

Towards more liberal agricultural trade

Introduction

Agricultural policies in OECD countries cost consumers and taxpayers over \$300 billion every year. Farmers receive more than one-third of their receipts from government programmes. The value of total agricultural support in OECD countries is more than five times higher than total spending on overseas development assistance and twice the value of agricultural exports from developing countries.

What are the effects of this high level of support? Many current policies reduce economic efficiency and disrupt international markets - at the expense of competitive suppliers, including those in developing countries. They often fail to achieve their objectives, in particular that of supporting low-income farmers, and in many cases are harmful to the environment. OECD Ministers have recognized the need for fundamental reform, but only modest progress has been made. As WTO members undertake further trade negotiations "... in order to correct and prevent restrictions and distortions in world agricultural markets", lessons can be learned from experiences in implementing the Uruguay Round Agreement on Agriculture (1995-2000). New challenges and opportunities are also emerging, for both developed and developing countries. ■

How significant was the Uruguay Round Agreement on Agriculture?

Prior to the Uruguay Round Agreement on Agriculture (URAA), GATT rules on trade in agricultural products were limited and often ineffective. A number of exceptions exempted agricultural products from most of the disciplines applying to manufactured goods. As a result, countries often resorted to measures such as export subsidies - which are not permitted in other sectors - as well as a multitude of non-tariff barriers that restricted agricultural trade.

The URAA was a turning point in the reform of the agricultural trade system. Countries agreed to reduce agricultural support and protection substantially by establishing disciplines and rules on market access, export competition and trade distorting domestic policies. These three sets of disciplines on agricultural policy are sometimes referred to as the three "pillars" of the URAA.

In addition to the three "pillars", a new Agreement on the Application of Sanitary and Phytosanitary Measures (SPS) was signed. The SPS provides for countries to take measures to protect human, animal, and plant health,

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while at the same time establishing rules to prevent countries from using arbitrary and unjustified health and environmental regulations as disguised barriers to trade. Finally, reforms were made in the Agreement on Technical Barriers to Trade (TBT). ■

What has happened since 1995?

The URAA has produced positive results, principally:

- Non-tariff barriers were converted to tariffs, which are bound and subject to reduction commitments,
- Export subsidies on agricultural products are for the first time subject to disciplines, and

- Domestic policies that affect production and trade of agricultural products are subject to a set of rules and bindings, and in the process are becoming more transparent.

These are important systemic changes from the pre-URAA period. However, distortions to agricultural production and trade remain high. In practice, the URAA achieved only limited reduction in effective protection.

On market access

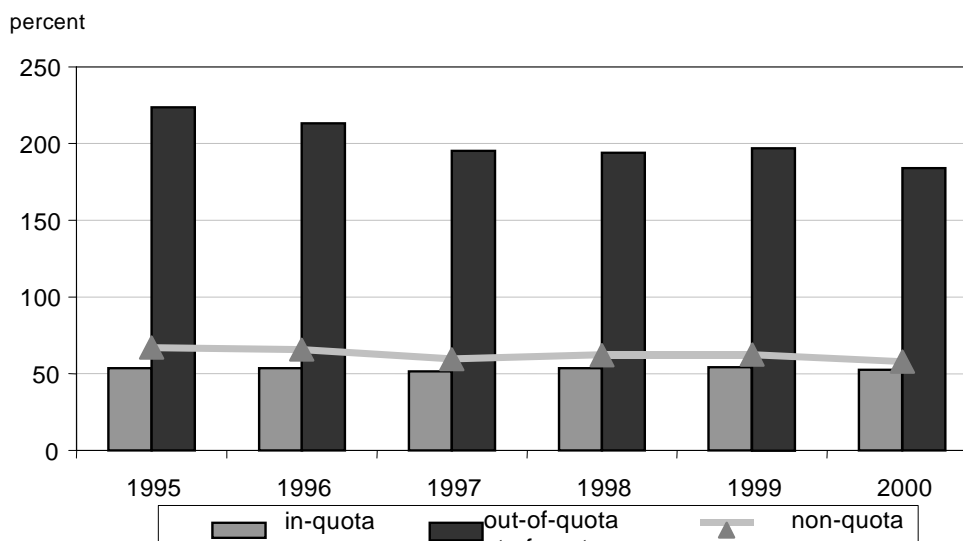
Tariffication – whereby import bans, quotas and other restrictive measures are converted to bound tariffs – was the main achievement under the market access discipline. Tariffs were subject to reduction, which should result in a reduction of the level of protection. In practice, agri-

cultural tariffs remain high. Recent estimates indicate average agricultural tariffs are in the region of 60% compared to industrial tariffs that rarely exceed 10%.

Protection actually increased for a number of agricultural products, particularly those perceived as being the most politically sensitive. In many instances, the bound rates agreed in the URAA afforded higher protection than what had existed in the base period (1986-88). This implies that the URAA bound tariff could be reduced significantly before market access is actually increased.

Tariff profiles have also become more complex with several different rates applying to the same products. There are many specific or combination tariffs, i.e. tariffs with both an ad valorem (percentage)

Chart 1. Average tariffs for selected agricultural commodities and selected countries



Source: OECD (2002-forthcoming) *Tariff-Rate-Quotas and Tariffs in OECD Agricultural Markets: A Forward Looking Analysis*, Paris.

Note: Based on 3152 tariff lines from the AMAD database. The averages are for the following commodities and countries: cereals, coarse grains, rice, sugar, oilseeds, vegetable oils, meats, dairy products; Argentina, Australia, Canada, EU, Hungary, Japan, Korea, Mexico, New Zealand, Poland, US, Iceland, Norway, Switzerland. Specific tariffs have been converted to ad valorem equivalents to arrive at the averages.

and a specific (monetary value) component. Tariff variability increased, as did the number of tariffs significantly higher than the overall simple average. Finally, the aggregate nature of the formula for tariff reductions gave countries a great deal of flexibility, thereby minimizing the real impact. That is, large percentage tariff reductions on commodities with already low tariff levels could be traded off with small reductions in commodities with large tariffs.

In recognition that the levels of protection likely to arise from tariffication could be prohibitive, a system of tariff rate quotas (TRQs) was put in place. The TRQ applied a lower tariff (in-quota rate) to imports below a certain quantitative limit (quota), and permitted a higher tariff rate (out-of-quota) on imported goods after the quota had been reached (Chart 1). Its purpose was twofold: to guarantee that historical trade levels were maintained, and to open hitherto closed markets by providing minimum access opportunities.

In general, OECD countries' TRQs are under-utilized by a significant margin. In addition, the average OECD rate of utilization (fill rate) has been falling over time, from 67% in 1995 to 57% in 1999. Under fill of TRQs may be due to a number of different factors including prevailing market conditions, the level of the in-quota tariff, and the methods by which quotas are allocated and administered. Many quotas are allocated to specific countries under preferential arrangements. This adds to the difficulty in interpreting the outcome. Nonetheless, consistently low and declining fill rates support the argument that TRQs provide lower than expected market access and trade flows.

Has market access improved over the implementation period from 1995-2000? There is evidence to suggest that progress has been modest: TRQ fill rates have been low; for tariffied commodities, little or no trade has occurred outside the TRQs; and the Special Safeguard (which permits import restrictions under certain conditions) has proved relatively easy to invoke. It is extremely difficult to disentangle macroeconomic, market or policy factors in explaining trends in trade. However, trade growth in agriculture seems to have decelerated during the period of URAA implementation. Significant also is the fact that developing countries, whose share of world industrial exports had been increasing steadily, have not managed to increase their share of agricultural exports. OECD research suggests that much deeper cuts in tariffs, or larger increases in the volumes admitted at lower tariffs, would be needed to improve market access significantly.

On export subsidies

The URAA did not ban export subsidies in agriculture—although they are not used in any other sector—but it did discipline them. It is almost exclusively a small number of OECD countries that use export subsidies. Export subsidies are an issue for non-OECD countries to the extent that they affect world prices and market conditions. For potential agricultural exporting countries they reduce prices and make it difficult for them to compete. For importers, they can bring short-term benefits in terms of lower import prices. But for both groups of countries they can be detrimental to agricultural development in the longer run.

Although it was probably the most tightly defined of the URAA disciplines, there are a number of fea-

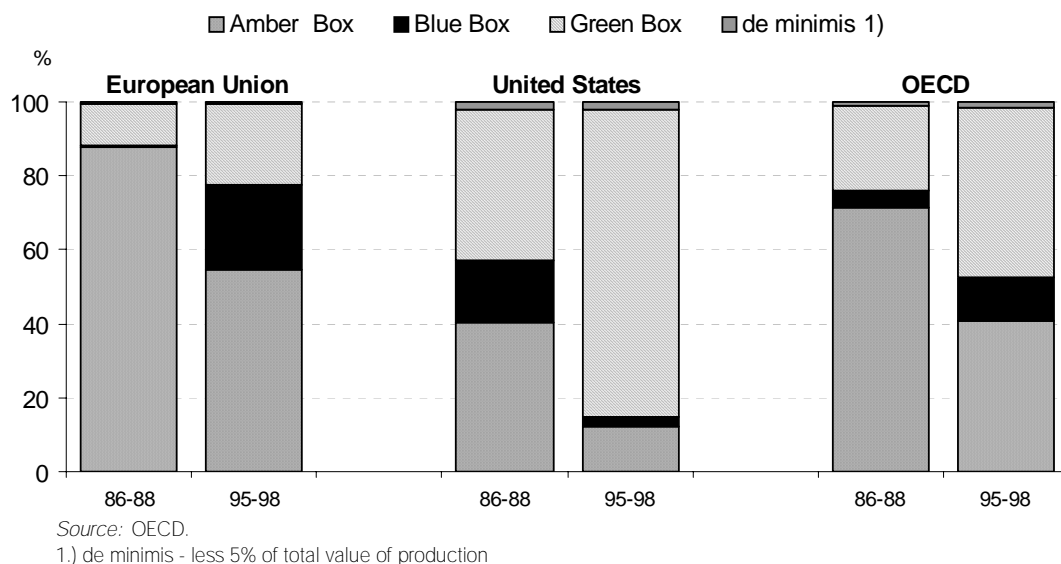
tures of the provisions that weakened them. For many commodities subsidy levels in the base period, from which reductions were calculated, were abnormally high. This created a paradoxical situation whereby distortions caused by export subsidies could, for some countries and commodities, have increased relative to the period immediately prior to implementation. Countries also had the flexibility to carry forward unused export subsidy allowances from one year to another during the implementation period.

Export subsidy commitments have rarely proved to be binding during much of the implementation period due to market conditions and unilateral reductions or suspensions by many countries. Nonetheless, many countries continue to apply large amounts of export subsidies and subsidised exports do account for an important share of world trade for certain commodities (such as dairy products). Moreover, should world or domestic market prices fall or exchange rates prove unfavourable to those countries with internal market price support, then the export subsidy constraints could become more binding.

On domestic support

The discipline on domestic support is probably the single most innovative element of the URAA. The impact of domestic support on trade was explicitly recognised and a system of rules and bindings put in place. These were designed to reduce distortions and encourage reform away from the most trade distorting forms of support, towards mechanisms and instruments deemed to be minimally or non-trade distorting. The most distorting forms of support were classified as “amber” and subjected to reduction requirements, and the least distort-

Chart 2. Composition of domestic support, 1986-88 and 1995-98



ing were deemed “green” and exempted from reduction. An intermediate category of “blue” box measures belongs in the middle in terms of their trade distorting impact.

In reality, the domestic support discipline proved the least binding in the sense that most countries have had little difficulty in meeting their commitments. The aggregate measure of support (AMS) was a numerical measure representing those domestic policies considered to have the greatest potential to affect production and trade (“amber box”). Most OECD countries have been reporting total AMS levels that are small relative to their permitted levels – below 70% with the exception of a few countries. In some countries, this was a result of policy changes that placed greater emphasis on blue box payments. This switch began even before URAA implementation had begun.

Another factor weakening the effect of the discipline was that the base year for reductions (1986) was for many countries a year that consti-

tuted an historic high for this kind of support. Additionally, the aggregate nature of the commitments meant that if support for some commodities was switched between boxes, countries could actually increase the most trade distorting support to other commodities.

That is not to say, however, that the domestic support discipline has not had an impact. It seems clear that policy makers throughout the OECD are extremely conscious of the imperative to design policies that conform to blue or green box criteria. There has been a strong increase, particularly in the latter type of measure. As a result, more than half of the total OECD domestic support notified to the WTO is exempted from any reduction requirement (Chart 2). Green box support in OECD countries doubled between 1986-88 and 1995-98, and has been higher than AMS over the entire implementation period. ■

What is needed to ensure significant progress in WTO negotiations?

The impact of the URAA was limited by the relatively modest disciplines imposed on each of the three pillars, and the considerable latitude exercised by countries in interpreting and implementing their commitments. Future progress could be enhanced by a stronger and clearer set of disciplines.

In the area of market access, a simplification of the legal requirements is desirable. The mere existence of TRQ or lower tariffs does not guarantee access. Other elements, including the various methods of quota administration and allocation, are important. Many agricultural commodity markets continue to be dominated by trade among OECD countries, with limited real access opportunities for non-OECD economies, particularly developing countries. Less complicated provisions

would undoubtedly ease developing countries' concerns about potential for a "balanced" agreement. Finally, in spite of the progress achieved in the URAA, many agricultural tariffs remain extremely high, and tariff levels tend to increase with the degree of processing undertaken. Alternative formulae could be applied to achieve more significant tariff reductions.

Although export subsidies were disciplined in the URAA, signatory countries did not reach an agreement covering all forms of export competition. In recognition of this, the Agreement includes a set of anti-circumvention provisions to exclude other policies that could be used as implicit export subsidies. These provisions need to be further clarified or strengthened. There is also a need to develop internationally agreed disciplines on export credits and other measures that could have similar effects as export subsidies. The use of export restrictions and taxes and the potential for state trading enterprises and food aid schemes to distort trade should be included in any review of the export competition discipline.

While there is no doubt that domestic support provided through green box measures is relatively less trade distorting than market price support, there are grounds for querying

whether many of these measures can be deemed to be minimally trade distorting. On-going work in the OECD suggests that seemingly non-trade distorting measures, i.e. measures that provide support that is not based on current production or factors of production, may nonetheless have production and trade effects. These occur because such payments may change the level of risk experienced by producers, make them more wealthy, or affect expectations that governments will continue to provide them in response to falls in market prices. The OECD is currently clarifying and quantifying the relative importance of these effects. This analysis, although not yet completed, could be of considerable interest to policy makers.

The discussion so far has focused on improving specific elements of the URAA. While this is a necessary condition to achieve real progress, a number of other questions also need to be addressed. ■

What about the concept of multifunctionality?

The Uruguay Round Agreement on Agriculture contains a specific provision (Article 20) that a new negotiation on agriculture be launched before the end of the implementa-

tion period and that that new negotiation take into account, inter alia, non-trade concerns. As the negotiation has got under way it has emerged that some OECD countries attach great importance to these non-trade concerns. And for some of these countries, many of these concerns are encompassed in a concept known as "multifunctionality".

The discussion of multifunctionality has been beset by the problem that the concept is not well defined and is therefore prone to different interpretations. Moreover, there are widely differing views as to its policy implications. Some countries believe that production-linked support and border measures are necessary in order to maintain or increase the multifunctional character of agriculture in their respective countries. Another group of countries, also strong proponents of multifunctionality, promotes targeted production-neutral measures. A further group rejects any role for production or trade-related policy instruments and is sceptical of the inclusion of the concept in multilateral trade negotiations.

To overcome these problems OECD has been in the forefront in elaborating a common terminology, identifying the key policy issues and developing a framework for the analysis of appropriate domestic

Officially supported export credits in agriculture - or, more simply, export credits - were a topic during URAA negotiations because of the widespread belief that these programs can be used to distort trade. By offering favourable financial arrangements to importers without offsetting fees, a government could influence the purchasing decisions of these importers of a commodity. Indeed, recent evidence indicates that some countries' programs have effectively distorted trade in just this manner, although the scale of such distortions are smaller than that attributable to export subsidies. Among the results of the URAA was a commitment to continue negotiations toward a set of disciplines to limit the scope of exporting countries to compete on financing, as opposed to on the price and quality of their goods. However, long and difficult negotiations by the Participants to the Arrangement on Export Credits has led them to a consensus minus one on new disciplines, thus an agreement remains elusive.

policies compatible with further trade liberalisation.

This work establishes multifunctionality as a positive concept, a characteristic of the agricultural sector whereby commodity and some non-commodity outputs may be joint products. The appropriate policy response will depend on how strongly the production of the so-called non-commodity outputs is linked to agricultural production. This will clearly vary hugely depending on whether we are talking about cultural, heritage or landscape features, rural employment, food security, or environmental quality (where agricultural impacts may sometimes be negative). There will also be large variations over space and time. Before drawing policy conclusions, it is also necessary to establish that there is market failure, in other words, that there is a shortfall between social demand for a “multifunctional output” and its supply. Only when these questions have been answered can we determine the appropriate policy strategy. This can range from market creation to voluntary or club provision, from local or regional to central government provision, and could encompass both sectoral and non-sectoral (e.g. territorial) approaches, depending on whether we are dealing with public goods and what the nature of those public goods is.

This framework should permit governments to weigh the benefits to society from preserving a given non-commodity output against all the direct and unintended costs of doing so and to narrow differences between countries concerning efficient policy strategies. Discussion is continuing at the OECD to clarify, and build consensus towards the concrete implications for agricultural policy reform and on-going trade liberalisation efforts. ■

What are the emerging issues in food safety and the environment?

Food safety has recently emerged as a significant global issue with international trade and public health implications. While the issue is not new, increased global food trade and a series of major food safety incidents have resulted in heightened consumer awareness. Food safety risk levels may vary greatly among countries due to differences in technology, indigenous plant and livestock populations, food production practices, cultural patterns of consumption, and geographic or climatic factors.

In recent years, policy reform has led to a gradual deregulation of agro-food markets. On the other hand, new regulatory requirements have been developed and enforced for product attributes such as food safety and food quality. Sanitary, phytosanitary and technical regulations can have significant transboundary implications. Import standards, rules and procedures can facilitate and enhance trade if they reduce the risk to consumers of purchasing unsafe or low-quality food and thereby increase confidence in imported products. However, these regulations can become barriers to trade, in particular if they place demands on importers that are more costly than for domestic producers.

Sectoral studies suggest that technical regulations in developed countries can constitute a considerable obstacle to agricultural and food exports of developing countries. Public concerns may also go beyond food safety to include such issues as the quality of food, how it is produced, the use of modern biotechnology, and related impacts on the environment.

Distinguishing trade barriers from legitimate measures for protecting consumers that may have incidentally the effect of restricting trade, but whose principal objective is to correct market inefficiencies, can be difficult. Work is underway at OECD to measure the pervasiveness and importance of sanitary, phytosanitary and technical measures applied to agro-food trade and to assess their economic and trade effects.

There are two basic issues concerning the linkages between environment, agriculture, and trade: the environmental impact of agricultural trade liberalisation and the trade impact of agro-environmental policies. The environmental impact of agricultural trade liberalisation will differ between agricultural sectors. In general, air, water, and soil pollution associated with agricultural production will change in the same direction as agricultural output. That is, where trade liberalisation leads to a decrease in production there is likely to be a reduction in the negative environmental impacts of agriculture, but where it increases production, the negative impacts may increase. Environmental benefits associated with agricultural production, will also be affected by changes in output. Therefore, a reduction in trade barriers can have both positive and negative effects on the environment.

A potential trade impact of agro-environmental policy measures arises from the effect of such measures on competitiveness. Where farmers are provided with support to achieve environmental outcomes, their trade competitiveness may increase relative to unsubsidised producers. On the other hand, where policy measures involve regulations or taxes, the trade competitiveness of such producers may decrease. A further issue concerns

the imposition of environmental requirements on imported products.

The OECD is currently examining these linkages, as well as the environmental effectiveness of agro-environmental policies in the livestock sector. This work will assist in understanding the extent of the linkages, and to assist countries in establishing best policy practices that are minimally trade distorting and environmentally effective. ■

What are the implications for non-OECD economies?

The concerns of non-OECD economies, and in particular developing countries, are increasingly prominent in multilateral trade negotiations. Non-OECD economies are a diverse group, but nevertheless have a shared interest in being further integrated into the world trading system, and in “transparent” legal commitments that are easily implemented and monitored. They also need a trade agreement that does not limit their ability to pursue broader development goals. In particular, trade reform may need to be accompanied by appropriate domestic policies.

Many non-OECD economies suffer from deficiencies in basic information, such as economic statistics and customs data. Often, this institutional weakness is compounded by the fact that they do not have the requisite trained professionals (statisticians, policy analysts). The problems of a weak domestic, human and institutional resource base are further amplified by a lack of international representation, and by weak communication between domestic exporters and international negotiators. Investment in these areas would lead to a more balanced representation in a multi-

lateral trade agreement, as well as providing broader economic benefits.

A major concern of non-OECD economies is that agricultural support in OECD countries should be reduced. The largest OECD countries dominate the use of domestic support measures and export subsidies. To the extent that these policies affect production and trade, world agricultural markets become distorted. This is particularly problematic for the least developed countries, where agriculture often constitutes the single most important sector in the economy.

OECD countries are often the most important markets for non-OECD economies. Non-OECD economies need market access in both directions; that is, foreign exporters’ access into their markets, and their own exporters’ access into OECD markets. Therefore, the impact of trade liberalization on non-OECD economies is directly linked to the degree of reform in OECD countries. ■

The way forward

A comprehensive, multilateral approach affords the best chance to address the multiple trade-related issues in all sectors, including agriculture. It offers a wide range of potential tradeoffs and a broad scope for gain due to the coverage of a large number of markets. In this respect, developing countries can play a stronger role. Much of the gains sought in the last round did not materialize, particularly in categories where some developing countries enjoy a comparative advantage such as agriculture.

More progress on trade reform, whether in agriculture or in other sectors, promises efficiency gains that should translate into higher incomes. But it is important to rec-

ognise that while trade reform promises aggregate gains, it does not guarantee that everyone will be better off. Within countries, there will be both winners and losers; and among countries, there may be some losers, at least in the short-term and especially from a narrow agreement. In particular, the concerns of net food importing countries and exporters who depend on one or two key commodities may need to be addressed.

Such factors do not compromise the case for further trade reform. But they do imply that trade reform cannot be viewed in isolation. In OECD countries where the agricultural sector is characterized by high levels of protection, there could be a case for adjustment assistance, as well as targeted intervention to correct market failures. In non-OECD economies, there may also be a need for export capacity building, a diversification away from traditional trading patterns, and improvements in infrastructures and institutions. Overseas development assistance clearly has a key role to play.

Poorly functioning markets, whether in developed or in developing countries, are an economic loss to all nations. A new agreement promises important benefits for stakeholders in OECD and non-OECD countries. As such, the decision taken at the Fourth Ministerial Conference of the World Trade Organization, that negotiations “... be concluded not later than 1 January 2005”, is a welcome development. ■

For further information

Further information about this *Policy Brief* can be obtained from Hsin Huang; Tel: (33-1) 45 24 95 28; email: Hsin.Huang@oecd.org. ■

For further reading

- **The Uruguay Round Agreement on Agriculture: An evaluation of the implementation in OECD countries**, 2001
ISBN: 92-64-18626-3, 46 euros, 164p.
- **The Uruguay Round Agreement on Agriculture: The policy concerns of emerging and transition economies**, 2001
- **Tariff-Rate-Quotas and Tariffs in OECD Agricultural Markets: A Forward Looking Analysis** (*forthcoming*)
- **A Forward Looking Analysis of Export Subsidies in Agriculture**, 2000
Free on Internet at: www.oecd.org/agr/
- **An Analysis of Officially Supported Export Credits in Agriculture**, 2000
Free on Internet at: www.oecd.org/agr/
- **Multifunctionality: Towards an Analytical Framework**, 2001
ISBN: 92-64-18625-5, 42 euros, 160p.
- **Decoupling: A Conceptual Overview**,
OECD Offprint 2001, volume 1, No.1
- **State Trading Enterprises in Agriculture**, 2001
ISBN: 92-64-18624-7, 28 euros, 104p.
- **Agricultural Policies in OECD Countries: Monitoring and Evaluation**, 2001
ISBN: 92-64-18685-9, 64 euros, 276p.
- **OECD Agricultural Outlook 2001-2006**, 2001
ISBN: 92-64-18632-8, 38 euros, 194p.

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