

WORLD TRADE ORGANIZATION: Agriculture

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**Harvard Model
Congress Asia**

HISTORY OF THE WTO

The end of World War II saw the establishment of several international organizations which aimed to re-establish world cooperation and provide guidance, such as the International Monetary Fund and the World Bank. Along with them the International Trade Organization was also established. The idea was to have an organization that could intermediate negotiations between governments on issues pertaining to cross-border economics, such as tariffs, taxes and restrictions on the mobility of goods and services. For organizational reasons, the ITO failed to fulfill that much-needed role.

The result of the negotiations that went into creating the ITO was the General Agreements on Tariffs and Trade (1947). This organization, which lasted until 1994, made important steps towards liberalizing international trade by promoting restrictions in tariffs, subsidies and quantitative trade restrictions.

The World Trade Organization was founded as a result of the GATT discussions and held its first conference in Singapore in 1996. This ministerial conference focused on four topics, namely, government procurement, trade facilitation, trade and investment and finally, trade and competition. These topics were pushed mainly by the developed countries, Japan, Korea and the EU, with soft support from the United States, but were mainly opposed by developing countries.

The current negotiation round of the WTO is called the **Doha Development Round**. It aims to reduce trade barriers globally, and talks are currently focused on agriculture. There is a deep division of views and interests between the developed and the developing countries. Developed countries, like the USA and the EU member states have in place an elaborate system that protects local agriculturalists mainly through subsidies. This allows their agriculture industry to compete internationally at very competitive prices, because their costs are artificially lowered by the subsidies provided by their governments. On the other side of the debate are the developing nations like Brazil and India which have a strong say in the Group of 20 and contain a vast share of the world's population and the world's poor. They object to the agricultural tariffs in the developed countries as unfair, because their own local agriculture sector can't compete with the more productive agriculture in developed countries, especially if it's also subsidized!

Doha Development Round - *The current trade-negotiation round of the World Trade Organization (WTO) which commenced in November 2001. Its objective is to lower trade barriers around the world, which allows countries to increase trade globally.*



The debate revolves around this charged issue. Developed countries are asking developing countries to take steps forward on the issue of market access, while developing countries are asking developed countries to eliminate unfair trade distortion policies such as subsidies.

The negotiations were launched in 2001 in Doha, Qatar. Further talks were held in 2003 (Cancun), 2004 (Geneva), 2005 (Paris, Hong Kong), 2006 (Geneva), 2007 (Potsdam) and 2008 (Geneva).

Negotiations are currently stalled on the topic of a Special Safeguard Mechanism (SSM). This is a measure that would allow countries to impose a special tariff in the case of a sudden drop in food prices or a surge of imports. The purpose of the SSM is to protect domestic farmers in such an extreme circumstance, ensuring that they will not be economically wiped out. During the break-down of the negotiations, the United States argued that the threshold had been set too low, with India and China pushing for an even lower threshold.

TRADE THEORY

Economists broadly agree that multilateral free trade leads to the largest overall gains for society. This is not a new theory, yet distortions on free trade have always been a part of the international trade landscape and have existed in opposition to theory, for reasons which will be explained in the next section.

Before discussing distortions to free trade, it is useful to take a minute to understand why free trade makes theoretical sense under this simple model, proposed by early British economist David Ricardo.

Let's imagine that there are only two countries, USA and Brazil. They only produce two goods, corn and computers. They both have, let's call it, 100 "units" of labor per year, which is just a way of saying that the populations can work the same amount of time in any given year. The USA can grow corn using 2 units of labor for every bushel of corn and it can manufacture computers using 5 units of labor for every device. Brazil is less efficient in producing both corn and computers; it produces corn at 4 units of labor / corn bushel and computers at 10 units of labor / computer. The following productivity chart summarizes all of this information, and it is useful to look it over until it makes complete sense:

<i>Country</i>	<i>Corn</i>	<i>Computers</i>
<i>USA (100 units labor)</i>	<i>2 labor / unit</i>	<i>6 labor / unit</i>
<i>Brazil (100 units labor)</i>	<i>3 labor / unit</i>	<i>15 labor / unit</i>



What if the countries refused to trade with each other? Let's say that the USA wanted to have both corn and computers. At maximum capacity they could produce about 35 bushels of corn and 5 computers. This uses up their entire labor force (try doing the math). Similarly, Brazil could produce only about 23 units of corn and 2 computers. The consumption is summarized in the following table:

<i>Country</i>	<i>Corn</i>	<i>Computers</i>
<i>USA</i> <i>(100 units labor)</i>	<i>35 units</i>	<i>5 units</i>
<i>Brazil</i> <i>(100 units labor)</i>	<i>23 units</i>	<i>2 units</i>

For every computer that the USA produces, it gives up 3 units of corn. However, for every computer that Brazil produces, it gives up 5 units of corn. This difference is what creates an opportunity for both countries to profit from free trade. Keep in mind that Brazil is less efficient at producing both corn and computers! Let's imagine what the countries' output would look like under free trade.

Ricardian trade theory tells us that each country should specialize in the production of a good in which it has a comparative advantage. In other words, the USA should specialize in computers, and Brazil should specialize in corn. If Brazil focuses just on corn, it will produce 33 bushels of corn. Assuming it keeps 23 for itself, which is as much as it had when there was no trade, it has 10 extra bushels of corn to trade. If it gives the 10 bushels to the USA, then the USA only needs to produce 26 bushels and it will consume 36 bushels, which is above its previous level of 35 bushels. By producing only 26 bushels, it has enough labor free to build 8 computers. It can keep 5, as much as it had under no trade, and give 3 away to Brazil. The consumption under free trade is summarized in the following table:

<i>Country</i>	<i>Corn</i>	<i>Computers</i>
<i>USA</i> <i>(100 units labor)</i>	<i>36 units</i>	<i>5 units</i>
<i>Brazil</i> <i>(100 units labor)</i>	<i>23 units</i>	<i>3 units</i>



Notice that under free trade, USA has an extra bushel of corn while Brazil has an extra computer. Thus, although the USA is more productive (requires less labor) to produce both corn and computers, both it and Brazil have clear benefits from free trade.

Despite the overall gains from trade, however, there are winners and losers among the producers of corn or computers. Specifically, the corn producers in the USA will face competition from the Brazilian corn producers despite being more productive. In our example, we can see this because the domestic production of corn in the USA goes down from 35 units to 26 units. Some of the people who previously were corn farmers will have to stay unemployed under the new trade rules. Similarly, Brazil's domestic computer production drops to 0. Therefore, all of the computer producers in Brazil will now be unemployed.

In theory, however, the gains from trade outweigh the losses. In other words, the American farmers who are out of a job should just switch to producing computers, and the Brazilian computer makers should switch to farming. The consumption they each get under free trade is superior to the consumption under no trade.

The model presented above is a very simple, reduced representation of reality, but most modern economists argue that it captures the essential elements of trade theory.

OBJECTIONS TO FREE TRADE

Today there are a multitude of government-imposed barriers to trade in the form of tariffs, quotas, and quantitative restrictions. How is that possible, when economists agree that free trade makes everyone better off?

First, the theory shows that certain social groups are 'winners' and others 'losers', and theory speculates that the gains of the winners are enough to overcompensate the losses of the losers and make everyone better off. This is not always the case in reality. In our example above, it may be difficult, if not impossible, for the American farmers to begin manufacturing computers, and for the Brazilian computer makers to turn into farmers. This may be possible at the macroeconomic level over several years, but within a short timeframe certain groups will certainly be hurt by the change. Therefore, policymakers could be convinced to adopt policies that are nationally inefficient to protect those specific groups of workers that would be disadvantaged by free trade. In return, the protected groups have an interest to offer political support to those parts of the political process which promise to help them and protect their livelihood. In reality, it's not just certain groups of laborers who would be negatively impacted by a change in the current trade restrictions, but also powerful industrial groups that currently benefit from



subsidies or tariffs on their external competitors.

Second, on a related note, it has been argued that this type of economic agreement will invariably result in poorer countries focusing on the production of primary, simple, low-profit-margin goods, with the developed countries focusing on the production of more sophisticated goods. This would lead poorer countries to remain underdeveloped, because their industrial sector would always be one step behind the rich countries' in productivity, and therefore would never be able to compete in price.

Finally, some have noted that the simple pro-free-trade argument fails to include second-order effects which transcend whatever model of productivity economists choose. As an extreme example, by trading with a developing nation and therefore enriching it quickly and substantially, that nation's military capacity will grow as well. This could lead to national security concerns for the previously dominant country and require further military spending to ensure that global balances of powers are preserved. These additional resources could mean that the cost of free trade is understated in traditional models.

TRADE RESTRICTIONS

A **tariff** is a tax applied on imports into a country. So, for example, if a Korean electronics manufacturer wants to sell a product in the United States for \$100 per unit, the United States can impose a 10% tariff on this good. The American consumer would therefore have to pay \$110 for the product, of which \$10 would go to the US government.

A **subsidy** is a form of aid administered to domestic protected producers. In the EU for example, the government compensates (pays) domestic farmers to help them defray their costs, maintain an adequate standard of living and preserve European agricultural tradition.

An **import quota** is a limit on the maximum volume of a good that can be imported into a country. A government could mandate that every year no more than, say, 100,000 automobiles be imported into a certain country. This has a very similar effect to an import tariff.

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CASE STUDY OF AGRICULTURAL TRADE POLICY: THE COMMON AGRICULTURAL POLICY (CAP) OF THE EUROPEAN UNION

Following the signing of the Treaty of Rome in 1957, which established the Common Market in Europe, six European states decided to implement a cross-border common agricultural policy. Each state individually wanted to maintain control over its own agricultural production, however under the new linked economic environment it became clear that trade was an improvement for all parties involved. Therefore, the agreement member states decided to preserve control over agriculture while unifying their markets. The three principles of the CAP are market unity, community preference and financial solidarity.

The methods by which the EU achieves the objectives of the CAP are import tariffs, import quotas, subsidies, production quotas and intervention prices. Import taxes, quotas and subsidies are explained in the previous section. Production quotas have almost been abandoned due to the ease with which farmers can abuse them. Intervention prices refer to the government promising to buy up the farmers' production at a certain minimum price, so that even if demand for their products is very weak, they will still be able to earn a living.

Goods protected under the European Union's Common Agricultural Policy are cotton, sugar, beef, veal, poultry meat, pig meat, sheep / lamb meat, goat meat, eggs, milk, wine, cereal, potatoes, rice, tobacco, among others.

FOCUS OF THE NEGOTIATIONS

Developed countries have an interest in preserving the current agricultural subsidy, although there is internal pressure to remove them. Consumer advocacy groups are interested in paying as little for food as possible, provided the adequate safety measures are observed. In contrast, agriculture lobby groups have a very strong, concentrated interest in subsidies as large as possible, since the revenues from the subsidies go directly into their profits.

In contrast, developing countries find themselves in the unfortunate position of being extremely uncompetitive in agricultural markets. Not only are they less technologically developed than their competitors which puts them at a 'natural' disadvantage, but they also have to compete with the artificially lowered costs that their competi-



tors achieve through subsidies. The developing countries have therefore more of a reason to argue in favor of lower trade restrictions.

SUMMARY AND CONCLUSION

Agricultural trade policy is not simply a matter of economics or wealth. Often it is a matter of life and death. When poor farmers in India are unable to sell their products because their price is less competitive than something produced in a developed nation, this can have dire consequences. It's up to you to find a solution that will be politically acceptable, improve worldwide incomes and prevent groups of people from going hungry.

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