg production.

<sup>5</sup> Appendix II contains a detailed analysis of why a modified supply management system could co-exist with the prospective Doha Round results.

definitions of a green program. However, in more recent years, mainly as a result of weak grain and oilseed markets and the effects of BSE, Canada's non-green support levels have increased significantly and a 60 percent reduction as envisaged in the Doha Round would force federal and provincial governments to more explicitly tailor the design of their policies to meet the green criteria.

Canadian policy-makers are frequently under political pressure to compensate producers for distortions caused by other countries' domestic agricultural policies. In recent years, the focus has been on the support policies of the US, which are, on average, lower than that of Canada but are concentrated in fewer sectors, particularly grains and oilseeds. The absence of a Doha Round result would certainly encourage Canadian grain and oilseed producers to continue to press for financial "compensation" for higher US support programs (and has already been obtained in some provinces). Conversely, a Doha Round result which reduced the US aggregate measurement of support from US\$19.1 billion to US\$7.6 billion and put a ceiling of around US\$13 billion on all forms of trade distorting support, would have the effect of constraining US non-green support in future market downturns.

A positive Doha Round conclusion would at a minimum result in the phase out of federal financial guarantees to the Canadian Wheat Board (CWB) in line with the phase out of export subsidies. It is still not clear whether a Doha Round result would also include the phase out of the export monopoly powers of developed country export state trading enterprises. Certainly, the pressure to do this would increase in line with the size of the overall agricultural package and the US (with the support of the EU) can be expected to press hard on this issue. However, even without a Doha Round result the future of the export monopoly powers of the CWB is problematic given the current government's promise to provide "marketing choice" for Canada's wheat and barley producers.

In sections 4.0 and 5.0, we turn to issues of particular importance to Canada's agrifood exporters and Canada's supply managed industries.

#### **4.0 CANADIAN EXPORT INTERESTS**

It is often argued that import sensitive sectors are more effective in lobbying against trade liberalization than export interests are in identifying the benefits of liberalization because the gains are diffuse and the losses are concentrated and visible. However, in the case of Canadian agriculture, the losses to agricultural exporters of a failed Doha Round are more concrete and visible than for most of the economy. In broad terms the consequences for Canadian exporters include: 1) the loss of improved market access opportunities; 2) a missed opportunity to substantially reduce trade distorting support and eliminate or discipline export



assistance; and 3) retrogression and increased strain on the international trading system. These issues are discussed in more detail below.

### **Loss of Improved Market Access Opportunities**

In terms of market access, failure of the Doha Round might result in slower growth in import demand, particularly in export-led (agricultural and non-agricultural) developing country economies which would have implications for Canadian agrifood producers. Such a failure would also mean that the proposed reductions in bound agricultural tariffs of around 50 percent for developed markets and 33 percent in the more advanced developing country markets would not take place. Also, there would be no doubling or tripling of tariff rate quota volumes subject to (reduced) lower tariffs, mainly in developed country import markets (e.g., pork and malt in the EU). There would be a loss of the positive result in trade facilitation negotiations which would have reduced red tape and transaction costs associated with imports. There would also be no new disciplines on trade remedies, particularly anti-dumping duties, which are being increasingly used by developing as well as developed country importers to protect their domestic markets. Failure would also imply no reductions in the gap between applied and bound tariffs with the risk that applied tariffs could be unilaterally increased.

The failure of the Doha Round would mean forgoing a major opportunity to further diversify Canada's

agricultural export profile in terms of commodities and markets. The majority of Canada's bulk commodity exports go to non-NAFTA markets. A significant reduction in tariffs on further processed products in these markets would tend to encourage the export of more value-added products. Export expansion to non-NAFTA markets would also tend to reduce Canada's heavy export dependence on the US.

Failure of the Doha Round would mean forgoing the opportunity to diversify Canada's agricultural export profile. Significant reductions in tariffs on processed products would encourage exports of more value-added goods and expanding exports to other markets would reduce Canada's heavy export dependence on the US market.

The reason why Canada's export performance in the US (and Mexico) has been so strong and diversified has been the duty free access we enjoy for almost all of our exports. The dramatic increase in Canada's exports of processed potatoes to the US is a classic example of how improved access can result in increased investment and production of a value-added product for export. The reason why Canada's performance in most offshore markets has been weak, in comparison, is the continued existence of high tariffs and tariff escalation. It is not luck that Canada's best non-NAFTA export performance is in China – a country whose

agricultural tariffs were significantly reduced as a result of its accession to the WTO.

### **A Missed Opportunity to Substantially Reduce Trade Distorting Support and Eliminate or Discipline Export Assistance**

Failure of the Doha Round will mean continued access to Uruguay Round export subsidy entitlements by Canada's competitors, particularly the EU. Also, there will be no new disciplines on food aid and export credit programs, particularly those of the US; no new reduction commitments on total trade distorting domestic support, particularly, the US and EU; and no commodity-specific caps on non-green support, particularly for US grains and oilseeds. No Doha Round deal means that there will be no international pressure to reform domestic agricultural policies in developed and developing country markets which would encourage a shift to more trade friendly policies. There will be no new disciplines on domestic support and other notification requirements (e.g., preferential trade agreements) to increase transparency.

The recent versions of the 2008 US Farm Bill passed by the House and Senate indicate that in the absence of any new multilateral commitment, the US Congress will enact new farm legislation that differs little from the retrogressive 2002 US Farm Bill. The only saving grace will be that Congressional leaders have made it clear that US legislation will be amended as necessary to bring it into conformity if there is a Doha Round result.

### **Retrogression and Increased Strain on the International Trading System**

If the Doha Round fails, Canadian agrifood exporters will also see no reduction in international price volatility and no upward price pressure as a result of the combined effects of: 1) elimination of export subsidies, disciplines on food aid and export credits; 2) reduction in trade-distorting domestic support; and 3) a substantial increase in market access opportunities, the largest improvements coming in the most distorted markets, (e.g., dairy). There will be increased pressure on our competitors to negotiate preferential trade agreements increasing the risk of trade diversion and a general loss of credibility for the multilateral trading system. A failure of the Round would also result in increased recourse to and pressure on the WTO dispute settlement system and increased pressure for countries to abuse SPS measures and other technical regulations to keep imports out.

There will be a general increase in risk and uncertainty in the Canadian agricultural business environment with consequent adverse implications for investment. Agrifood producers will experience smaller productivity gains as a result of continued inability to service new market access opportunities abroad

(and to meet increased import pressures at home). Increased trade distortions and uncertainty in the multilateral trading system will discourage investment and growth and inhibit productivity gains. Canada's experience following the Canada/US FTA illustrates how new access opportunities and/or import pressure can transform sectors. Canadian examples

Canadian experience following the Canada/US FTA illustrates how new access opportunities and/or import pressure can transform sectors. Think of the subsequent massive growth of the greenhouse industry, major investments in world class beef packing plants, and renewal of the grape and wine industry.

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## **5.0 CANADA'S IMPORT SENSITIVE SECTORS**

The main consequences of a Doha Round failure for Canada's import sensitive sectors, primarily the supply managed industries, would be to further delay the necessity for these industries to adjust to global pressures for more open markets and to rely less on price support policies. In the short-term, a Doha Round failure would have limited impacts on the supply managed sectors. The main down side would be lower international prices (particularly for dairy) than those that would prevail with a Doha Round result. In the medium- to longer-term, the adverse consequences would be considerably greater to the extent that the supply managed industries' international competitiveness would continue to progressively deteriorate. Further delays will increase the cost of adjustment, which will be inevitable at some point, and will increase the competitiveness gap between Canadian and foreign producers. In particular, the tendency for the benefits of the system to be capitalized into the value of unproductive production quotas will continue to increase Canada's costs of production and will exert pressure to further increase import protection. This pressure already has been manifested in the recent proposals to extend tariff rate quota protection to certain milk protein concentrates and to change the federal compositional standards for cheese, limiting the use of imported non-traditional dairy ingredients in cheese making.

In short, while older producers, who are close to retirement, may breathe a sigh of relief that a Doha Round failure would eliminate, at least for the time being, the threat of an imminent reduction in domestic market share and perhaps quota values, younger producers will continue to face uncertainty. Given payback times

on loans for quota acquisition that are now around eight to ten years, younger producers will have to take into account that changes after 2008 in international trade commitments still could materialize in the near term, either in the form of a delayed Doha Round result or as a result of a future WTO round.

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## **6.0 WHAT IS LOST WITH A DOHA ROUND FAILURE IN AGRICULTURE?**

One consequence of a failed Doha Round would be the loss of the benefits of the deal on the table after six years of negotiation. The Chair's draft modalities paper of February 2008 provided a good indication of what a final deal would contain. Most of the outstanding problems hinge on the "flexibilities" to be permitted in market access in order help both developed and developing countries manage the more politically sensitive sectors. Although some key numbers are still not agreed, it would appear that, if a deal is to be struck, it would contain the following elements: 1) elimination of export subsidies; 2) a substantial reduction in trade-distorting domestic support; and 3) significantly increased market access. Each of these is discussed in more detail below.

### **Export Competition**

The potential Doha Round deal, as detailed in the Chair's paper, would include elimination of developed country export subsidies by the end of 2013 and those of developing countries by 2016. New disciplines on food aid, export credits, and exporting state trading enterprises would be expected also.

### **Domestic Support**

A Doha Round deal would include tiered formulas to reduce overall trade-distorting domestic support in the EU by about 80 percent, in the US by about 70 percent, and in most other developed countries by about 60 percent. Countries would still have the right to provide unlimited amounts of "green," non-trade-distorting support but there would be some modest tightening of the green criteria. There would also be some constraints on support for individual commodities to reduce commodity concentration concerns.

The big remaining question on domestic support is the precise level to which US total trade-distorting support will be reduced. For its part, the US has made it clear that how far it will reduce its trade-distorting support commitment will depend on the ambition of the market access result – the bigger the market access package, the deeper the US domestic support reductions.

## **Market Access**

Under the proposed Doha Round deal, a tiered formula would be the main approach for cutting tariffs. Tariffs under 20 percent would be cut by about 50 percent, tariffs between 20 and 50 percent would be cut by about 60 percent, tariffs between 50 and 75 percent would be cut by about 65 percent, and tariffs above 75 percent would be cut by about 70 percent.

There is no question that the market access file is the most difficult politically for most countries and thus smaller tariff reductions will be applicable for more sensitive commodities. This flexibility would be available to both developed and developing countries. In return for being allowed a smaller tariff cut, developed countries would have to allow at least some imports at a lower tariff (via a tariff rate quota which will expand if a tariff rate quota already exists). The draft modalities suggest that sensitive products would be permitted deviations of up to two-thirds of the otherwise applicable tariff formula reduction. If the maximum deviation of two-thirds was applied to an existing over-quota tariff, the (additional) amount entering under the lower in-quota tariff would have to be equivalent to about five percent of consumption.

In the case of the highest over-quota tariffs (those over 75 percent), a sensitive product would only be subject to a tariff reduction of about 24 percent, instead of a full tariff formula cut of 70 percent. The balancing obligation for being able to apply the minimum tariff reduction on the high over-quota tariff would be an increase in the quantity entering at the low in-quota tariff.

The maximum number of tariff lines which would be designated as "sensitive" is expected to be around five percent, but countries may be able to designate a higher number if they are prepared to "pay" by providing additional low in-quota access. For example, instead of having to increase low in-quota access by an amount equivalent to about five percent of domestic consumption, the increase might be to six percent of consumption if the number of sensitive tariff lines were increased to perhaps seven to eight percent of the total number of tariff lines.

Sensitive product designation will be available to all countries but only developing countries will be entitled to designate certain products as "special." This flexibility is for food and livelihood security and rural development concerns in developing countries. The tariff cuts and maximum number of tariff lines eligible for special treatment have yet to be determined but the tariff cuts will be even smaller than those applicable to sensitive products.

In order to encourage deeper formula tariff cuts there will likely be provision for some form of a special agricultural safeguard (at least for developing countries) which will permit tariffs to quickly snap-back to at least their pre-Doha Round levels if certain price or volume levels are triggered.

The key question which remains in the market access negotiations is the extent to which the tariff reductions inherent in the tiered formula are eroded by the various flexibilities provided by the sensitive products, special products and special safeguard provisions. As analysts at the World Bank have noted (Anderson and Martin), the trade and welfare improvements expected from a given tariff reduction formula are very sensitive to the number of exceptions. Hence the need for offsetting the smaller tariff cuts for sensitive products with additional tariff quota expansion. If the final average cut for all agricultural tariffs in developed countries is in the order of 50 percent (with a minimum tariff reduction of 24 percent), this will compare very favorably with the 36 percent average reduction of the Uruguay Round (with a minimum tariff reduction of 15 percent).

While some observers insist that a result along these lines only represents a "modest" agricultural result (presumably modest in relation to free trade but who realistically expected free trade?), others would argue strongly that, given the political sensitivities involved, the overall results represent substantial progress in agricultural trade reform – a reform which only really started with the Uruguay Round. Certainly, an agreement to finally eliminate export subsidies and discipline other forms of export assistance would be major accomplishments.

Given the political sensitivities involved, the overall results of a successful Doha Round would represent substantial progress in agricultural trade. Certainly, an agreement to finally eliminate export subsidies and discipline other forms of export assistance would be major accomplishments.

Similarly, reductions in trade distorting domestic support of 60-80 percent in developed countries will provide a solid base on which to aim for their complete elimination in the next round and would force domestic policy reforms in a number of countries as a consequence of implementing such Doha Round results.

Although it is true that the market access negotiations would still permit very high over-quota tariffs for some sensitive products, there would have to be substantial improvements in the volumes permitted to enter at relatively low tariffs. Moreover, while the reduction commitments for market access and domestic support for many developing countries are only two-thirds of that of developed countries (the least developed developing countries would not be asked for reductions), important policy disciplines would be placed on the agricultural policy options of the emerging economies which are the main export growth markets of the future.

In other words, such a deal represents a mixed result, but a result which nevertheless means significant and worthwhile progress in the continuum of agricultural trade liberalization.

## 7.0 OPTIONS FOR CANADA

If the Doha Round negotiations break down completely or are effectively placed in the deep freeze for several years, what trade policy options are available to Canada and which should be followed? Several, not mutually exclusive options, are reviewed below.

### **Reliance on the Domestic Market, the Existing NAFTA Market, and a Limited Number of Other Preferential Markets**

This option reflects the trade policy *status quo* plus the completion of planned preferential agreements with Korea, CARICOM, and several Latin American countries. It is a cautious, reactive trade policy, one which responds to the initiatives of others and assumes Canada's existing duty free access to the US will continue to be the main trade policy imperative for all sectors of the Canadian economy. Under this scenario, agriculture and other natural resource sectors will be told that Canada will continue to support the multilateral trading system, but the resumption of the Doha Round or the start of a completely new WTO round will be something we cannot influence in any meaningful way, so Canada will be able to do nothing but wait and see.

This largely *status quo* scenario would please the supply managed industries but would certainly not please the rest of the Canadian agrifood sector, which is aware that that such a scenario would: 1) negatively affect the sector's offshore growth opportunities; 2) place it increasingly at a competitive disadvantage vis à vis those competitors who are pursuing more aggressive preferential trade agreement policies; and 3) generally retard the growth and competitiveness of any export oriented sectors. At the same time, this scenario would continue to allow the international competitiveness of the supply managed sectors to deteriorate, particularly regarding the cost implications of a continued increase in production quota values.

Maintaining the <i>status quo</i> might please the supply managed industries, but the rest of the Canadian agrifood sector will experience impaired growth and competitiveness in international markets.
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## **Concentrate on Deepening and Broadening the NAFTA**

While this is a longstanding goal of much of the Canadian business community, the unfortunate reality is that there appears to be little current or prospective support in the US for expanding and deepening NAFTA, particularly as it applies to the US/ Mexico trading relationship. Nevertheless, the US may be interested in a very narrow negotiation which is limited, *inter alia*, to completing the agricultural chapter of NAFTA which continues to contain a limited number of exceptions to duty free trade. At the time of the Canada/US Free Trade Agreement negotiations, the US first insisted on these exceptions, but by the time of the NAFTA negotiations, the US pressed for comprehensive free trade in agriculture (which it agreed to do with Mexico and which will be fully implemented in 2008). In contrast, Canada insisted on continuing to retain tariff rate quotas for supply managed products.

Presumably, under this scenario, Canada would claim that if it (and the US and Mexico) agreed to phase out the remaining agricultural tariffs on intra-NAFTA trade, this would not be a self-balancing package and Canada would require offsetting compensation in other areas. While it is beyond the scope of this paper to delve too deeply into possible trade-off scenarios, it is clear there would be massive opposition from the supply managed sectors (and a number of provinces) to a phase out of over-quota tariffs which would inevitably mean a phase out of supply management and a complete loss of production quota values. In contrast, while the US dairy and poultry industries would strongly support the progressive elimination of all remaining NAFTA agricultural tariffs, the US sugar lobby would not be so supportive. In the absence of tariffs, there would be a massive shift of production of sugar containing products to Canada which has a sugar policy based on world prices.

While the rest of agriculture might welcome this development to the extent that it would permit Canada to pursue a much more aggressive trade liberalization agenda internationally, the reality would be that the political debate would center on the fact that such an option means the end of supply management. While economists might argue that the welfare gains for the rest of the economy would outweigh the costs to the limited number of current holders of production quotas and that it would be possible to cushion the loss of the supply management system by a lengthy transition period and appropriate adjustment programs, the politics of this scenario are daunting for any Canadian political party, given the concentration of dairy and poultry production in Quebec and Ontario and the effective political influence of the industry throughout Canada.

A more limited but more plausible scenario would be for Canada to concentrate on limiting any "thickening" of the border as a result of US security concerns while intensifying the development of more harmonized technical regulations within NAFTA (e.g., pesticide registration, country of origin labeling).



## **Pursue a More Aggressive Preferential Trade Agreement Agenda**

As noted earlier, bilateral or even regional free trade agreements are not suited to deal with export assistance and domestic support issues, but they do offer the possibility of deeper and faster improvements in market access than multilateral negotiations. Unfortunately, the history of most free trade agreements is to treat agriculture as a special sector requiring exceptions to the duty free norm. Nevertheless, even if most countries regard PTAs as a second best solution, a Doha Round failure would reinforce existing pressures in a number of countries to pursue preferential arrangements. It would be hard for a Canadian government to ignore pleas to level the playing field in the face of existing or new preferential agreements by Canada's export competitors in third markets.

A more aggressive preferential trade agreement agenda could involve actively pursuing PTAs with prospective major markets individually (China and India especially) or as part of a larger plurilateral initiative, such as the mooted Asia Pacific PTA. In some respects, it would be preferable to pursue PTAs on a bilateral basis because the negotiating difficulties can be expected to increase with the number of participants. On the other hand, it might take a large plurilateral PTA to generate the requisite critical mass necessary to launch negotiations in the first place.

The only way to determine what is negotiable on a bilateral or plurilateral basis would be to test the waters. But first it would be necessary to prioritize which of the potential candidates should be pursued and to examine what Canada would be prepared to offer. What Canada could bring to the table would include security of supply of a number of resources, but to make this attractive to a country like China; it would also likely involve negotiations aimed at minimizing restrictions on foreign investment in Canada's resource sectors. Canada would need to examine carefully what it would be prepared to offer to make it an attractive preferential trading partner to a country like China and why a PTA should be pursued with it, as opposed to other potential suitors.

Aggressively pursuing bilateral agreements would not preclude actively encouraging the negotiation of large plurilateral agreements, such as an Asia Pacific PTA, which would presumably take longer to negotiate than a bilateral deal, given the number of participants and the increased complexities this implies.

Further proliferation of PTAs could very well precipitate calls for the resumption of the Doha Round or the launch of a new round of multilateral trade negotiations with a broader agenda than the Doha Round. Certainly, countries which find themselves on the outside of PTAs will then realize the virtues of a non-discriminatory trading system. This will be particularly true for the smallest and poorest countries.

## Press for a Re-engagement of the WTO Negotiations

If the Doha Round negotiations fail to conclude in 2008, then most observers think that it will not be possible to conclude a WTO negotiation until 2011 at the earliest. This presupposes that a new US administration will obtain Trade Promotion Authority in

2009/10. Following a prolonged negotiating hiatus it will be difficult to believe a new or resumed Round can be initiated without a visible signal from the US that it is ready and willing to negotiate. Moreover, there is no guarantee that negotiators can "freeze" what appeared to be on the table in early

2008 and then simply pick-up where they left off when negotiations resume several years later. Nevertheless, if it appears that the Doha Round negotiations will not conclude in 2008, it is important for the "friends" of the WTO to press for a "managed" disengagement rather than an acrimonious breakdown. This would involve Canada working with others to ensure that what is on the table in 2008 will not be reopened and that efforts are made to conclude the Round as soon as the major players, especially the US, are in a position to do so. If instead, the Doha Round collapses with no further meetings scheduled, Canada should begin the analytical and bridge-building work that will be needed to launch a new Round in 2011. A meltdown of the multilateral trading system is something Canada should exert every effort to avoid and a new Round which responds to the interests and concerns of the WTO membership in the 21st century is the best way of ensuring the continued credibility and growth of the multilateral trading system.

A meltdown of the multilateral trading system is something Canada should exert every effort to avoid and a new Round which responds to the interests and concerns of the WTO membership in the 21st century is the best way of ensuring the continued credibility and growth of the multilateral trading system.

Under any scenario, if Canada wants to play a more influential role in resuscitating and sustaining

multilateral negotiations, it needs to more effectively reconcile its agricultural trade liberalization goals with the political sensitivities of supply management. In both the Uruguay and Doha

Round negotiations, Canada's ongoing defensive preoccupations with supply management have undermined its credibility and therefore limited its ability to influence the negotiations. While regarded as a help to the Doha Round negotiations in terms of the ideas it brings to the table in a number of other

If Canada wants to play a more influential role in future WTO negotiations, it needs to more effectively reconcile its agricultural trade liberalization goals with the political sensitivities of supply management.

negotiating areas in agriculture, Canada is regarded as part of the problem rather than part of the solution when it comes to market access.

If Canada really wants to retain supply management as a domestic agricultural policy tool (which all of the main political parties support), it must articulate how it intends to do this in light of the global trend to reduce trade barriers and move away from price support policies. However, this is unlikely to occur in a minority government context or just before a general election.

The EU experience in reforming the CAP provides some useful guidance on how to approach politically sensitive agricultural policy adjustments. The approach of the EU Commission of setting out the challenges and identifying possible ways to meet these challenges in a white paper before entering into detailed consultations with all stakeholders (producers, processors, and EU member states) has enabled the CAP to evolve so that it is much more compatible with an open trading system. If such an approach were tried in Canada, it would require the wholehearted support and cooperation of the provinces, given their pivotal role in supply management.

One option Canada could try would be to prepare a white paper which outlines why the best way to ensure the continuation of supply management for the foreseeable future is to identify how it can co-exist with a WTO outcome incorporating Doha Round-like results, that is, modest reductions in over-quota tariffs and increases in the in-quota volumes to five to eight percent of consumption. This paper would also need to outline the kinds of adjustment programs that would enable supply managed sectors to smoothly adjust to a trading environment based on a Doha Round result.

A white paper outlining how supply management can co-exist with a WTO outcome incorporating modest reductions in over-quota tariffs and increases in the in-quota volumes would need to outline adjustment programs that would enable supply managed sectors to adjust to a trading environment based on a Doha Round result.

Such an initiative would require considerable political courage, but the alternative of repeating the Uruguay and Doha Round negotiating positions is a recipe for having to accept what the rest of the international community has negotiated at the end of the day. The option of Canada walking away from a WTO Round over a refusal to marginally reduce over-quota tariffs and to provide expanded in-quota volumes is not credible, domestically or internationally.

The focus of the supply management/trade policy conundrum needs to be shifted away from the two extremes of maintaining the *status quo* or eliminating supply management to a more centrist, pragmatic approach which recognizes the

political realities of Canadian public policy. Hopefully, an informed debate arising from a realistic white paper would allow for the development of a viable game plan for the future of supply management, while permitting Canada to pursue an aggressive and credible trade policy aimed at concluding either a new or resumed Doha Round.

## 8.0 CONCLUSIONS

Canadian agricultural policy-makers need to recognize that suspension or failure of the Doha Round negotiations in 2008 would not mean the end of multilateral negotiations and that a more likely scenario would include the resumption of the negotiations or the start of a new Round within the next several years. Preferential trade agreements are expected to continue to proliferate but are not a substitute for multilateral agricultural trade reform, especially for smaller countries like Canada. The bottom line is that the external trade policy environment will continue to condition and constrain Canada's agricultural policy options. In other words, the domestic policy *status quo* will continue to be under pressure to adapt to a more open and less distorted trading system.

None of the four options explored above are mutually exclusive. In practice, elements of each of the four can be pursued concurrently, although the prospects for making major changes to the agricultural provisions of the NAFTA may be problematic at this juncture. There does not appear to be any compelling reason why Canada could not pursue a more aggressive multilateral policy, provided a way can be found to manage the politics of supply management. Even a more aggressive preferential trade agreement option can be expected to run into the supply management wall at some point.

The option of maintaining the supply management *status quo* is a recipe for being forced to accept sooner or later what others have negotiated. Canada must extricate itself from this trade policy blind alley. In order to do this, Canada

The option of maintaining the supply management *status quo* is a recipe for being forced to accept sooner or later what others have negotiated.

will have to develop a supply management game plan which allows it to gradually reduce its border protection while permitting producers to benefit from the stability and security provided by a more market responsive supply management system.

It is easy to forget that agricultural trade reform is a means to an end, not an end in itself. For Canada, the main reason why a rules-based, more open and less distorted multilateral trading system should continue to be an overriding goal is

that it provides the best opportunity for ensuring a more sustainable, more competitive agricultural economy for all regions of Canada. Pursuit of new preferential trade agreements in a post-NAFTA world is largely a defensive response to the initiatives of others and for this reason will undoubtedly need to be pursued. However, for an agricultural trading country such as Canada, multilateral trade reform should be paramount and Canada

For an agricultural trading country like Canada, multilateral trade reform should be paramount and we should position ourselves so we can more effectively influence and shape the future of the international trading system. The alternative is to be swept along by the current of globalization, whether we like it or not.

should position itself so it can more effectively help influence and shape the future of the international trading system. The alternative is to be swept along by the current of globalization, whether we like it or not.

If Canada is to pursue a more aggressive position in support of a strengthened multilateral agricultural trading system, it must be seen to be willing to put its own house in order if it is to have any credibility internationally. Provided this can be demonstrated, Canada is in a better position to assert a leadership role in working with other like-minded countries in the Cairns Group and the G-20 to conclude the next leg in agricultural trade reform.

Clearly there are limits to what a medium-sized trading country can accomplish in influencing the future shape of the agricultural trading system. Moreover, as increasing numbers of developing countries grow to the point where they begin to play more active roles in the WTO, the number of potential influential players has increased. Nevertheless, Canada has demonstrated in the past that it can effectively punch above its weight and has the potential to continue to play an influential role in the WTO. The challenge will be to position itself so that it can fully exploit this potential – a task which will require a comprehensive and credible negotiating position on agriculture. The alternative is to continue to muddle through and hope that problems will become more manageable if decisions are delayed long enough.

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## **APPENDIX I: WHY MIGHT THE DOHA ROUND FAIL?**

There are a number of factors working against a successful Doha Round conclusion. Several of these affect the linkages and trade-offs between the main elements of the Doha Round negotiating agenda, particularly agriculture, non-agricultural market access (NAMA), services, and rules. For most of the past six years, the negotiating difficulties in agriculture were regarded as the main constraint to concluding the Doha Round. However, in recent months, as the shape of the agricultural package became clearer, it has become apparent that there are also major obstacles to be overcome elsewhere in the negotiations; especially in NAMA.

Some of the factors which have influenced the pace and the level of ambition of the negotiations include: 1) the problem of applied versus bound tariffs; 2) limited pressure from non-agricultural interests in governments; 3) US internal support for agricultural trade reform is weaker than it was in the Uruguay Round; 4) the increased negotiating leverage of developing countries; 5) differing interests among developing countries; and 6) expanding WTO membership makes negotiations more complex and difficult. These are each discussed below.

### **The Problem of Applied versus Bound Tariffs**

Developing countries were told this was to be the "Doha Development Round" which implied that their interests and concerns would be front and centre in the negotiations, particularly as regards agriculture. In contrast, the developed countries expected that, although there would be special and differential treatment for developing countries – mainly in the form of lower reduction commitments, this would not prevent substantial improvements in market access for both agricultural and non-agricultural products. However, few recognized at the beginning how difficult it would be to reconcile these expectations. The problem is that most developing countries (India and Brazil for example) have applied tariffs which are substantially below their bound rates (and which form the agreed baseline from which to negotiate tariff reductions). This so-called "water in the tariff" gives these countries complete policy flexibility to increase applied tariffs up to the bound ceiling level overnight. In contrast, the applied rate is identical to the bound rate for virtually all tariffs in developed countries and China as well. This means that it is very difficult for any tariff formula to bring developing country bound tariffs below the applied level without requiring a linear tariff reduction which is greater than that applied to developed countries. However, for agricultural exporters (developing as well as developed) a major goal in the Doha Round was to improve access to the rapidly growing emerging markets of the developing world.



## **Limited Pressure from Non-agricultural Interests on Governments**

Agreement on the part of the developing countries to launch the Doha Round was conditional on a narrow negotiating agenda which concentrated on the "unfinished business" of agriculture and the remaining tariff peaks on manufactured products in developed countries. Attempts by some developed countries (in particular the EU) to broaden the agenda to increase support for potential trade-offs were rebuffed and as a result the pressure on governments from non-agricultural interests to conclude the Doha Round is not as broad, or as deep as it was in the Uruguay Round. Furthermore, a number of issues have been successfully negotiated on a sectoral basis after the Uruguay Round (e.g., pharmaceuticals and information technology), which has further reduced the potential number of interest groups exerting pressure on governments to conclude the Doha Round.

In other words, the Doha Round is concentrated on overcoming the toughest defenders of the *status quo* in the agricultural and non-agricultural sectors while having relatively fewer champions of freer trade to counteract this defensive pressure. In Canada, for example, the non-agricultural champions of freer trade have been virtually invisible (many are of the view that NAFTA has largely addressed their trade interests). With minimal pressure for an ambitious Doha Round result from non-agricultural interests, the agricultural exporters have been effectively neutered by the political power of the import sensitive supply managed sectors.

## **US Internal Support for Agricultural Trade Reform Is Weaker than it Was in the Uruguay Round**

Many US agricultural export interests (which were disappointed that the Uruguay Round results did not live up to their hype) are aware that the major beneficiaries of agricultural trade liberalization would be low cost producers such as Brazil, Argentina, New Zealand, and Australia – countries whose land values do not reflect the benefits of farm programs, but rather what the market will return. US agriculture's interest in further trade liberalization has also been eroded by the fixation on biofuels and the conviction that the political energy spent on promoting and defending biofuel policies will pay a better economic dividend than multilateral trade policy. Compounding the situation has been a failure, at least until relatively recently, of the US Administration to explain to US producers that reductions in trade-distorting domestic support can be replaced in part or in whole by green support.

The end result is that US agriculture's support for the Doha Round is considerably softer than it was for the Uruguay Round where it can be argued that the single-minded determination of the US to bring agriculture under operationally effective international rules and disciplines was mainly responsible for the advances that were made.

## **The Increased Negotiating Leverage of Developing Countries**

The dramatically increased influence of developing countries, especially the large emerging economies, within the WTO has meant that the US and the EU can no longer ram through the results of their bilateral negotiations on a take it or leave it basis. While it is true that the Cairns Group of developed and developing agricultural exporters can claim much of the credit for ensuring the Uruguay Round got off to a good start on agriculture, with many of its ideas incorporated into the final Agreement on Agriculture, the end-game negotiations (Blair House and subsequently) were completely dominated by the two economic superpowers.

In the Doha Round, Brazil and India together with the other members of the G-20 group of developing countries have demonstrated a capacity to generate proposals which have been incorporated into the Chair's modalities paper along with the leverage necessary to reject US/EU accommodations which do not reflect their interests. In particular, the G-20 has made it clear that their willingness to move on NAMA will depend upon the progress they make in agriculture. For the G-20 developing countries, the magnitude of the reduction of US trade-distorting domestic support has become their main barometer of agricultural trade reform.

The upshot of this is that while the G-20 has managed to keep the level of ambition in the agricultural negotiations higher than it would be if the US and the EU had been left free to conclude and push through another "Blair House" bilateral deal, the unwillingness of the large emerging economies to meet the market access aspirations of the developed countries on non-agricultural tariffs has become a major stumbling block.

## **Differing Interests among Developing Countries**

It is important to point out that the interests of the developing countries are not homogeneous. Many developing countries are more concerned about reducing their non-agricultural tariffs because of anticipated competition from China than they are about import competition from developed countries. Similarly, in agricultural market access, many developing countries are just as concerned about import competition from highly efficient developing country exporters, such as Brazil or Malaysia as they are with import competition from developed country exporters. This is particularly true for countries with a large number of subsistence farmers who often coexist with a much smaller number of larger-scale commercial farmers. In countries like India, China, Indonesia, and the Philippines, the ability to continue to shield their vulnerable subsistence farmers from import competition is viewed as a political imperative. Hence, their insistence on small or no tariff cuts on "special products."

## **Expanding WTO Membership Makes Negotiations More Complex and Difficult**

The increasing size of the WTO (over 150 members) and its current institutional structure (based on consensus rather than a majority vote) have been cited among the reasons why the conclusion of the multilateral negotiations has become so difficult and protracted.

Considered in isolation, none of these factors would be sufficient to prevent the Doha Round from concluding, but their cumulative effects so far have been sufficient to blunt any attempt to bring the negotiations to a successful conclusion.

## **APPENDIX II: WHY SUPPLY MANAGEMENT CAN CO-EXIST WITH THE PROSPECTIVE DOHA ROUND RESULT**

The Canadian supply management system could continue to function under the prospective Doha Round result. The main change the industry would face would likely be the replacement of the present pricing system in dairy and eggs with a system of negotiated prices between producers and processors (paralleling the existing situation for chickens and turkeys) which still would reflect very substantial protection via the remaining over-quota tariffs. The main adjustment would be that Canadian producer prices would start to more closely track world prices which should be less volatile and higher as a result of the phase out of export subsidies and the creation of new market access opportunities. The impact of a Doha Round result on the production quota values created by supply management is hard to judge and would depend heavily on the adjustment policies adopted by the Canadian federal and provincial governments chosen to facilitate a “soft” rather than a “hard” landing for producers. Given the political influence of the supply managed industry at both the federal and provincial level, it would appear safe to assume that every effort would be made to assure a soft landing and a continuation of most of the main elements of the supply management system.

Increased import competition from a Doha Round result would impact the supply managed sectors in different ways. The greatest impacts would be expected for dairy, turkey, and egg producers, while the impacts on producers of chicken and broiler hatching eggs and chicks should be considerably less, reflecting the fact that for these latter products Canada's NAFTA market access obligations already provide considerably more low in-quota tariff access than Canada's existing WTO commitments. For example, Canada is obliged, under NAFTA, to provide low duty access for chicken equivalent to 7.5 per cent of the previous year's production. This compares to Canada's existing WTO commitment to provide low duty access for an amount equivalent to five percent of consumption in the 1986-88 period. Given that Canadian broiler production has grown considerably since then, this means that the NAFTA rather than Canada's WTO commitment is the binding import access obligation. In the case of broiler hatching eggs there would be no new market access under a Doha Round Agreement since Canada's existing NAFTA access obligation (21.1 percent of the anticipated current year's production) already greatly exceeds its current and prospective WTO obligations.

The situation for dairy, turkey, and eggs would differ in that much of the increase in WTO quota volumes would represent new access. However, even for these products, the actual import increase will be moderated by the fact that in a number of cases the supplementary import permit system already allows in more imports than the current WTO commitment levels (however, it would not be permitted to count imports for re-export against in-quota obligations).

The upshot is that a Doha Round outcome along the lines of the Chair's draft modalities would imply that Canada will need to increase the volume of WTO in-quota imports to something in the order of five to eight percent of domestic consumption in exchange for only having to reduce its 200-300 percent over-quota tariffs by less than one-quarter (instead of around 70 percent if there was a full application of the tiered tariff reduction formula). Thus, the remaining over-quota tariffs still should be high enough to allow a slightly modified supply management system to survive

The most vulnerable sector, dairy, would still retain sufficiently high over-quota tariffs to enable it to compete against low cost suppliers, such as New Zealand and Australia – even if the US dollar continues to be depressed relative to other currencies. However, Canadian supply managed prices would have to increasingly reflect the landed, duty paid cost of imports. This would mean less price stability than that provided by a fully insulated administered pricing system. Moreover, to the extent that a Doha Round result would contain caps on trade-distorting domestic support, any remaining administered prices would be subject to a cap and roll-back to the average prevailing in the 1995-2000 period – which, in effect means a move to negotiated pricing.

On the export side, a Doha Round export subsidy phase out would force a parallel phase out of Canadian supplied managed exports priced at below the administered domestic price, particularly in dairy. Dairy product exports would virtually cease, but processed food exports incorporating dairy products could continue, provided the milk used was priced the same, irrespective of whether the processed food was exported or sold on the domestic market (as is already the case for milk sold for the manufacture of chocolate confectionaries).

As noted earlier, the precise impact on the value of production quotas for dairy (by far the most important supply managed sector) of a Doha Round result is difficult to predict. Currently, strong international dairy product prices, reinforced by the Doha Round results, will make it more difficult for imports to enter Canada even over reduced over-quota tariffs and this will help moderate the impact of increased import access into the Canadian market. The only thing which appears sure is that asset values could fall more than necessary; unless the adjustment game plan is known early, all stakeholders are given time to adjust, and appropriate adjustment assistance is provided. The manner in which the EU has managed its reform of the Common Agricultural Policy demonstrates that even the most politically sensitive policies (e.g., EU sugar and grains) can be modified to make them compatible with a more open trading system.

Questions of political influence aside, there are valid reasons why governments need to consider adjustment assistance. Most current supply managed producers had to purchase their production quota and make other long-term investments in the context of an ongoing supply management system. These investments were made in good faith on the basis of long-standing policies supported by virtually all

political parties at both the federal and provincial levels. If the rules of the game are to be changed as a result of a multilateral trade agreement, it is only fair that governments provide appropriate financial adjustment assistance.