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AGRICULTURE FOR DEVELOPMENT POLICY BRIEF

Leveling the Playing Field in International Agricultural Trade

Significant gains can be made from agricultural trade reforms. Gains will, however, be unevenly distributed among commodities—and among and within countries. It is urgent that the Doha Development Round of trade negotiations emphasize removing the most distorting policies that hurt poor countries. Complementary policies and programs are needed to compensate losers and to facilitate rapid and equitable adjustment to emerging comparative advantages.

Agriculture is a major cause of contention in international trade negotiations, such as in the Uruguay and Doha Rounds. Agricultural policies are estimated to account for about two-thirds of the costs of current distortions to all merchandise trade, three-fourths of which are contributed by developed countries. Much discussion in these negotiations is on reducing the negative effects that developed country trade policies impose on developing countries. A particular focus is the effort to open markets to developing countries (see brief on Getting Prices Right) and to remove the agricultural subsidy policies of developed countries.

Protection and subsidies remain high in developed countries.

Relatively little progress has been made in reforming agricultural policies of developed countries. Protection and subsidy support to producers in countries of the Organisation for Economic Co-operation and Development (OECD) declined from 37 percent of the gross value of farm receipts in 1986 to 1988 to 30 percent in 2003 to 2005. Although this decline of 7 percentage points is progress, the amount of support increased over the same period from US$242 billion a year to US$273 billion.

There has been a shift, particularly in the European Union (EU), away from support linked directly to agricultural product prices, output levels and inputs used to other less-distorting forms, such as cash transfers "decoupled" from production. But such transfers are not always neutral for production because they reduce aversion to risk (via a *wealth effect*), reduce the variability in farm income (via an *insurance effect*), and allow banks to make loans to farmers that they otherwise would not.

OECD countries have increased preferential market access for some developing countries (for example, the African Growth and Opportunity Act of the United States and the Cotonou Agreement and the "Everything but Arms" agreements of the EU), but overall welfare costs of current policies remains high.

Welfare costs of trade policies are high.

Recent estimates show that the global welfare costs of trade tariffs and subsidies will reach about US$100 billion to US$300 billion a year by 2015. About two-thirds of the costs are estimated to come from agricultural tariffs and subsidies (the remainder from tariffs and subsidies reforms in other sectors), much higher than agriculture and processed food's 6 percent share of global gross domestic product (GDP) and 9 percent share of international trade.

Developing countries are estimated to incur 30 percent of the welfare costs of current global agricultural trade policies—a portion higher than their share in global GDP. Agricultural tariff and subsidies in developed countries alone cost developing countries annually the equivalent of about five times the current levels of overseas development assistance to agriculture.

On average, more than 90 percent of the global costs are estimated to arise from market access restrictions through tariffs rather than from export subsidies or domestic support. However, the relative importance of market restrictions and export subsidies varies significantly by product. For example, 89 percent of costs of interventions in cotton markets are estimated to come from export subsidies and domestic support programs and 11 percent from tariffs.

Developing countries will see effects of liberalization.

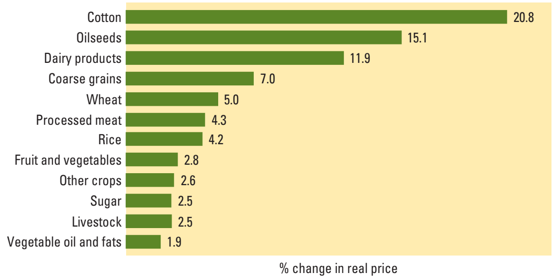
Trade reforms offer significant scope to reduce the global costs of current policies by raising international agricultural prices, particularly for export crops important to developing countries. Raising prices is expected to increase developing countries' aggregate share of global agricultural trade and agricultural output growth rates. However, not all developing countries will gain.

Effects vary by region and country. The largest estimated price increases from full trade liberalization are for cotton and oilseeds (figure 1a). Removing U.S. cotton subsidies alone is estimated to increase the incomes of West African cotton producers by 8 percent to 20 percent. Developing countries are estimated to gain 11 percentage points in their share of global agricultural exports—increasing from 54 percent to 65 percent—and much higher for oilseeds and cotton (figure 1b). Reforms are estimated to raise agricultural growth rates in developing countries over a 10-year period by an average of 0.3 percent per year.

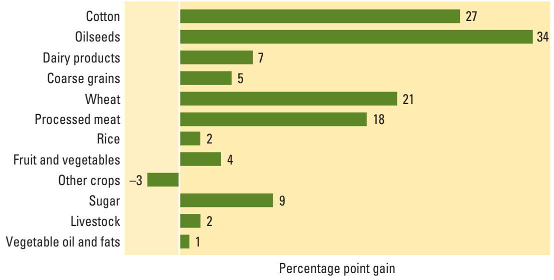
However, gains are not evenly distributed. Latin America and Sub-Saharan Africa share the largest gains in estimated agricultural output growth, while developed countries share the largest losses. Among the big expected gainers are Brazil, Thailand, and Vietnam.

Figure 1. Price Increases and Developing Countries' Corresponding Trade Shares Gains

a. Estimated real international commodity price increases following complete trade liberalization (% of current price)



b. Corresponding estimated trade shares gains of developing countries (percentage point gains)



Source: Anderson, Martin, and van der Mensbrugghe 2006. Distortions to World Trade: Impacts on Agricultural Markets and Farm Incomes. Review of Agricultural Economics 20(2):168-94.

Higher prices of food staples are a particular concern for food-importing countries who do not export products that will benefit from trade reforms, such as Burundi, Niger, and Rwanda.

Poverty declines in many countries, but not in all. The transmission from global trade reforms to poverty reduction involves many channels. These channels vary widely in their importance by country. The poverty effect of price changes from agricultural trade reforms depends on where the poor are, what they do for living, and what they consume. For example, a recent study found that high prices lead to more positive results for the poor in Thailand than in Brazil. In contrast with Brazil, where most poor people are net food buyers, the extreme poor in Thailand are predominantly rural households with diversified income sources and are estimated to gain from price increases.

Gainers and losers among the poor occur within countries. A particular concern with trade policies relating to staple foods is the potential welfare effect on the poor. Although most poor are net buyers of food, others are net sellers. Any change in price will therefore produce gainers and losers among the poor. The distribution of gainers and losers is quite country specific, although in most countries net food buyers are more common. The degree of transmission of international prices to rural households also matters. High transaction costs and low ability to trade within the country limit the effects of trade reforms on food prices in many poor countries.

Scope of the gains depends on the result of negotiations.

The Doha Development Round of trade negotiations provides an opportunity that should not be missed for realizing at least part of the potential gains of full trade liberalization. The best outcome would be an agreement on further reforms, particularly on agricultural products important to the poorest countries, such as cotton. The potential effect depends on content of an agreement—particularly the following:

- *The extent to which bound rates for tariffs are reduced below actual applied tariff levels.* Current average bound tariff rates are almost double applied rates in developed countries and more than two-and-one-half times applied rates in developing countries.
- *The level of subsidy reduction in developed countries for key commodities, such as cotton.* A significant reduction would be an important gain for developing countries, particularly the cotton-exporting countries in Sub-Saharan Africa.
- *The special treatment of "sensitive products" identified by individual developed countries.* If not tightly constrained, rules on sensitive products can undercut the effects of reform. Estimates show that if only 1 percent of all tariff lines in the EU were exempted as sensitive products, the expected overall average tariff reduction estimated under an agreement with no exemptions could drop to half what it would otherwise be.
- *The treatment of "special products" in developing countries—deemed important for food security, livelihood security, and rural development in these countries.* The potential effect of any exemptions will be country specific and will depend on how net buyers and net sellers are affected. Net buyers of food, especially the very poor, will likely be hurt by tariffs on food staples that raise prices.
- *Agreements on complementary policies and programs.* These programs include aid-for-trade and programs to protect vulnerable groups (transfer programs) and to facilitate rapid and equitable adjustments by smallholders to emerging comparative advantages (investments in public goods and institutional reforms).

The political economy will be important in reforming trade policies.

The political economy will determine the pace and extent of further reforms to level the playing field in international trade. Membership in the WTO can help bring reform. U.S. cotton subsidies have been successfully challenged under WTO rules, although the ruling has yet to be implemented. And the media can expose taxpayer costs and unequal incidence of gains. In some cases, bargained compromises and compensation schemes for the losers are important—as in Japan's rice policy reforms and the EU's sugar reforms. A big push is needed to successfully conclude the Doha Round and to eliminate undesirable consequences of failure such as shifting back to global protection, reversing past efficiency gains, and reversing the efforts to reduce poverty. OECD subsidies are already influencing some developing countries to call for higher protection rates on a range of agricultural products.

This policy brief has been extracted from the World Bank's 2008 World Development Report, *Agriculture for Development*. Further information and detailed sources are available in the Report. The Report uses a simple typology of countries based on the contribution of agriculture to overall growth, 1990-2005 and the share of rural poor in the total number of poor (2002 US$2-a-day level). In agriculture-based countries (mostly Africa), agriculture contributes a significant (>20%) share of overall growth. In transforming countries (mostly in Asia), nonagricultural sectors dominate growth but a great majority of the poor are in rural areas. In urbanized countries (mostly in Latin America and Europe and Central Asia), the largest number of poor people are in urban areas, although poverty rates are often highest in rural areas.