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SUBSIDIES BEYOND 2006[1]

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Agricultural Markets Are Distorted

Agricultural industries are among the most distorted markets in the world economy. The OECD Secretariat estimated in 2002 that support for agricultural producers just in OECD member countries totaled $248 billion on average per year between 1999 and 2001. When subsidies for consumers and input suppliers are added, total support to agriculture is estimated at $330 billion per year or nearly $1 billion per day, a figure often cited in newspaper editorials. During 1999-2001, the subsidies provided in OECD countries amounted to an average of 49% of farm revenues, indicating how highly distorted agricultural markets are. The commodities receiving the greatest levels of support in OECD countries are meat, milk and rice, which together accounted for 47% of total support. The most common forms of support in agriculture are high domestic market prices paid by consumers and enforced by high tariffs and quota protections. According to the OECD, of total support to agriculture in developed countries, 70% comes from consumers in the form of higher prices derived from trade restrictions and 30% from direct subsidies.

Cotton is not even enumerated in OECD tables but is lumped together with “other” at the bottom. Agricultural policy has been debated historically primarily in terms of wheat and rice, with lesser concern for animal products, oilseeds and feed grains. Specialty crops, including cotton, citrus, vegetables, legumes, sugar, coffee, cocoa, tea and others are rarely considered during international discussions on broad agricultural issues.

Countries would disadvantage their own textile industries by imposing effective import barriers to cotton lint. Therefore, most of the support to cotton provided around the world comes in the form of direct payments that are relatively easy to calculate. There are many countries with barriers to cotton imports, including the USA and India with quotas and numerous countries and regions with tariffs. However, in every significant case, there are escape clauses such as rebates on exported products or special quotas in times of shortage, that render the constraints on cotton imports relatively ineffective.

The ICAC Secretariat estimates that direct support to cotton production during 1999/00 through 2001/02 averaged about $5 billion, of which $3 billion was provided in OECD member countries (the USA and the EU) and the rest in non-OECD countries. Therefore, support to cotton represented less than 1% of total support provided to agriculture in OECD countries.

Since fiscal year 1980 (years ending in September of the year indicated) spending in the USA on the upland cotton program ranged from a high of $3.8 billion in FY 2000 and $3.3 billion in FY 2002 to a low of $-79 million in FY 1990 when loan repayments actually exceeded net new outlays. On the basis of cents per pound of upland cotton production, subsidies in the U.S. have

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[1] Presentation to the Liverpool Cotton Association, 2 October 2003, Liverpool.

been as high as 47 cents twice, in FY 1986 and in FY 2000; the average subsidy per pound between FY 1980 and FY 2002 was 19 cents. The average U.S. upland cotton farm price over those years was 59 cents per pound. Thus, program benefits accounted for one-third of the farm value of production on average.

The Secretariat has been collecting data on cotton program spending under the Common Agricultural Policy of the EU since 1997. Expenditures on cotton in the EU ranged from a low of $645 million in 2000/01 to a high of $980 million in 2001/02. The average benefit per pound of production during the six seasons was 77 cents, compared with an average Cotlook A Index during the period of 56 cents per pound. Thus, benefits to cotton in the EU averaged more than 100% of the farm value of production between 1997/98 and 2002/03.

Pressure for Change

As noted by The World Bank[2] until the 1990s, developed countries usually protected agriculture through direct subsidies to producers plus trade barriers, while developing countries taxed agriculture. This development model was used by Japan in the late 1800s and was considered by the development economics profession to be a proven path to industrialization. However, during the 1990s, developing countries tended to shift from taxing agriculture to encouraging it by reducing restrictions on manufactured imports, devaluing exchange rates, and by eliminating direct export taxes as well as multiple-exchange rate systems that penalize agricultural exports.

However, agricultural policy reforms in most industrial countries have been modest. As noted by The World Bank, border protection (tariffs and quotas) in rich countries continues to be high, nontransparent, and antidevelopment. Average agricultural tariffs in industrial countries are up to four times higher than tariffs on manufactured products. As a result, developing countries almost doubled their share of world trade in manufactured products over the last two decades but their share of agricultural trade did not grow. In cotton, the economic liberalization policies imposed by international lending agencies have required a restructuring of the cotton sectors of many African and Latin American countries, even while subsidies to cotton production in industrial countries have been maintained. This difference in treatment of growers in developed and developing countries, and the apparent inconsistency in adherence to free market principles, is a source of great resentment.

The pressure for change in agricultural policies in developed countries is growing. Agriculture was included under the World Trade Organization (WTO) in the Uruguay Round of international trade negotiations, generating increased hopes among developing countries that subsidies and trade barriers would be reduced. While economists inevitably disagree over assumptions and models leading to disputes over the specific impacts of government measures on individual commodities, there is broad agreement that distortions in agricultural markets, including direct payments and border protections, lead to overproduction and price declines, reducing opportunities for developing countries to expand exports.

WTO Talks

After six years of negotiations, members of the WTO launched a new round of multilateral trade negotiations in Doha, Qatar in November 2001. WTO Trade Ministers called for 1) the reduction, with a view to phasing out, of export subsidies, as well as 2) substantial improvements in market access and 3) substantial reductions in trade-distorting domestic support.

The U.S. tabled a proposal in July 2002 to eliminate export subsidies, reduce tariffs on agricultural products, and limit direct subsidies that distort production and trade to a maximum of

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[2] Global Economic Prospects 2004 – Realizing the Development Promise of the Doha Agenda, Chapter 3: Agricultural Policies and Trade.

5% of the value of agricultural production. The EU tabled a proposal in July 2003 that would keep total agricultural support at current levels but would separate some support from current production decisions and increase spending on social programs, rural development, animal welfare and environmental protection.

Regarding the U.S. proposal, negotiators for the EU, Japan and developing countries noted that it would eliminate export subsidies, which the U.S. does not use extensively, would lower tariffs, which developing countries feel they need, and would reduce production subsidies without touching the fixed payments under which U.S. growers receive approximately one-third of total support. Regarding the EU proposal, negotiators for the USA and developing countries noted that it would not reduce total support for agriculture and would result in only modest reductions in direct support to production and trade. Consequently, WTO members were not able to agree in the talks on agriculture, and the meeting of trade ministers in Cancún, Mexico in September 2003 ended without an agreement to move forward.

Prospects for the Doha Round

There is general recognition that agriculture is crucial to the success of the Doha Round of talks, and the Doha Round will probably not succeed without the support of developing countries. Negotiations under the Doha Round will continue, if for no other reason than that a whole bureaucracy and a small army of consultants exists in Geneva and many capital cities to support trade talks. However, the Doha Round discussions may not reach a conclusion by the end of 2004 as originally scheduled.

An agreement to reduce subsidies that distort production and trade in agriculture will not be easy. Many countries provide support to an estimated 160 agricultural commodities including cotton. The issue of agricultural support is complicated by the existence of state trading organizations, the use of export credits and credit guarantees, tariffs and tariff rate quotas on agricultural products, food aid and other agricultural issues. Further, many countries impose tariffs on textile and apparel products, and the quotas under the Multi Fiber Arrangement (MFA) are still being phased out.

While there are some exceptions to the norm, in general developed and developing countries have broadly separate views regarding the talks on agriculture in the WTO. Generally, developed countries do not wish to consider sector-specific initiatives but instead want to continue to discuss agricultural issues in the aggregate. In contrast, some developing countries with high dependence on specific commodities wish to have separate agreements for individual commodity markets, including cotton. Developed countries are pressing for increased access to textile markets in developing countries. Many developed countries are insisting on negotiations covering labor rights, environmental protection, rules for investment, and rules for government procurement (the Singapore issues) while developing countries are generally resisting these initiatives. In addition, many developing countries believe they are entitled to special and differential treatment in trade negotiations.

An unprecedented aspect of the current round of world trade talks is the emphasis on cotton. Cotton is unusual in being both a labor-intensive crop in developing countries and a capital-intensive crop in developed countries. Even though government measures in cotton constitute approximately 1% of all support to agriculture in OECD countries, the Financial Times declared that the talks in Cancún unraveled over cotton.[3] The ICAC, of course, is focused on cotton and the work of the Secretariat has helped to inform governments of the nature and scope of distortions in the cotton market. Discussions in the ICAC have helped to raise the profile of

[3] Financial Times, Tuesday, September 16, 2003, page 17.

cotton and to emphasize the importance of cotton to hundreds of millions of producers and their families.

Cotton has captured the attention of a number of non-government organizations with a flair for dramatic public relations. Cotton has also caught the attention of some governments in Europe with an interest in economic development in the least developed countries. Nevertheless, even in the ICAC, a number of governments did not support sector-specific provisions in the talks on agriculture during the most recent ICAC Plenary Meeting in Gdansk, Poland. There was a concern by several countries that a separate agreement on cotton would reduce the incentive for countries to negotiate a broad agreement encompassing all of agriculture in the WTO.

A separate agreement just for the cotton sector is very unlikely. Cotton is important to the history and culture of the Greece, Spain and the USA. Within the U.S. and Europe cotton farming occurs in lower-income regions, often in areas where economic alternatives are not attractive. Consequently, there is a long chain of political support for cotton among land owners, cotton input suppliers and small-town merchants with vested interests in continued cotton production. Areas of cotton production in Greece and Spain are categorized as the lowest-income regions within the European Union, and average cotton farm size in Europe is less than 5 hectares. Consequently, the EU sees the cotton income support program as a justified mechanism to help small, low-income producers with limited impact on the world cotton market.

Both the U.S. and the EU argue that as net importers on a whole trade pipeline basis, each is actually helping to sustain the world cotton market. The EU is the largest import market for textiles in the world, and the U.S. is the largest retail market for cotton. The U.S. industry and government contribute approximately $60 million per year in domestic and international cotton market development efforts. These efforts, begun in the 1950s, are boosting world demand for cotton, perhaps by more than subsidies boost U.S. production.

Long Term Prospects for Reduced Distortions

Taking a very long term view, there are grounds for optimism that distortions in agricultural markets will eventually be eliminated. In the period immediately after World War II, the accepted model for government intervention in commodity markets was domestic supply controls, such as acreage allotments and marketing quotas, coupled with international buffer stock schemes. As late as 1980, the world cotton industry was engaged in serious talks to establish an international buffer stock in cotton, and the last commodity buffer stock scheme in natural rubber survived until 1997. While it took about 40 years, the folly of international buffer stock agreements was eventually recognized and buffer stocks are no longer proposed as a solution to commodity problems.

In textiles, developed countries began imposing restraints on imports in the 1950s, and a complex regimen of quotas by product, fiber content and country of origin developed that has governed trade in textiles and apparel since. That whole construct of quotas is being phased out by January of 2005, ending approximately 50 years of textile market distortion.

These examples provide an analogy for what may happen with agricultural support systems that distort production and trade. Farmers and rural sectors enjoy much cultural and political support in almost all countries, and support for agriculture will continue. However, the direct payments to farmers tied to current production and high retail prices enforced through trade barriers are losing intellectual legitimacy as tools of public support for farming. Just as buffer stocks are no longer seen as credible policy alternatives, government measures that distort agricultural production and trade are loosing credibility. As a consequence, even though the negotiations to reduce government measures in agriculture involve complex tradeoffs, subsidies have reached international visibility, and pressures are increasing. Therefore, it is likely that a reduction and eventual elimination of agricultural subsidies, including subsidies to cotton production, will be negotiated within the WTO.

The process of reducing trade-distorting government measures began in the 1980s during the Uruguay Round of trade talks, and if the analogy with buffer stocks holds, it will be another 20 or so years before subsidies to cotton production are eliminated. In the meanwhile, the Secretariat estimates that cotton production in the USA will continue between 3.5 and 4 million tons on average, production in Greece and Spain will continue at its current level of around 500,000 tons, and production in China (Mainland) will continue to vary widely between 4 and 6 million tons.

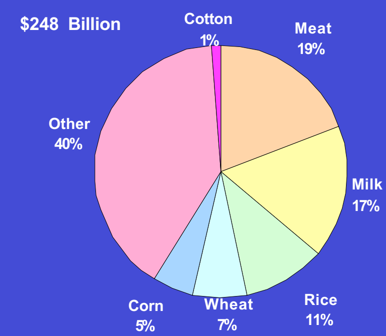
Over the next 20 years, gradual and reciprocal changes in agricultural support programs are likely. There will be an increasing tendency for governments to provide support for rural economic development, animal welfare and environmental protection decoupled from commodity production decisions. As an example of the kinds of changes that are likely, the EU proposed in September that 60% of the support payments for cotton will be decoupled from current production beginning in 2005. Overall levels of spending for agricultural and rural economic support may actually increase in OECD countries as governments struggle to maintain viable rural sectors without making direct cash payments to farmers.

Emphasis will shift in international trade talks, at least for several years, to regional and bilateral negotiations, but it will be difficult to negotiate agricultural subsidies country-by-country. The structure of agricultural subsidies is such that it is nearly impossible to reduce payments to one commodity without also reducing payments to other commodities, and it is impossible to reduce subsidies on commodities by country. For example, in the context of the U.S. cotton program, if a loan rate is provided to cotton producers, it is not possible to withdraw that loan rate for cotton destined for export to Mexico, which produces cotton, but not withdraw the loan rate for cotton destined for Korea, which does not produce cotton.

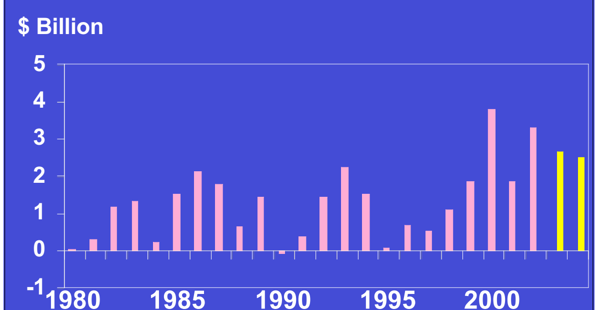
Therefore, the talks on agriculture within the WTO remain the best, and probably the only, forum for discussions to reduce, and eventually eliminate, subsidies that distort production and trade.

International Cotton Advisory Committee

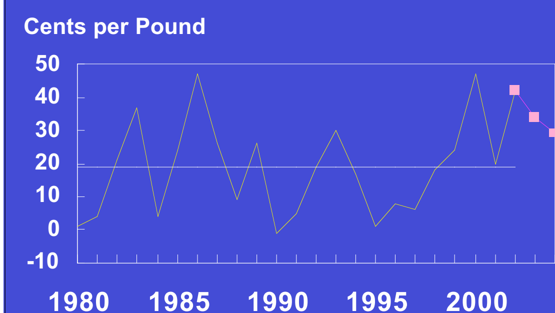
AGRICULTURAL SUBSIDIES
OECD Countries



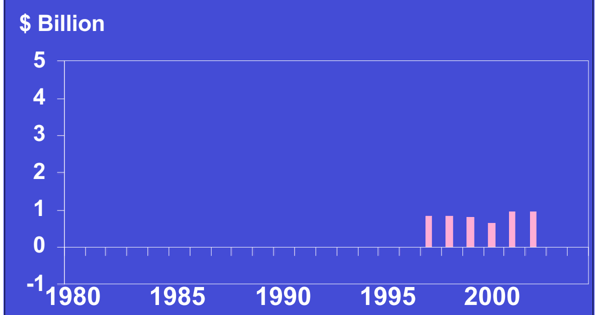
U.S. UPLAND PROGRAM



U.S. Cotton Payments



EU COTTON PROGRAM



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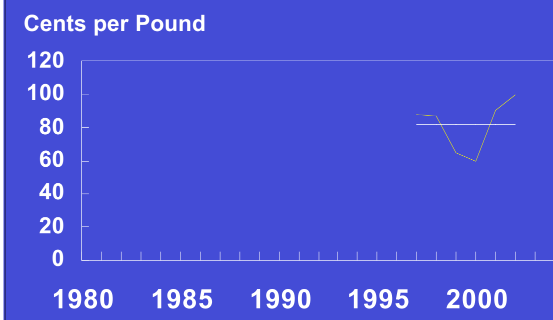


General Patterns of Support

Developed Countries Protect Agriculture – Modest Changes in last decade

Developing Countries Taxed Agriculture prior to 1990s –
Liberalization recently

Resentment Creating Pressure for Change

Distortions lead to overproduction and reduced prices

Doha Ministerial Declaration

1) **Reduce Export Subsidies**
2) **Improvements in Market Access**
3) **Reductions in Domestic Support***

*** Cotton Market Distorted Primarily by Domestic Support**

Doha Round Continuing

160 Commodities

Complex issues:

State Trading Organizations, Export credits, guarantees, tariffs, quotas

Developed vs. Developing Country Views

Emphasis on Cotton Unprecedented

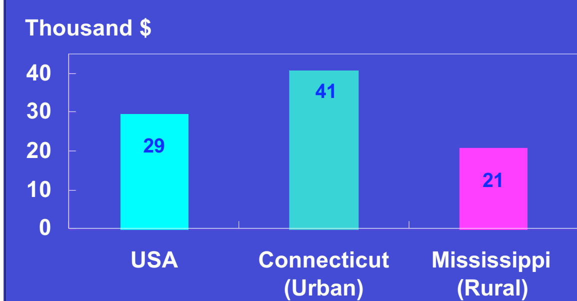
Work of ICAC: Raise Awareness, document injury

NGO's

European Governments

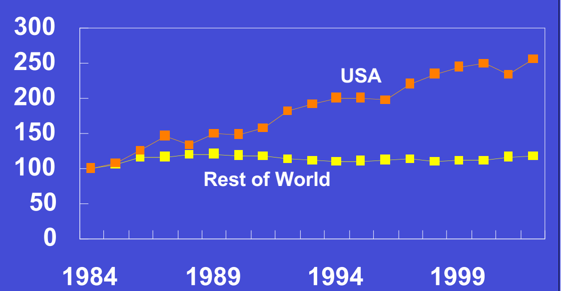
However: No Sector-Specific Agreements

PERCAPITA INCOME



RETAIL COTTON CONSUMPTION

1984 = 100



Long Term Prospects

- Buffer Stocks Gone
- Textile Quotas soon to be Gone
- Agricultural Distortions Losing Legitimacy

Next 20 Years

- Gradual and Reciprocal Reductions in Direct Support
- Increased Rural Development, Animal Welfare, Environmental Protection
- Bilateral and Regional Talks, but WTO is best Hope for Agriculture