WTO Annual Report 2003 Shows that Distortions in Global Trade Continue

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The World Trade Organization (WTO) has recently published its latest annual report. It shows that even seven years after the implementation of the Uruguay Round Agreements, distortions and imbalances in world trade are still pervasive. The report highlights that imbalances and distortions are particularly high in sectors where developing countries have export interest.

In developed countries, agriculture is still receiving huge amount of subsidies despite its small and declining share in domestic GDP. In 2002, total support to agriculture in OECD countries was around US$ 311 billion, which was equivalent to about 1.3 percent of total GDP of the OECD area. The amount of agricultural subsidies is more than six times higher than the annual development assistance budget of OECD countries, which is about US $50 billion. In countries like Japan, Republic of Korea, Norway, and Switzerland total support to agriculture is close to or exceeds the sector's contribution to GDP (Table 1). From Figure 1 it can also be observed that in all the Quad countries (EU, Canada, Japan and US), support given to agriculture, when measured as a percentage of total farm receipts, is higher in 2001 than in 1997.

Table 1. Selected Indicators of support of agriculture in OECD countries, 2001

	Agriculture's share of GDP (%)	TSE (% share of GDP)	Percentage PSE (%)	MPS + OP[a] (%)	IS[a] (%)	Producer NPC	Consumer NPC
Australia	3.3	0.3	4	3	66	1.00	1.00
Canada	2.2	0.7	17	53	9	1.11	1.15
Czech Republic	3.6	1.2	17	41	19	1.06	1.06
European Union	2.1	1.4	35	62	6	1.33	1.41
Hungary	3.7	1.4	12	30	56	1.01	1.00
Iceland	9.6	1.6	59	74	10	2.11	1.68
Japan	1.1	1.4	59	93	5	2.36	2.12
Korea, Rep. of	4.9	4.7	64	93	3	2.64	2.47
Mexico	5.5	1.3	19	67	12	1.17	1.21
New Zealand	7.2	0.3	1	60	40	1.00	1.02
Norway	1.5	1.4	67	56	22	2.27	1.94
Poland	4.1	1.0	10	70	27	1.07	1.07
Slovak Republic	3.6	0.9	11	..	..	1.01	1.01
Switzerland	1.2	1.9	69	59	5	2.39	2.33
Turkey	14.1	4.3	15	81	9	1.15	1.16
United States	1.4	0.9	21	55	15	1.15	1.13
OECD Average	..	1.3	31	69	8	1.31	1.37

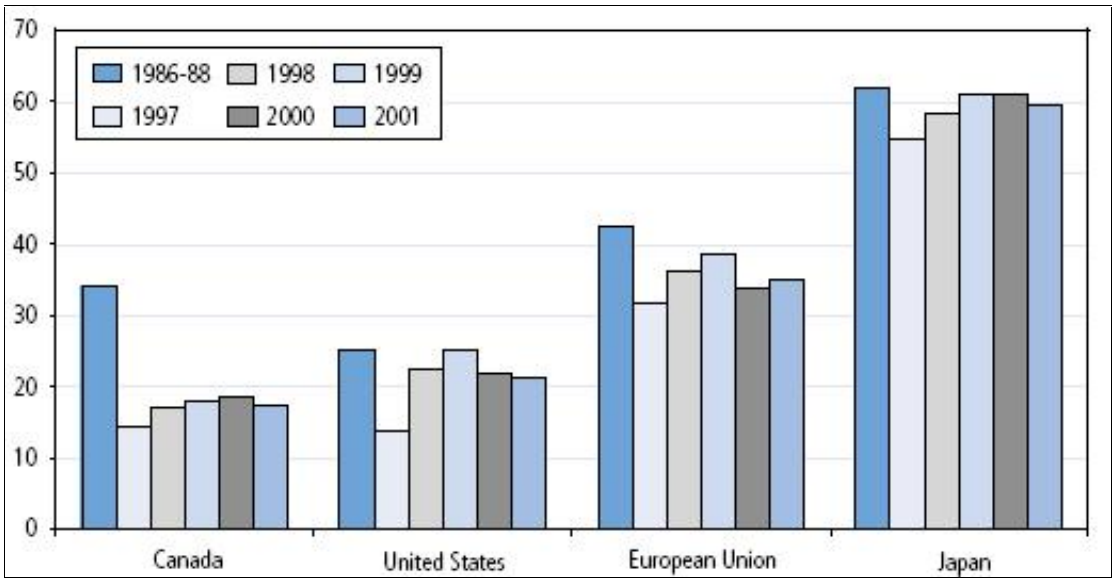
.. Not available.

[a] Percentage share of PSE.

Note: TSE = total support estimate; PSE = producer support estimate; MPS = market price support; OP = payments based on output; IS = Payments based on input use; NPC = nominal protection coefficient.

Source: OECD (2002), *Agricultural Policies in OECD Countries – Monitoring and Evaluation*.

Figure 1. Trends in Producer Support Estimates (PSE) in the "Quad", 1986-2001
Percent of total farm receipt



Source: For Table 1 and Figure 1, WTO Annual Report 2003

The Annual Report also reveals that, contrary to popular belief, subsidies in most developed countries are not targeted towards the poor farmers. In fact, in most OECD countries, a very high proportion of subsidies goes to the top 25 percent of farmers. Quoting an OECD study, the report highlights that in EU, USA, Canada and Japan top 25 percent of farmers receive 70 percent, 89 percent, 75 percent and 68 percent of total agricultural subsidies respectively. Data published in the Annual Report also contradict the claim that OECD countries have mostly moved away from market distorting subsidies like price support to relatively less market distorting subsidies like Blue and Green box subsidies. Data show that market price support is still prevalent in these countries as prices received by the OECD farmers continues to be much higher than international prices. The producer Nominal Protection Coefficient (NPC) of OECD countries shows that the prices received by the OECD farmers were 31 percent higher than international prices in 2001. Estimates show that in 2001, highly trade distorting subsidies like market price support (MPS) and output payments (OP), together accounted for 69 percent of total support to producers in OECD countries. On this, the WTO Annual Report 2003 comments:

"… the continued dominance of the most distortive forms of support means that farmers in many OECD countries remain largely insulated from world market signals. They also constrain agricultural growth and development opportunities in non-OECD countries". Pp. 22.

Recent domestic policies undertaken in most OECD countries suggest that high subsidization of agriculture is going to continue. The proposed reform of Common Agricultural Policy (CAP) of EU has already run into problems in countries like France and it is not yet certain whether and when the CAP reforms will be eventually implemented. But even if the CAP reforms are implemented, the WTO Annual Report suggests that the total EU farm budget will be around €40 billon. However, the report also mentions that this figure does not include subsidies given to farmers via price support and tax concessions. As has been already mentioned, farmers in all the OECD countries, including the EU countries, continue to receive generous price support from their respective governments. Once these subsidies are

added to the figure of €40 billon, it is not clear how much actual reduction in subsidies is going to take place even after the CAP reforms are implemented.

Secondly, USA, through its Farm Security and Rural Investment Act of 2002, has proposed to increase its agricultural subsidies significantly. Under this law, federal spending on US agriculture is slated to increase by US$ 82.6 billion over the next ten years. This will be in addition to US$ 100 billion which the US Government was already set to give farmers. The WTO Annual Report indicates that this huge increase in subsidies primarily will be in production enhancing subsidies. It says: "several of the subsidies contained in the bill would provide incentives to boost production. This is particularly true of "counter-cyclical payments", under which growers of wheat, corn, rice, soyabeans, and cotton will be guaranteed a certain price irrespective of market conditions, thereby distorting both production and trade; in the event that prices fall further, such subsidies will rise accordingly, although a "circuit breaker" built into the legislation is designed to keep spending within the WTO ceiling". Pp. 22.

This large increase in production enhancing subsidies in the US is likely to exacerbate the distortions present in global agricultural trade by artificially inducing overproduction of agricultural commodities and thereby further depressing international agricultural prices. After the Uruguay Round, most developed countries increased their farm subsidies but they did so by shifting some of their more production distorting subsidies (or the Amber Box subsidies) to Blue and Green box subsidies, which are supposedly less trade distorting. But, as USA is now planning to increase their production enhancing subsidies by a huge amount, it is almost certain that distortions and imbalances of the international agricultural trade are going to go up in near future.

The new US farm bill also marks a crucial shift in the negotiating position of USA in the current round of agricultural negotiations. During the earlier stages of negotiations, USA was arguing for sharp reduction in domestic subsidies while the EU was arguing for a more conservative approach. But, given the new US farm bill, it is almost certain that USA will no longer push for a large reduction in domestic subsidies in the current round of negotiations. This has changed the balance of negotiations completely and there is currently an apprehension among developing countries that reluctance of these two major players to reduce domestic subsidies will practically preempt any move by other WTO Member countries to achieve higher reduction in domestic subsidies in the next agreement on agriculture. A recent joint draft proposal submitted by USA and EU about the ongoing agricultural negotiations strengthens this apprehension[1].

The WTO Annual Report also points out that apart from high subsidies, existence of tariff peaks[2] and high specific duties in developed countries continue to restrict market access of agricultural exports from developing countries. According to the WTO Annual Report, incidences of tariff peaks are particularly high in the agriculture sector of these countries. Estimates suggest that roughly 60 percent of the imports of the QUAD countries, which face tariff peaks, come from developing countries. Most developed countries also use specific duties for agricultural imports (see Box 1 for an explanation of specific duty). Specific duties are inherently more problematic than ad valorem rates because they are more opaque than Ad Valorem tariffs and often conceal a very high level of Ad Valorem Equivalent (AVE)[3]. The WTO Annual Report reveals that "between 94 and 98 of the top 100 tariffs (in AVE terms) in Canada, the EU and Japan involve specific duties; they range from 61% to nearly 210% in the EU, from 47% to roughly 1,739% in Japan, and from 56% to 314% in Canada. In the United States, 84 of the top 100 tariffs involved specific duties whose AVEs ranged from 34 to nearly 253%". Pp 17.

Box 1. Specific Duty

Specific duty is defined as an import tax set at a fixed amount per unit or per unit of measure regardless of the value of the item imported. This is different from ad valorem duty which is fixed percentage of the value of an imported product. The major difference between advalorem duties and specific duties is that specific duties do not depend on the prices of imported products and therefore can be used more as a price stabilization and protection mechanism.

As far as market access for non agricultural goods are concerned, the WTO Annual report shows that among manufactured products, tariff peaks are concentrated in textiles, clothing and footwear sectors. For both developed and developing countries, bound rates are highest in textiles and clothing, leather, rubber, footwear and leather products. Tariff rates are higher than average in fish and fish products and transport equipments also. It is not a coincidence that sectors where the developing countries have export interest are attracting much higher tariff rates.

Widespread existence of tariff escalations also hinders exports from developing countries. In most developed countries for both agricultural and industrial goods, tariffs tend to increase with the level of processing. This is called 'tariff escalation'. Tariff escalation discourages exports of value added commodities and locks developing countries in the cycle of producing and exporting primary products and restricts them from diversifying towards more value added exports. It also acts as a major obstacle to local processing of domestic primary products (stage 1) as well as of semi-finished goods (stage 2). The WTO Annual report shows that, among industrial products, incidence of tariff escalation is particularly high in textiles and clothing, leather and footwear products. The WTO Annual Report also points out that in the textiles and clothing sector there is evidence of escalation in non-tariff protection (greater protection given to higher value-added products through non-tariff barriers). Quoting the report of WTO Textile Monitoring Body, the report shows that in the textiles sector, most developed countries have removed quota restrictions mainly on products which belong to the lower value-added range. As the Annual Report comments, such protection impedes developing countries in their efforts to move their production into higher value-added products.

To further restrict market access in their countries, developed countries are increasingly using trade defense mechanisms as Non Tariff Measures. The Annual Report shows that protectionist measures taken by WTO Member countries have gone up in the recent years. The steady increase in trade defense mechanisms like anti-dumping duties, countervailing measures and safeguards leads to the suspicion that these measures are increasingly used as Non-Tariff Measures (NTMs) by the member countries. For example, the number of cases of initiation of Anti-dumping measures increased steadily from 157 in 1995 to 347 in 2001. More than half of the anti-dumping measures imposed by WTO member countries are directed towards two categories of products, namely 'base metals and articles thereof' and 'chemicals and articles'. Secondly, the use of SPS (Sanitary and Phytosanitary Measures) and TBT (Technical Barriers to Trade) have also increased steadily over the years. There is a growing concern among developing countries that these measures are used by developed countries to restrict market access. The report also points out that instances of WTO members resorting to other trade defense mechanisms like safeguards and countervailing measures are also on the rise in the recent years.

These findings are particularly disconcerting for developing countries because implementation experiences show that the Uruguay Round did not bring any fundamental changes in the global trading system. As the WTO Annual Report points out, continued

presence of high level of subsidies in agriculture, backloading of quotas in textiles and lack of meaningful liberalization in the services sector have ensured that the benefits accruing to the developing countries are much less than anticipated. Given this backdrop, this new trend of increased use of trade defense mechanisms is going to be a serious cause for concern for developing countries. Continued deadlocks in the current round of negotiations are not helping the matter either.

Given these problems, it is not surprising that the optimism about the multilateral trading system is gradually fading in most developing countries. As an alternative, most countries are trying to improve their trade relations on bilateral or regional basis. Consequently, there has been a proliferation of Regional Trading Agreements (RTAs) among developing countries in the recent years. According to the WTO Annual Report, currently more than 240 RTAs are operational and as the last years' Annual Report pointed out, more than 50 percent of global trade now takes place through the regional trading groups. It is to be noted here that trading within RTAs does not come under the purview of WTO and, therefore, these regional alternatives are posing a significant challenge to the multilateral trading system. The WTO Annual Report 2003 expresses deep concern about this latest development and comments: "RTAs can complement the multilateral trading system, help to build and strengthen it. But by their very nature RTAs are discriminatory; they are a departure from the MFN principle, a cornerstone of the multilateral trading system. Their effects on global trade liberalization and economic growth are not clear given that the regional economic impact of RTAs is ex ante inherently ambiguous".

However, unless the Cancun Ministerial manages to address the concerns of the developing countries, it is unlikely that the growth and proliferation of RTAs are going to subside. In fact, failure of the Cancun ministerial may even drive countries more towards alternative forms of international trading systems.

The Complete Report can be Downloaded/Viewed at:
http://www.wto.org/english/res_e/booksp_e/anrep_e/anrep03_e.pdf

[1] View the draft text here . For an analysis of the EU-US text, see Martin Khor's article here

[2] Tariff peaks are defined as tariffs which are three times or more the average MFN tariff rates of a country

[3] Ad Valorem Equivalent is the ad valorem tariff that would be equivalent, in terms of its effects on price, to a specific duty.