The WTO negotiations: What interests are the OECD countries pursuing?

*The WTO negotiations are a difficult balancing act between mercantilism and rational policy reform. Some OECD countries still tend to rely on traditional price support policies. Insight is growing – albeit gradually – that this agricultural policy approach has substantial disadvantages as it primarily benefits large-scale agricultural producers and impacts adversely on the environment, to say nothing of substantially distorting international markets.**

The WTO is the forum where countries come together to establish the rules to govern international trade. This takes place through negotiations where the rules, along with specific commitments for all the WTO members, are established and developed. The current talks on the Doha Development Agenda are the latest round in these negotiations. Their stated objective is to achieve the greatest possible liberalization of world trade. The underlying assumption is that free world markets are in the international community's common interest as they help ensure the most efficient and economic use of global resources.

The WTO – a balancing act between liberalization and protectionism

In reality, however, the WTO negotiations are often some distance away from this goal. Governments tend to demand as much liberalization as possible from other countries while keeping their own political commitments to a minimum. They view the opening of other countries' markets as a successful outcome to the negotiations, but see any commitment to open their own markets as a 'concession' – the price which has to be paid in order to encourage other countries to be flexible. Of course, this may be a typical feature of negotiations everywhere, but in the WTO, it reflects an outdated mercantilist philosophy – «exports good, imports bad» – which regards imports as harmful to the economy. Economists demonstrated long ago that this position is fundamentally flawed. Exports are indeed beneficial to a country's economic prosperity, provided that they result from internationally competitive production and are not artificially stimulated by government subsidies. But imports can also be good for the economy if they encourage the importing country to cease production of goods which can be manufactured at lower cost elsewhere. The fact that higher imports are viewed as detrimental to the economy, while higher exports are welcomed as beneficial, has much to do with adaptation processes and short-term economic gain. When a country is able to increase its exports because other countries are opening their markets, new jobs are created and business improves, with benefits for these employees and companies. However, if more imports flood into the domestic

Many OECD countries are still defending their traditional agricultural policies which are based on price support. This will inevitably cause fresh conflicts in the WTO negotiations.

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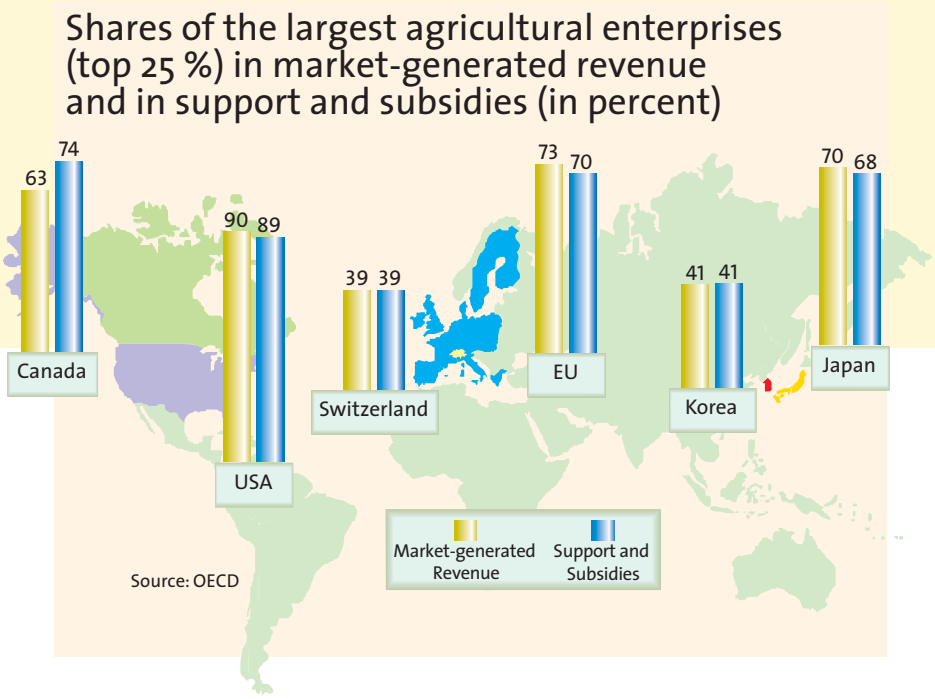

market or the volume of subsidized goods being exported is reduced, this has an adverse effect on business and puts jobs at risk. The pressure is felt fiercely and there are howls of protest. The benefits for individual consumers are generally negligible, however, and are thus a less significant factor in the political debate.

In the context of the WTO's agriculture negotiations, this means that countries with an agricultural sector which is able to hold its own in the international markets, and which can therefore expect export opportunities to improve, are pushing for substantial progress on liberalizing agricultural trade. In contrast, countries with a less competitive agricultural sector that benefits from relatively high levels of support and protection are tending to apply the brakes. There are clear dividing lines: firstly, between the developing and the industrialized countries, and secondly, among various groups of industrialized countries.

In most developing countries, agriculture receives less price support than in many industrialized countries. Many of the developing countries are therefore hoping that worldwide liberalization of agricultural trade will improve their agricultural export prospects and are calling for swingeing cuts in the OECD countries' protection and farm subsidies. The industrialized countries, on the other hand, are keen to sidestep any demand for a rapid overhaul of their farm sectors. This mismatch of interests has become more apparent than ever in the current WTO negotiations, especially with the breakdown of the Ministerial Conference in Cancún in September 2003.

However, divisions are also apparent among the OECD countries. Competitive agricultural exporters such as Australia and New Zealand are pushing hard for rapid and full liberalization, whereas countries that support their agricultural sector with high subsidies, such as Japan and Norway, are more restrained.

The WTO agriculture negotiations are therefore a delicate balancing act between different groups of countries: some pressing for liberalization, others keen to maintain their protectionist policies. Nonetheless, every country will need to establish a healthy balance between mercantilist tendencies, on the one hand, and a rational understanding of the economic benefits of market liberalization, on the other. Those OECD countries that have traditionally maintained high levels of agricultural subsidies are finding this balance hard to achieve. Nonetheless, they are increasingly accepting that reforms of their domestic agricultural policies within the WTO framework are in their own interests as well.

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Agricultural policy reforms and the interests of OECD countries

During the period 2001-2003, price support and government subsidies to farmers across the 30 member countries of the OECD accounted for 31 percent of farm income on average; just 69 percent was earned in the markets (OECD, *Agricultural Policies in OECD Countries – At a Glance*. Paris 2004). In some countries, agricultural policy measures made up around 60 percent of farm income (Japan and Korea) and, in certain cases (Norway and Switzerland), more than 70 percent. In Australia, by contrast, just 4 percent of farm income comes from agricultural policy measures; in New Zealand, the figure is even lower – 2 percent. For the OECD countries, the substantial majority of agricultural subsidies directly link payments to production: three-quarters of total subsidies in the OECD countries come from price support and government subsidies per unit of output or input.

This form of support is especially problematical in the international context as it artificially stimulates domestic production and therefore distorts world trade. The result is a detrimental impact on farmers in other countries who wish to supply the world markets. Abolishing such types of farm subsidy is therefore a high priority in the WTO negotiations.

However, with the flaws in their current policies increasingly being exposed, it is also in these OECD countries' own interests to reform their agricultural policies and reduce this type of support. Broadly speaking, the OECD countries' agricultural policies pursue two main objectives: to maintain adequate income levels in the farm sector, and to safeguard the social benefits that this sector provides, notably environmental management and landscape conservation. However, price support and other output-linked subsidies have failed to achieve either of these objectives.

Price support has no effect on farmers' incomes because out of every euro which goes to subsidizing the farm sector, less than 25 cent ultimately rewards the farmers for cultivating their land and contributing their labour. The rest is channelled to suppliers of inputs or to landowners who lease the land to tenant farmers, or it is used to cover the additional costs of expanding production (see graph). When area premiums are 'decoupled' from output, on the other hand, the income effect is doubled.

Furthermore, price support and similar measures inevitably benefit the farmers who produce the largest quantities – and

In some OECD countries agricultural reforms have begun, directed to no further directly subsidize production.

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they are not usually the ones struggling to survive on low incomes. In the EU, 25 percent of the largest agricultural enterprises account for around 70 percent of total farm income, and the same percentage of agricultural subsidies. In the USA, the figure is as high as 90 percent (see graph). Agricultural policy measures therefore benefit the farmers who produce most, not those suffering from poverty. In other words, price support and other similar measures which are still the driving force behind the OECD countries' agricultural policies do not resolve income problems in those areas of farming where these problems are most acute.

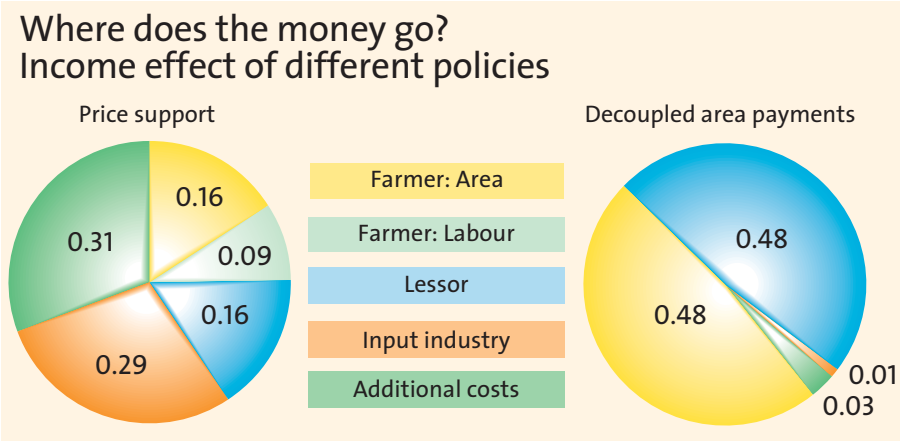
So how effective are conventional agricultural policies in safeguarding environmental management and landscape conservation? Here the situation is equally problematic. Agricultural policies that aim at increasing farmers' receipts per tonne of wheat or sugar beet produced cannot possibly contribute to a better environment or landscape. On the contrary, they are far more likely to encourage intensive production, thus inflicting damage on the environment. Targeted payments that are decoupled from output and are directly linked to the desired benefits – such as the payment of a premium for every metre of hedgerow planted – are far more likely to be successful.

Free trade and policy reform

Some OECD countries participating in the WTO negotiations have tended to defend their traditional agricultural policies. They find it hard to dismantle their high tariffs and export subsidies, because they want to maintain price support in their domestic markets. But it is becoming increasingly apparent that this type of agricultural policy is ineffective in fulfilling today's agenda. A debate about radical agricultural policy reform is therefore underway in a number of OECD countries; indeed, in some cases, reforms have already begun. The direction is clear: to decouple support from production and to target government subsidies towards precisely defined objectives. The total amount spent on payments to farmers can be reduced at the same time because this new type of support regime is far more effective than traditional agricultural subsidies.

Agricultural policy reform which leads in this direction is conform with the OECD countries' enlightened self-interest. It also means that progress can be made in the WTO negotiations. The progressive abolition of price support allows tariffs and export subsidies to be dismantled as well, and domestic production-linked subsidies ('deficiency payments') can be reduced. In short, these reforms will increase the effectiveness of agricultural policy at domestic level, minimize distortions of international trade, and expedite progress in the WTO negotiations. It is a win-win situation; in other words, everyone benefits. However, it must also be recognized that the OECD countries cannot – and will not – abandon their subsidies altogether. Agriculture provides social benefits such as environmental management and landscape conservation which the market cannot reward. It is up to governments, through the development of appropriate policy measures, to ensure that farming can continue to perform this role. As long as this is achieved through payments that are decoupled from production and targeted towards specific objectives, other countries should be able to endorse this position. A shift away from market-distorting instruments towards decoupled and targeted payments will go a long way towards minimizing distortions in international trade. It is a significant step forward which will facilitate progress in the WTO negotiations.

If overall support is reduced at the same time, even more successful outcomes can be achieved. Abolishing market-distorting policies such as tariffs, export subsidies and coupled domestic payments is therefore a high priority. Even if only a proportion of the current support is switched to decoupled and targeted payments, this will bring considerable benefits for international trade.



Source: OECD