The Role of the WTO in Achieving Equity and Efficiency in International Markets for Agricultural Products

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It is not only possible to pursue non-trade concerns with measures which do not distort trade and production - it is also the most efficient way of pursuing these non-trade objectives. What is required is not that Members abandon their non-trade concerns, but simply that they choose better instruments for achieving these objectives.

And there is a simple reason why we [the Australian Government] seek this outcome. To promote the non-trade concerns of one Member through trade-distorting measures is to ensure that other Members are denied the opportunity to promote their non-trade and trade concerns. Given that most of the leading countries promoting the importance of non-trade concerns are rich, exporting such a burden to poorer countries violates a basic concept of fairness and is alien to the goals of the multilateral trading system. (WTO 2000a) (emphasis in the original)

1. Introduction

The WTO Agreement on Agriculture was seen in 1994 as only a first step towards the liberalisation of agricultural trade. In Article 20 of the Agreement it was required that further negotiations should take place in order to continue the process of liberalisation (WTO 1995, p. 55). These negotiations began in 2000 and were subsequently incorporated into the single undertaking of the Doha Round in 2001. The aim of the negotiations is ‘to establish a fair and market-oriented trading system through a programme of fundamental reform encompassing strengthened rules and specific commitments on support and protection in order to correct and prevent restrictions and distortions in world agricultural markets’ (WTO 2001, para 13). Fairness is to be achieved through incorporating special and differential treatment for the developing and least-developed countries, and efficiency is to be achieved through improving market access, phasing out all forms of export subsidies and substantially reducing trade-distorting domestic support.

In the Punta del Este Declaration of 1986 there is the clear indication it was realised by the Contracting Parties to the GATT that improving market access and reducing domestic and export subsidies would in all likelihood cause governments to shift support and protection towards sanitary and phytosanitary barriers as a means of continuing to pursue their objective of supporting farmers’ incomes. Therefore, an additional element in the Uruguay Round negotiations was to find ways of ‘minimizing the adverse effects that sanitary and phytosanitary regulations and barriers can have on trade in agriculture ...’ (Croome 1995, p. 387). The outcome was the Agreement on the Application of Sanitary and Phytosanitary Measures (The SPS Agreement). In this Agreement, governments are to use
recognised international standards in setting their quarantine barriers or, if they choose to impose a higher standard, then a scientific risk assessment is required. In this way, governments are required to demonstrate that their choice of import barrier can be justified in terms of its nature and setting, that the motivation for it is to achieve an acceptable level of risk, that it achieves that level in a minimally trade-distorting way, and that it is not in place to protect domestic producers from competing imports.

The introduction of the SPS Agreement and the Agreement on Agriculture have been significant, albeit cautious, first steps in helping to achieve more efficiency, more predictability and more equity internationally in markets for agricultural products. However, much remains to be done to achieve a market-oriented system and the slow pace of the negotiations on agriculture since 2000 provides an indication of how difficult the next steps will be.

The objective in the paper is to make the case that the WTO matters a great deal for international trade in agricultural products and for the welfare of the international community, particularly the developing and least-developed country members for whom agriculture is especially important. The paper is structured as follows. In section 2 there is a brief summary of the current state of play in the agricultural negotiations as required by Article 20. An explanation for the current apparent impasse in the negotiations is provided in section 3 by considering the political economy of government intervention in agriculture and the social norms on which that intervention is based. These two sections provide evidence to support the argument that the WTO is necessary as a coordinating institution within which governments can attempt to resolve their substantial differences over the rules for agriculture. This argument is put in Section 4, while some conclusions are presented in section 5.

2. The Current Impasse

During the years of GATT 1947, agriculture was largely neglected in the various negotiating rounds. This outcome arose for two reasons. First, agriculture was not subject to the same restrictions on the use of instruments as was the manufacturing sector, e.g., import quotas and export subsidies were permitted for trade in agricultural products but not

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1 Another WTO Agreement of some relevance to agriculture is the TRIPS Agreement because of the current demand, particularly by the European Union, for geographic indications to be recognised. This topic is not pursued in the remainder of the paper.
2 The SPS Agreement is not on the negotiating agenda in the Doha Round.
3 For a detailed history of agriculture in the GATT, see Josling et al. (1996).
for trade in manufactures; and second, reciprocal tariff reductions were the principal focus of
the negotiations in these rounds and agricultural trade in general was not restricted by tariffs.
It is generally agreed that the GATT rules for agriculture during the period prior to the
Uruguay Round were woefully inadequate in the attempt to bring order to international
markets and to prevent the accompanying and unnecessary welfare losses. In addition, the
dispute settlement process during this period was also deficient as a means for a contracting
party to prevent these losses of welfare which were caused by actions of other contracting
parties.

It became accepted during the 1980s that the fundamental source of the trade
problems in agriculture was really the pursuit of domestic objectives and the instruments used
to achieve them, rather than agricultural trade policy *per se*. Thus the outcome for agriculture
of the Uruguay Round can be seen as a significant departure from previous rounds in that
domestic instruments as well as trade instruments were subject to new constraints. In
particular, all non-tariff barriers were converted to tariffs, subject to reductions, and then
bound. Domestic policy instruments were classified into one of three boxes (amber, blue and
green) ranging from trade distorting to minimally trade distorting, respectively, with total
support in the amber box subject to reduction; and assistance to exports was also reduced and
bound. Market access was to be guaranteed through the use of tariff rate quotas (TRQs) and,
through Article 13 (the ‘Peace Clause’), agricultural subsidies which were in accordance with
the Agreement would be non-actionable until 31 December 2003 when the clause was to
expire. Special and differential treatment was accorded the developing and least-developed
countries.4

However, agriculture continues to be a source of considerable tension in the current
multilateral trade negotiations.5 There are many reasons for this tension but fundamentally
there are two principal explanations. First, there is the inconsistency between the economic
efficiency objective of the WTO and the pursuit by Members of non-economic objectives
(i.e., objectives other than economic efficiency) in their agricultural sector through trade
distorting instruments. These objectives, traditionally, have included, *inter alia*, the level and

4 There exist several accounts of the outcome of the Uruguay Round, its implementation and its shortcomings.
In addition to Josling *et al.* (1996), the most concise sources are those which were published by the International
Agricultural Trade Research Consortium in a series of commissioned papers (see <http://iatrcweb.org>).
5 In the area covered by the SPS Agreement there continues to be tension on a bilateral basis but these
disagreements are being resolved through the Dispute Settlement Body.
stability of farm incomes, the productivity of labour employed in agriculture, the security of 
food supply and the efficient marketing of agricultural products.6

The second explanation is that some governments appear to believe that the 
aricultural sector is somehow special and that the principles of economics should not apply 
to it at all or at least should not be applied as rigorously as they are in other sectors.7  The 
special characteristics of agriculture are claimed to include *inter alia* the link between food 
production and culture, between food production and landscape, and between food 
production and the viability of rural communities.  These special characteristics are part of 
the so-called multifunctional agenda which is based largely on the notion that the agricultural 
sector produces not only food and fibre but also public goods and positive externalities.8  The 
multifunctional agenda is a subset of the agenda covered by the term ‘non-trade concerns’. 
This agenda also includes food safety (including the controversial issue of GM foods), food 
security, geographic indications, animal welfare and biological diversity.  The issues raised 
by ‘non-trade concerns’ has further divided Members but the issues cannot be avoided 
altogether because, under Article 20, they are required to be part of the agenda.

Another cause of disagreement has been the scheduled expiry of the ‘Peace Clause’ 
which has exempted agricultural subsidies from challenge in the Dispute Settlement Body, so 
long as they are consistent with the Agreement.  Some countries having proposed that the 
Article should not be allowed to expire, while others have proposed that it should expire and 
that, henceforth, agricultural subsidies ought to lose their special status and, therefore, ought 
to be treated according to the Agreement on Subsidies and Countervailing Measures.9

The negotiations themselves have been arranged into Phase 1 (2000-2001) and Phase 
2 (2001-2002) during which time Members submitted their proposals for negotiation.  In 
early 2003, the Chair of the Agriculture Committee produced a modalities document based 
on his reading of the various proposals made and the discussions of them held in the

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6 For a discussion of these non-economic objectives, see Winters (1990).  He regarded them as so-called non- 
economic objectives.

7 For a detailed discussion of how agriculture is thought to be special and why the application of economic 
principles ought to be suspended, according to some governments, see WTO (2000b).  In this document a set of 
discussion papers is provided which represent the positions adopted on non-trade concerns by the EU and by the 
governments of Japan, Korea, Mauritius, Norway and Switzerland.

8 The analysis of multifunctionality has been bedevilled by a lack of definition of the term.  The OECD (2001) 
has chosen to use ‘commodity outputs’ and ‘non-commodity outputs’ in its economic analysis.

9 It might appear from a non-lawyer’s reading of Article 13 that it is obvious what should have happened at the 
end of 2003 when the Article was due to expire.  However, the issue seems to be much more complicated as 
explained in Steinberg and Josling (2003).  Further background and analysis is provided in Morgan and Goh 
(2003).
Special Sessions of the Committee on Agriculture. The content was criticised by some governments for going too far towards liberalisation and by others for not going nearly far enough. His revised document (WTO 2003a) received a similarly less than enthusiastic reception. During the Cancún Ministerial Conference in September 2003, a revised draft of the Draft Ministerial Text was produced which subsequently has been referred to as the Debrez text (WTO 2003b) and which will now form the basis of the further negotiations.

What is interesting about the text is it illustrates that after almost four years of negotiations, almost nothing has been agreed about the modalities. For example, a part of the text on Domestic Support reads as follows:

1.1. Reduce the Final Bound Total AMS in the range of [...]% - [...]%. Product-specific AMS shall be capped at their respective average levels during the period [...].

Part of the text on Market Access reads as follows:

2.1 The formula applicable for tariff reduction by developed countries shall be a blended formula under which each element will contribute to substantial improvement in market access for all products. The formula shall be as follows:

(i) [...]% of tariff lines shall be subject to a [...]% average tariff cut and a minimum of [...]%; for these import-sensitive tariff lines market access increase will result from a combination of tariff cuts and TRQs.

(ii) [...]% of tariff lines shall be subject to a Swiss formula with a coefficient [...].

(iii) [...]% of tariff lines shall be duty-free.

[The resulting simple average tariff reduction for all agricultural products shall be no less than [...]%.]

On Export Competition, a part of the text reads:

3.1 With regard to export subsidies:

— Members commit to eliminate export subsidies for products of particular interest to developing countries. A list of these products shall be established for the purpose of tabling comprehensive draft Schedules. Elimination of the export subsidies for these products shall be implemented over a [...] year period.

— For the remaining products, Members shall commit to reduce, with a view to phasing out, budgetary and quantity allowances for export.

Within each topic, there are further statements about how special and differential treatment are to defined for Developing countries and for Least-developed countries. The statement relating to Article 13 reads

‘The Peace Clause will be extended by [...] months.’

It is clear from the number of empty square brackets in the foregoing that under each heading of the negotiations there is almost no agreement on how to improve market access, by how much to reduce domestic support, or the time period over which export subsidies are to be phased out altogether. Why there remain substantial disagreements is explained in the next section.
3. Explaining Agricultural Policy

The quote at the beginning of this paper reflects accurately the separation of policy objectives from policy instruments adopted by economists when undertaking the analysis of economic policies, including agricultural policies. It also reflects the extent to which the Australian Government has adopted the economic approach on matters of agricultural policy. Given a non-economic objective, it is possible using the tools of welfare economics to identify the best instrument to achieve the objective in the sense of minimising the deadweight costs of the intervention. If transfer efficiency is defined as the net benefit to producers divided by the cost to consumers and taxpayers of transferring a dollar’s worth of net benefit, then the economist’s policy advice to government is that it should choose the instrument with the highest transfer efficiency (i.e., as close to unity as possible). In some instances it is also possible to derive a ranking of instruments according to their transfer efficiencies. This approach is very much in the tradition of the targeting rule which was developed by Corden (1957), generalised by Bhagwati (1971) and extended by Srinivasan (1996).

As an example of this type of analysis, consider how income support for farmers, which has been, and remains, an over-riding objective of agricultural policy in most developed countries, ought to be provided. The economists’ policy prescription for redistributing income is the lump sum payment in theory and the de-coupled income payment in practice. This transfer mechanism achieves the income objective without incurring unnecessary deadweight costs and it is not trade distorting in theory and minimally trade distorting in practice. If implemented universally, de-coupled income payments would remove the need in the WTO Agreement on Agriculture for there to be the ‘three pillars’ of market access, domestic support and export assistance. By contrast, governments, particularly in the developed countries, have chosen to support farmers’ incomes through direct intervention in markets by manipulating prices or quantities and, in doing so, they have needed to restrict imports and, occasionally, to subsidise exports, in order to achieve their objective. When the countries using this approach are large, in the sense that they affect international market prices, then prices, trade volumes and the social welfare of individual countries become a function of the instruments chosen and the levels at which they are set.

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10 For an elaboration and discussion, see OECD (1995).
More efficient outcomes would be generated by the choice of de-coupled instruments, if income support is the objective.

However, this normative approach to policy analysis and economic advice fails dismally in most instances to predict what is observed in practice about governments’ choice of instruments. It fails because it is assumed in the analysis that government acts as an omniscient planner, given its non-economic objective, pursuing the national interest. Because of this failure to predict both in agricultural policy and in trade policy, some analysts have turned to a political economy approach in order to explain why governments do what they are observed to do.

Dillon et al. (1991, p. 93) have argued that political economy provides a framework rather than a theory for analysing government intervention. Indeed there are many theories of political economy but they all have in common the proposition that government should be modelled as a rational, self-interested participant in the economy in a manner analogous to rational, self-interested consumers and producers. They differ on what is assumed about the government’s objective function and the constitutional framework within which government operates. The objective might be defined in terms of maximising political support with the choice of instrument dependent upon the degree of obfuscation which it generates for the losers and the amount of rent it transfers to the intended beneficiaries.11

In the political economy framework it is possible to explain why the targeting rule is mostly ignored and why domestic objectives are often sought through instruments of trade policy. In the agricultural sector, prior to the implementation of the WTO Agreement on Agriculture, non-tariff barriers were amongst the instruments of choice, even although the objectives were domestic. For example, the twin domestic objectives of the level and the stability of farm incomes could have been achieved through taxpayer-funded, de-coupled income payments together with various private risk-reduction strategies employed by producers using forward or futures markets or through insurance contracts. Instead, governments invariably chose to raise domestic prices as a way of raising the level of incomes and to insulate the domestic market from the perceived vagaries of international markets, through quotas or sliding tariffs, without regard to the effect of these instruments on international markets. Stabilisation of the domestic market was achieved at the expense of

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11 For a survey in the context of agricultural policy, see Brooks (1996) and for one in the context of trade policy, see Rodrik (1995).
greater instability in international markets.\textsuperscript{12} Depending upon the instrument chosen to raise domestic prices, the domestic costs were borne by domestic taxpayers and food consumers, although probably neither group realised that this was the case, while the beneficiaries (farm groups) were well aware of the benefits.

In the normative approach the focus is on identifying the optimal instrument to achieve the non-economic objective based upon the criterion of economic efficiency. The objective itself is not subject to analysis. In the political economy approach the focus is again on the choice of instrument but now it is based upon a political criterion. However, neither of these approaches appears to be adequate to explain the approach of some governments to non-trade concerns. These appear to be based largely on a set of social norms which differ substantially from the social norms of those countries which believe that economic principles should apply equally to the agricultural sector as to other sectors.\textsuperscript{13} In particular, governments in the former category appear to act as if economic efficiency were not an objective at all. For example, countries in the former group do not approach multifunctionality in a positive way, i.e., they do not consider the characteristics of joint-ness of outputs (private or public) to be a feature of economic activity in general but believe it to be special to agriculture. Instead, for them, multifunctionality is a normative concept specific to agriculture: ‘agriculture as an activity is entrusted with fulfilling certain functions in society’ (OECD 2001, p. 9). From this perspective, multifunctionality is a policy objective and one which, it is argued, can only be achieved through the continued use of price-distorting instruments. A vibrant agricultural sector then becomes an instrument to achieve a higher-level objective for society.

Thus, there are two disjoint sets of countries: those in the category “Article 20 Approach” and others in the category “Market-only Approach” (see WTO 2000). For the first set, multifunctionality is bound up with the joint-ness of the commodity and non-commodity outputs of agriculture and with the fundamental question of whether ‘the actual provisions under the URAA are sufficient to let agriculture play its specific role and fulfil the multiple objectives assigned to it by societies.’ (WTO 2000, p. 5) For the second set, the objectives sought by the first group are believed to be attainable through non-market distorting instruments but this position is not accepted by the first group. Hence, there is an

\textsuperscript{12} For a discussion of the domestic stabilisation effects of different trade instruments, see Lloyd and Falvey (1985).

\textsuperscript{13} For a discussion of the importance of social norms as an underpinning for economics, see Basu (2000), particularly chapter 4.
impasse as neither set of countries appears to want to compromise either philosophically or pragmatically.

Therefore, in the absence of governments’ willingness unilaterally to pursue their objectives for agriculture through the use of non-trade distorting instruments, there is a clear need for enforceable international trade rules which moderate or which prevent governments from using instruments which distort trade, and which thereby, reduce social welfare and which prevent the efficient use of the world’s resources.

4. Why the GATT/WTO is Necessary

With the exceptions of Australia and New Zealand, governments in the developed countries have been unwilling for several reasons unilaterally to reduce significantly their support to farmers (Table 1). Two features of this Table are important. First, there is considerable variation across OECD countries in the support provided. For the period 2000-2002, when measured in terms of NPC, support ranged from 1.00 to 2.37; and when

Table 1: Measures of Support for Agriculture

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<tbody>
<tr>
<td></td>
<td>NPC^a</td>
<td>%PSE^b</td>
</tr>
<tr>
<td>Australia</td>
<td>1.05</td>
<td>9</td>
</tr>
<tr>
<td>European Union</td>
<td>1.76</td>
<td>40</td>
</tr>
<tr>
<td>Japan</td>
<td>2.46</td>
<td>61</td>
</tr>
<tr>
<td>New Zealand</td>
<td>1.02</td>
<td>11</td>
</tr>
<tr>
<td>United States</td>
<td>1.19</td>
<td>25</td>
</tr>
<tr>
<td>OECD average</td>
<td>1.57</td>
<td>38</td>
</tr>
</tbody>
</table>

Note:  
^a Producer Nominal Protection Coefficient which is defined as the ratio of the average farm-gate price received by producers and the border price (measured at farm-gate level)  
^b Percentage Producer Support Estimate which is defined as the ratio of the PSE to the value of gross farm receipts (i.e., total gross farm receipts (at farm-gate prices) plus budgetary support), where PSE is an indicator of the value of transfers from consumers and taxpayers to producers.  
Source: OECD (2003, Table III.3)

measured in terms of %PSE, support ranged from 1 to 59. Second, there is little evidence of reductions in assistance in the countries which had high levels of support during the period 1986-88. For example, for the EU the %PSE fell from 40 to 35, for Japan from 61 to 59 and the U.S. from 25 to 21. The proportion of that assistance coming from market price manipulation is shown in Table 2. The countries which are in the “Article 20 Approach”
were clearly visible during 2000-2002, with Japan at 90 per cent, as were those very much in the “Market-only Approach”, with Australia at 3 per cent. The United States, at least in its rhetoric, falls into the latter group but, in reality, it remains in the middle ground with 35 per cent. During the period 2000-2002, there was also substantial variation in the percentage PSEs for the U.S. which varied from a low of 4 per cent for pig-meat, poultry and eggs (largely non-traded commodities) to a high of 55 per cent for sugar (OECD 2003, Table III.45).

### Table 2: Market Price Support as a Percentage of Total Support

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Australia</td>
<td>47</td>
<td>3</td>
</tr>
<tr>
<td>European Union</td>
<td>86</td>
<td>57</td>
</tr>
<tr>
<td>Japan</td>
<td>90</td>
<td>90</td>
</tr>
<tr>
<td>New Zealand</td>
<td>19</td>
<td>69</td>
</tr>
<tr>
<td>United States</td>
<td>47</td>
<td>35</td>
</tr>
<tr>
<td>OECD average</td>
<td>77</td>
<td>63</td>
</tr>
</tbody>
</table>

*Source: OECD (2003, Table III.7)*

Would it have been the case, in the absence of the tightened GATT rules, that the reductions in overall support would have occurred, and would a decreasing proportion of that support have come from market price instruments? At least in the case of the European Union, it is accepted, although not universally, that the reforms of the Common Agriculture Policy which were begun in 1993 were largely the result of the outside pressure created by the need to conclude the Uruguay Round. Given the even wider agenda in the current Round, which includes the several contentious, non-trade concerns, there has to be a presumption that there is a need for the WTO. In the absence of an enforceable set of trade rules, delivered through the Dispute Settlement Body, the chaos of the years prior to 1995 could well return with consequential substantial welfare losses for most countries.\(^{14}\)

### 5. Conclusions

There is a considerable dispersion amongst governments in their approach to agricultural policy. At one extreme are governments which limit their attention to the pursuit of...  

\(^{14}\) Importing countries have benefited from the lower level of import prices for some agricultural products caused by export subsidies and the greater levels of production in the EU and the U.S. encouraged by their respective agricultural policies. Hence, a return to the conditions pertaining pre-1995 could be to the benefit of importing countries, *ceteris paribus*. On the other hand, third-country exporters would experience a loss.
of economic efficiency within their agricultural sectors: at the other are governments which regard their agricultural sectors as fulfilling a higher level social objective without regard to efficiency. Given these quite different positions, it is proving difficult to find any middle ground in the current negotiations in the WTO which were initiated under Article 20 of the Agreement on Agriculture.

The economic theory of distortions and welfare can make a contribution to reconciling these two positions. It can do so: first, by separating policy objectives from policy instruments; second, by demonstrating that at least as many instruments as objectives are necessary to achieve the objectives; and third, by using transfer efficiency as a basis for ranking instruments to achieve a given objective. When there is only one objective, this analysis is straightforward; when there are several, it becomes more difficult but not infeasible. At issue for governments, in the context of the negotiations, is whether or not the policy implications of this type of analysis form a legitimate basis for negotiated outcomes. Obviously, most economists believe that the conclusions are valid and that they would help, even if only as a structure within which to clarify the issues and the alternative means of achieving given ends.

The basic objectives of the negotiations, as re-iterated in the Doha Declaration, are to strive for a fair and market-oriented international trading system for agricultural products, while keeping in mind non-trade concerns. However, it would appear for some governments in developed and developing countries, that non-trade concerns receive a greater weight in their objective function than the economic efficiency to be achieved through a liberalised trading system. But the link between the pursuit of non-trade concerns by market-distorting instruments and the consequent lack of fairness for developing and least-developed countries, appears not to have been made by former group of governments. For the latter group of countries, an essential element of fairness in international markets for agricultural products is improved access to developed country, as well as to developing country, markets. The conclusion from the theory of distortions and welfare shows that the twin pursuits of non-trade concerns domestically and of fairness internationally are compatible. Unfortunately, governments which emphasise non-trade concerns, as well as some of those which do not, are ignoring the international spill-over effects of the price policy instruments that they insist on continuing to use, and in so doing are ignoring alternative and feasible ways of achieving their objectives. Fundamentally, however, they are diminishing the possibility in the Doha
Round of achieving an efficient and a fair international trading system for agricultural products.
References


WTO (2000b) *Note on Non-Trade Concerns*, G/AG/Ng/W/36, Special Session of the Committee on Agriculture, Geneva, September.

