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CURRENT ISSUES

Export subsidies in the current WTO agriculture negotiations

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Explicit limits were placed on the use of agricultural export subsidies

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Important multilateral trade negotiations under way could have a major impact on the future of agricultural trade. The negotiations are taking place under a directive in the 1994 World Trade Organisation (WTO) Agreement on Agriculture.

The Agreement on Agriculture was the first serious international attempt to reform agricultural trade policies that have depressed and destabilised world prices and markets for many years. Under the agreement, explicit limits were placed on the use of agricultural export subsidies, while efforts were also made to increase market access and to reduce distorting domestic support.

Existing controls on export subsidies

Two export subsidy reduction commitments were included in the Agreement on Agriculture: (1) to reduce the volume of subsidised exports by 21 per cent and (2) to reduce the value of export subsidies by 36 per cent.

These cuts were for developed countries and were implemented over the six years to 2000. For developing countries, the cuts are two-thirds as large and to be implemented over ten years to 2004. But how effective are these controls?

The impact of export subsidies on world markets flows from their ability to increase exports from subsidising countries. The volume commitment directly limits that effect. The value commitment also indirectly limits the world price-depressing impact of subsidised exports by reducing the incentives used to divert domestic supplies onto world markets. Thus, the commitments on export subsidies are well targeted to the cause of the problem.

Main findings

- Countries have been using less than their maximum permitted export subsidies under the World Trade Organisation Agreement on Agriculture, but billions of dollars of export subsidies are still in use.
- Elimination of the remaining export subsidies is estimated to raise global incomes by no more than US$3.6 billion a year.
- However, if countries were to use the maximum permitted export subsidies, then global incomes could be reduced by several times that amount; therefore, further reduction or elimination of export subsidies is important.
- Wider agricultural liberalisation delivers greater benefits, with global incomes estimated to be US$53 billion a year higher as a result of broader agricultural liberalisation.
- Since the World Trade Organisation Agreement on Agriculture came into force, there has been a dramatic increase in the use of exempt categories of domestic support, which have the potential to be hidden export subsidies.
- There is also substantial potential for countries to use food aid and export credits as hidden export subsidies.
- It is imperative that export subsidy reform be part of a wider, coordinated approach to agricultural trade policy reform, because export subsidies are just one component of agricultural support systems.

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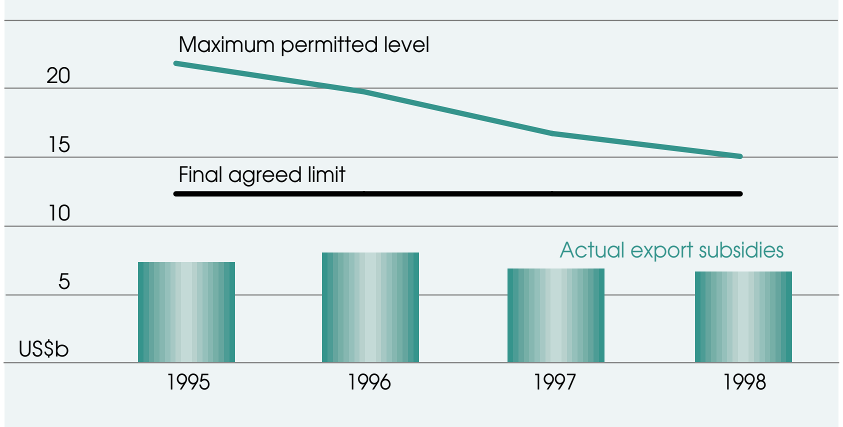
Export subsidy reforms – smoke and mirrors?

At first glance, the export subsidy commitments appear to have been the most successful of the reduction commitments under the present Agreement on Agriculture. By 1998, two-thirds through the implementation period, total agricultural export subsidies were US$6.6 billion — well below the final agreed level of US$12.3 billion (figure A).

While the reduction commitments have been met, this encouraging outcome may be more illusory than real. Instead of reducing the harmful effects of agricultural protectionism, the controls on export subsidies may have encouraged countries to shift their support toward other support measures, both internal and external. Organisation for Economic Cooperation and Development (OECD) estimates support such a claim, showing that overall agricultural protection is still around the peak levels experienced in the period 1986–88 (OECD 2000a).

Given that further controls on agricultural support are being negotiated, it is important to discover how countries have been so successful in meeting their export subsidy commitments while overall support has remained relatively unchanged. Such knowledge will help negotiators to reach a successful outcome.

A Comparing actual use of export subsidies to permitted values



Why have the current controls on export subsidies failed to reduce support?

Poor choice of base period

The choice of base period has reduced the impact of the agreed reform. The base period, 1986–1990, was a time of abnormally low world market prices for agricultural products and high export subsidies.

During that period, the United States and the European Union were running down government stocks of agricultural products through the use of export subsidies. These stocks had built up over half a decade before the base period. As such, the level of export subsidies in the five year base period represented the disposal of surpluses built up over almost a decade of excess production. Cuts from such a high base can still allow subsidised exports above the average levels that have applied in any other period.

In aggregate, export subsidy commitments in value terms have been met with a great deal of potential expenditure to spare. This reflects the abnormally high base levels and restraint by some countries that are entitled to use export subsidies. It also reflects abnormally high world prices for key commodities, especially cereals, in the mid-1990s, which reduced pressures to subsidise exports.

Shuffling the deckchairs

In addition to explicit export subsidies, forms of domestic subsidies can increase production and exports and depress world prices. Success in reducing adverse effects of agricultural protection on world prices and trade therefore requires complementary reductions in all forms of distorting support. However, this task is complicated because questions remain about how market distorting some domestic subsidies actually are.

A major contribution to the reduction in export subsidies that enabled commitments to be easily met was the reorientation of support away from export measures for key commodities and into exempt forms of direct domestic support payments. These payments cover cereals in the United States and cereals and beef in the European Union.

In those countries, the annual values of export subsidies for cereals and beef declined by US$4.1 billion between the base period and 1998 and 1999 (the most recent years for which this information is available). In the same period, domestic support in the form of exempt direct payments for those commodities rose by an estimated US$18.9 billion a year in the European Union alone.

The switch to exempt direct transfers has the potential to undermine the effectiveness of the export subsidy commitments, depending on the extent to which these transfers are market distorting. These payments replicate many of the functions of export subsidies on the volumes exported. They cover the gap between internal returns and those that could be obtained from sales at world market prices. But there is no limit on the use of such support measures.

Changes to support systems have helped the European Union and United States to meet their export subsidy commitments while easing pressures to reduce domestic support. For commodities where the support arrangements have not been changed, notably dairy and sugar, these countries have generally been closer to their value and volume limits for export subsidies.

Even where countries have largely switched support to exempt domestic measures, the limits on export subsidy volumes still need to be met. However, it would be possible for countries to replace export subsidies fully with direct transfers that are exempt from limits or cuts under the WTO Agreement on Agriculture. In such cases the policies could still increase exports. Those exports would not be subject to limitation under export subsidy or domestic support provisions. The European Union is close to this situation for cereals.

Export subsidy cuts need to be part of an overall strategy to reduce all forms of market distorting support. Under the current agreement, countries are free to switch to exempt domestic measures, which may still act as *de facto* export subsidies. These include payments deemed to be minimally distorting or production limiting. If these policies are used in distorting ways, then they need to be controlled.

Potential for more shuffling

In the late 1990s there was a large increase in the use of government sponsored export credits and food aid which are not controlled under the WTO Agreement on Agriculture. These can also be used as *de facto* export subsidies. The contribution of these measures to surplus disposal has been much smaller than the use of explicit export subsidies. However, if further controls on export subsidies were agreed, then these measures could be increasingly used as indirect export subsidies. Box 1 contains an explanation of how some food aid can be misused as hidden export subsidies.

There is no widely accepted definition of export credits, but this term generally is used to cover policies that involve some government action to provide consumer credit or guard against payment defaults. Such policies include governments' direct financing of purchases, government guarantee of payments for exported products, and government provision or subsidisation of default insurance.

A recent OECD study shows that most such credits are on trade between developed OECD countries and that they have provided relatively little implicit subsidy. The total subsidy equivalent for 1998, the year in which their use peaked, was estimated at US$300 million compared with total export subsidies of around US$6.6 billion. However, such credits are widely used by the United States, where their subsidy equivalent in 1998, at US$191 million (OECD 2000b), exceeded overt export subsidies of US$147 million.

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It would be possible for countries to replace export subsidies fully with direct transfers that are exempt from limits or cuts under the Agreement on Agriculture

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Box 1: Why some food aid can be hidden subsidised exports

Food aid is a prime target for hidden export subsidies. While it fulfils a vital function to overcome want, it is used more as an avenue for surplus disposal — one that can adversely affect commercial markets (Ruttan 1993). The supply driven nature of food aid can be seen in the relationship between total food aid and cereal stocks in the United States and European Union (figure B).

The largest component has been program food aid. The stated purpose of program food aid is to provide financial assistance to countries with balance of payments or budgetary difficulties (World Food Programme 1999). Countries supply products on concessional terms for the recipient government to sell domestically. Such sales displace commercial trade and lower market prices for such goods in recipient countries, although the extent to which this happens can vary markedly in differing circumstances.

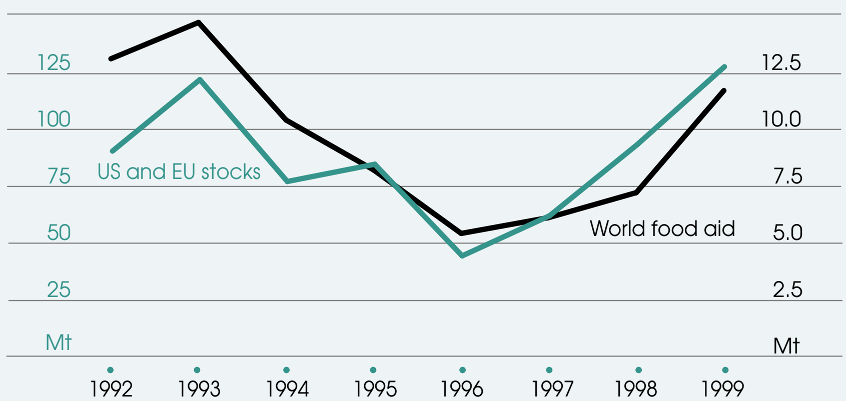
Most program food aid is provided when world prices are low and less is provided when prices are high (figure C). Countries that receive program food aid to address balance of payments problems are usually agricultural importers and would be expected to experience the greatest balance of payments deficits when agricultural prices are high. Therefore, program food aid provides the greatest benefit when there is the least need, and the least benefit in periods of greatest need.

There appear to be few reasons that food should be provided for program aid in preference to money, other than surplus disposal and the support of

Food aid is a prime target for hidden export subsidies

B

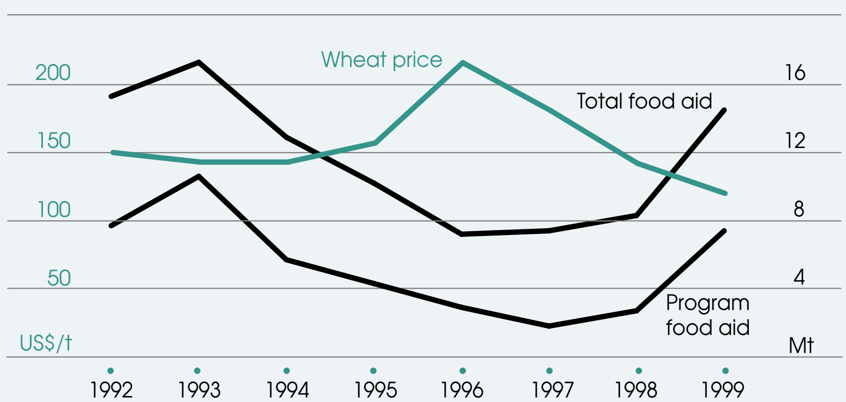
Cereals – world food aid shipments and US and EU commencing stocks



Sources: World Food Programme (1999); Food and Agriculture Organisation (2000).

C

Food aid and world wheat price



Source: World Food Programme (1999).

farmers in donor countries. If the key objectives were to meet the needs of people in developing countries, then program aid would be provided as cash.

It is arguable that the dominant type of food aid is effectively subsidised exports, more for the benefit of farmers in donating countries than to help recipient countries.

To avoid food aid being increasingly used as *de facto* export subsidies, reform is required. However, it will be important that such reform does not reduce the benefits provided by the food aid system to recipient countries. The system would be less susceptible to hidden export subsidies if cash donations replaced program food aid. If all donors provided cash to a multilateral body that then purchased appropriate food at the required times, then the system would be much less open to abuse, in terms of circumventing export subsidy commitments, and could be better targeted to the needs of recipients. Food aid needs would then become effectively integrated into commercial markets.

While the incidence of export credits has been small relative to that of export subsidies, these credits have considerable potential to circumvent export subsidy commitments. As such, controls on the subsidy element of such credits are desirable, to safeguard the effectiveness of cuts to export subsidies.

Why export subsidies should not be analysed in isolation

Under the WTO Agreement on Agriculture, support policies were divided into three areas: export competition, market access and domestic support. Current negotiations are taking a similar approach.

The analysis in this paper addresses important issues for further reform of export competition. However, any agreement will cover all areas of agricultural policy, not just export competition. Further, efforts are being made to introduce wider ranging negotiations covering manufacturing and other activities.

Given the interactions between the various forms of policy measure within agriculture and between agriculture and other sectors, estimates of the effects of reforms of a single aspect of agricultural support, such as export subsidies, can be misleading when considered in isolation. For that reason, results in this paper, when they refer to export subsidy reform alone, need to be interpreted carefully.

Effects of further reforms

To assess the significance of reform to agricultural export subsidies, an analysis using the GTEM model (box 2) has been carried out, assuming complete elimination of such subsidies. With elimination of agricultural export subsidies from the expected levels in 2005, annual global incomes are estimated to be US$3.6 billion a year higher by 2010, than if expected levels of export subsidies persisted and there were no further reforms.

Export subsidy elimination is an efficient means of reforming agricultural support. Where export subsidies are used, they are usually the critical component of the price support system, and their removal will result in lower internal prices unless other policies are adopted. This will encourage a redirection of domestic resources to more profitable activities than protected agriculture.

The greatest income growth from elimination of export subsidies is in the European Union, the dominant export subsidiser. Agricultural production would decline and production in more profitable sectors, particularly services, would increase. In contrast, agricultural production would rise in countries producing items that had little support, particularly for commodities that had been heavily supported by others.

While the use of export subsidies has been around US$6–7 billion dollars, the average level of export subsidies use is expected to be US$8.8 billion over the first four years of this decade. In the analysis, export subsidies are assumed to remain at this level from 2000 to 2010. The benefits that could be expected from the elimination of export subsidies

With elimination of agricultural export subsidies from the expected levels in 2005, annual global incomes are estimated to be US$3.6 billion a year higher by 2010

Box 2: Global trade and environment model (GTEM)

GTEM is a multiregion, multisector, dynamic general equilibrium model of the world economy. It is derived from the GTAP model (Hertel 1997) and the MEGABARE model (ABARE 1996). Developed at ABARE to analyse global change issues, GTEM has been used in assesments of international climate change policies and domestic and international trade policies. It is highly suited to analysis of policies that involve complex interactions between sectors and between regions. A detailed description of the model, together with some working papers, can be found on ABARE's web site (www.abareconomics.com).

Eliminating export subsidies would increase world market prices for agricultural products

would be a fraction of the expected value of export subsidies.

The elimination of export subsidies entirely in one year, 2005, is estimated to provide global benefits of US$1.8 billion in that year, or around one-fifth of the value of the previous export subsidies. However, the effects would be compounded over time as resources are progressively released from agriculture to higher return activities. The elimination of export subsidies over the period 2005–10 is estimated to raise global incomes by US$3.6 billion a year by 2010.

This estimate represents the maximum global benefit that could be expected. To achieve that benefit, it is assumed that countries do not reorient their support to other agricultural assistance programs. If support is re-oriented, then the benefits of the export subsidy elimination will be reduced.

In the context of the WTO negotiations, large reductions in permitted export subsidy levels will be necessary if actual subsidised exports are to be further reduced. This is because present limits under the WTO Agreement on Agriculture greatly exceed actual levels of subsidised exports for some important commodities. Large reductions or full elimination are required if significant global growth is to be achieved.

But, the desirability of further reforms to export subsidies extends beyond such gains. As shown in figure A, the use of overt export subsidies has been well below permitted levels. Therefore, the potential exists for countries to increase their use of export subsidies. Because such an increase could be substantial, it is important that permitted levels of export subsidies are markedly reduced, or preferably eliminated, in the present negotiations.

Do all countries benefit from export subsidy elimination?

Eliminating export subsidies would increase world market prices for agricultural products. That would benefit net exporting economies and farmers in importing countries, yet add to import costs for agricultural importing economies. However, it must be stressed that the current negotiations will not reform export subsidies in isolation and that the benefits to countries will largely depend on reforms to other measures.

The benefits that importing countries receive from low priced subsidised imports may also be less than they appear. The largest export subsidies are provided when supplies in exporting countries are highest and world prices are therefore low; much lower subsidies are provided when prices are high. As such, export subsidies benefit low income food importing countries the least during times of greatest need and the most during times of least need. Agricultural support (including export subsidies), which tends to be highest in developed countries, increases world price variations — an issue of major concern to food importing countries (Tyers and Anderson 1992).

Export subsidies are often claimed to reduce hunger by reducing the cost of food to the world's poor. However, export subsidies are timed to benefit producers in countries pursuing agricultural support and are used less when world prices are high. Replacing agricultural export subsidies with cash donations at times of need would result in a much better targeted and more effective means of assistance. The majority of workers in low income countries derive their living from agriculture, so such a system would also stop export subsidies from lowering the incomes of some of the world's poorest people.

For the economies of exporting countries that provide support, the economic benefits from eliminating export subsidies are greater than any costs to importers of subsidised products. The capacity therefore exists to provide more aid that can be far better targeted to areas of need than occurs indirectly through depressing international agricultural prices.

The elimination of export subsidies and other agricultural reforms represents only part of reforms required for many developing countries to realise their economic potential. Institutional reforms and improvements to transport infrastructure, exchange rate policies and taxation reforms can all contribute. Not only are there benefits to individual countries from undertaking such domestic reform, but such reform can significantly alter the benefits from global agricultural reform (Wobst 2001; Collier and Gunning 1999; Killick 1993).

Further analysis highlights the significance of export subsidy elimination being part of wider reforms. It is estimated that 50 per cent reductions in barriers to market access, domestic support and export subsidies would raise annual global incomes (gross national product) by US$53 billion (Freeman et al. 2000). The reductions in all forms of agricultural support, as well as adding to the economic benefits to major export subsidisers and other major agricultural exporters, allow many agricultural importers to gain. It is therefore critical that export subsidy reductions are pursued in conjunction with increases in market access and reductions in domestic support.

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REFORMING Domestic Agricultural Support Policies THROUGH THE World Trade Organisation

Reforms to domestic support and to market access and export measures are critical, interdependent elements of the WTO negotiations that are taking place to enhance the benefits from trade in agricultural products.

In this study, the strengths and weaknesses of domestic support measures in the current WTO agreement are examined, and the requirements to ensure greater benefits from markets that are less distorted by government policies are identified.

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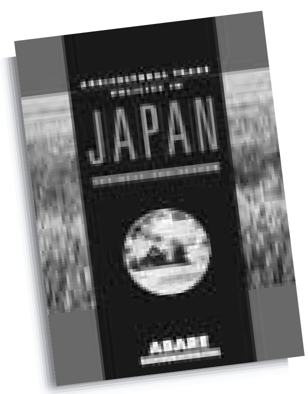
AGRICULTURAL TRADE POLICIES IN JAPAN THE NEED FOR REFORM



International cooperation to advance the benefits from more open and less distorted agricultural markets took a step forward when agreement was reached in the Uruguay Round in 1994. However, reform in several countries, especially Japan has been minimal. The Japanese agriculture sector remains characterised by widespread government interventions that distort production, consumption and trade in agricultural products. These distortions are costly to both consumers and producers in many countries.

This report provides information designed to facilitate a better understanding of existing Japanese agricultural policies and their effects, and the potential for beneficial reform.

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