institut du développement durable et des relations internationales – 6, rue du Général Clergerie – 75116 Paris – France – Tél. : 01 53 70 22 35 – iddri@iddri.org – www.iddri.org

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Trade and agriculture

Tristan Le Cotty (Iddri, Paris)

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institut du développement et des relations internationales durable

6, rue du Général Clergerie Téléphone :
75116 Paris – France 01 53 70 22 35
www.iddri.org Télécopie :
iddri@iddri.org 01 53 70 21 45

www.cat-e.org

Report on

Trade and Agriculture

Author: **Tristan Le Cotty, IDDRI, Paris**

Reviewers: **Aaron Maltais, SEI, Stockholm**

David Baldock, IEEP, London

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Trade and Agriculture

Preface

The Concerted Action on Trade and Environment (CAT&E) is designed to provide an opportunity for the large and growing community of European researchers working on trade and environment issues to meet regularly, to discuss research hypotheses and methods, to review results, and to develop new lines of co-operative research. CAT&E will launch a dialogue with policy makers at all levels. It aims to create a process that can document the progress of research and generate new research impulses in this area. It seeks to advance the resolution of current conflicts between trade and environment. The information obtained in the course of the Concerted Action is annually summarised in state of the art reports and bibliographies in a fashion that is useful to both researchers and policy makers. The bibliographies focus on the most recent literature. The reports serve as an input to CAT&E's annual members' meetings and open conferences. To structure the reporting and discussions, the following themes have been identified initially (in random order; the theme of the present paper is underlined):

- ✓ Subsidies
- ✓ Government Procurement
- ✓ Investment
- ✓ TBT, SPS, and Labelling
- ✓ Trade and Development
- ✓ Trade, Environment and Human Rights
- ✓ Trade in Commodities
- ✓ Implementation Procedures
- ✓ Trade in Services
- ✓ Intellectual Property Rights
- ✓ Trade and Multilateral Environmental Agreements
- ✓ Dispute Settlement
- ✓ Transparency and Participation
- ✓ Sustainability Impact Assessment of Trade Agreements
- ✓ European Trade Policy Development
- ✓ Trade and Agriculture
- ✓ Trade, Environment and Labour
- ✓ Trade, Environment, and Public Health
- ✓ Science and Precaution
- ✓ Trade and Environment in the Architecture of International Governance.

Introduction and scope of the paper

The fierce debate over agricultural issues at the Cancún Ministerial WTO Conference illustrates just how fragile and young multilateral agricultural co-operation is. The Uruguay Round trade rules in agriculture covering market access, domestic support, export competition and differential treatment for developing countries were to provide a common basis for further trade reform. The repeated rejection of this common basis before and at Cancún suggests that it is not flawless and that the conditions for further liberalisation have changed. Some major countries are afraid that these rules go too far in terms of liberalisation, and not far enough in terms of multilateral co-operation that is synonymous with fair trade, with less distorting policies in rich countries and more agricultural development co-operation in Southern countries. Understanding and helping to overcome the impasse that has characterised agricultural negotiations since the Seattle Conference is a major challenge that politicians are urging academic and field research to address. The impact of liberalising farm policies is not very well known yet and needs more conclusive work regarding the conditions for reaching balanced agricultural trade reform. In particular, this includes a better understanding of the impacts of trade liberalisation on farm income, rural livelihoods and the environment, and a clearer view of the policies requested to limit negative impacts and enhance positive impacts. Researchers have to be imaginative and help figure out what type of trade rules for further liberalisation would provide guarantees to those who are afraid of too much liberalisation and too little co-operation. Why has the academic research agenda failed to adequately address these political needs? What kind of role could researchers play in designing more balanced trade regulation and farm policy regulation at a multilateral level? These are the types of broad issues that the emerging research agenda in agriculture and trade will have to tackle.

Identification of relevant research hypotheses

More conclusive and operational research is required on the role and impacts of trade in agricultural development.

Opening frontiers and removing domestic policies are not sufficient for agricultural development, as structural adjustments in Africa in the 1980s show. They do not seem to be necessary either, since countries like China and India, which are now becoming exporters, have developed their agriculture in an interventionist way. Furthermore, different types of agricultural development are possible, and the ability of domestic policies to take local goals and cultures into account seems to play a key role in determining the type of development, sometimes more than trade per se. It would therefore appear to be very important to gather theoretical and empirical results in order to understand the conditions under which freer markets can lead to sustainable agricultural growth and the type of non-trade policies which should be implemented together with trade regulation. To understand the effects of trade on farm structures and the environment, a lot of investigation is still required, particularly in the developing world where these changes could be more pronounced than those experienced in developed countries because of the importance of the rural population and the difficulties in non-agricultural sectors (FAO,

2004). What domestic policies should be implemented in Southern countries in order to improve productivity in keeping with Southern objectives of sustainable development? What mitigation policies could be adapted to the social and environmental consequences of the increased competition observed in certain sectors -- the banana and sugar cane sectors, for instance? There seems to be widespread social demand for different types of sustainability impact assessments in connection with trade liberalisation all over the world, even within WTO negotiations (for example, see Kirkpatrick & George, 2005).

Researchers should help devise a multilateral framework including negotiated non-trade policies and co-operation rules as a part of policy reforms.

A challenge for the future of international trade-related rules is to design a multilateral framework that can help remove trade distorting or unfair policies without suppressing domestic policies that the new rules will require at the local, national or multilateral levels (e.g. policies supporting societal goals or policies supporting farm investment in Southern countries). This seems to be a necessary condition for trade negotiations to be trusted more around the world, both from the free-traders point of view and from that of the more protectionist countries. An enlarged negotiation framework such as this would help make the two goals of efficiency and sustainable development mutually supportive.

Researchers could help provide a clearer understanding of the economic rationality or lack of rationality of WTO rules.

WTO negotiations tell the story of historical commercial compromises (between the EU and the United States, in particular) more than illustrating a clear economic rationale for trade co-operation. The present trade reform is based essentially on the idea that any national policies suspected of distorting trade should be reduced and, if possible, eliminated. The procedure for going about this is set out explicitly in the WTO Agreement on Agriculture (AoA) and based on box categories for domestic support reform. The implicit reference, or ideal situation, is free trade, which carries a lot of theoretical and empirical problems. First, free markets are generally not optimal as long as externalities exist, which is usually the case with agriculture. Second, they do not consider non-economic goals like food sovereignty. Third, historical policies that impact on today's trade (such as price support, etc.) are not taken into account: only today's policies are taken into account in the reform. In other words, the definition of distortion is very unclear because the implicit WTO reference (free trade) is questionable, even from a welfare theory standpoint. At the same time, the liberalisation of domestic support policies can be welfare-improving for countries that over-support certain farm sectors. Therefore, theoretical research should be conducted to help clarify the type of distortion to be banned. Is it price modification in relation to free trade, or in relation to socially optimal prices, after internalisation of externalities? If so, what kind of decoupling and policy reform are called for (see Anderson, 2003; 2005)?

National research agendas should be co-ordinated to help improve the weak consensus on the rules required

The EU has been developing a position on trade and non-market concerns through the definition and possible implementation of multifunctionality, which still seems highly relevant to the challenges that agriculture will have to face all over the world in the coming years. Specifically, the EU is currently facing a consistency problem with legitimate claims based on multifunctionality, animal welfare, food safety and food quality, on the one hand, and criticism of rent-based and distorting agricultural policy, on the other (Mahé & Ortalo-Magné, 2002). This dilemma of how to support societal goals relating to agriculture in a non-distorting way remains at the heart of the negotiations. Research in Europe could gain from closer association with foreign countries on this controversial and misunderstood issue.

Research needs to answer once and for all the old question of whether agriculture's specificity might eventually justify a special regime

Many authors have argued that agriculture is a specific sector that justifies its own trade regime. The specific characteristics of this sector include the importance of land, implications for rural management, the number of people depending on it, national food security, and the risks associated with erratic, outdoor production. For some, this justifies a special regime, making room for more national sovereignty in policy making, and therefore special status at the WTO. The problem is that agriculture's specificity is often associated with the need for protectionism, although it can also lead to reform proposals. Many authors have also argued that its specific characteristics do not stand in the way of the advantages of trade liberalisation. Open economies can ensure food security, landscape management, etc. A synthesis of this work would help clarify what is at stake with agriculture liberalisation as a whole.

Survey of methodological approaches

From impact assessment to better trade co-operation

The current farm policy reform is already having a very large impact worldwide, although there have been no major changes as yet. In many countries, agriculture is not fully market-based. Effects include changes in farm economics and impacts on the environment and social structure in rural areas. Impact assessments are being carried out all over the world and are showing some interesting findings in terms of the evolution of environmental and social conditions in some areas (NFTA, the Euro-Mediterranean Free Trade Area, WTO). We can identify two main gaps in these studies for operational conclusions:

- The precise causal link between the changes observed and policy reform is not well-documented. (Are these changes due to domestic liberalisation, domestic side-policies, global regulation or global growth, etc.?). Hence, the political and economic conditions required for trade to produce desirable environmental and social effects are not very clear yet.

- Sustainability impact assessments are generally not intended as practical tools for policy making, at the national or the international level. This issue is very sensitive because the role that scientists should play in political decisions is very controversial, but at the same time decision-makers need some kind of advice from scientists.

We know that a key condition for a country to arrive at the social gains expected from free trade theory is efficient labour re-allocation between economic activities. The ability of farmers to adapt to changing markets and rapidly develop alternative activities depends on the country's facilities in terms of access to education and access to credits, and also on industry and service sector development. The re-allocation of production due to increased trade (and specialisation) can sometimes be either impossible or have very significant social, environmental and cultural impacts. Research probably has a key role to play by investigating the economic and political prerequisites for this re-allocation to be possible and successful; appropriate policies for handling these changes; and their trade implications (see Wolf, 2004).

Impact assessment also tends to relate today's impacts to today's policies. It is nevertheless unanimously recognised that historical policies have an impact on today's economy. Farm policies in the EU and the United States have had tremendous consequences on the present situation. The liberalisation rationale under these circumstances is very different from the liberalisation rationale in developing countries that have never had these farm policies. Price support, in particular, has led farmers to invest in and considerably increase their productivity in Western countries. Does this mean that Northern countries should help finance Southern countries' domestic support in order to re-establish more balanced trade?

Towards a better understanding of WTO economic rationality

To move towards mutually advantageous reform and take better advantage of existing and future impact assessments, it is important to better understand the trade reform rationale (what negotiators expect of it) and its legitimacy (what reform is socially desired). Adapted instruments and rules will then be easier to conceive and negotiate. In particular, there is still no clear scientific answer to the following fundamental question: is trade reform supposed to increase each country's wealth (no 'losers') or is it only supposed to increase aggregated wealth (with possible redistribution between countries). In other words, what kind of gains do negotiators expect and what kind of gains should they expect? If reform is supposed to benefit each member country, why are negotiations so difficult and why should WTO rules be compulsory? If reform is not mutually advantageous, what is its legitimacy and should 'losers' be compensated? The answers to these questions lead to two types of trade rule rationality and two types of literature.

The first type of rationality is based on co-operation. This means that each country would benefit from the reform, on the condition that other countries undertook the same reform. This presupposes that the present state of trade is accepted as a base-reference and every member country seeks a kind of reform that would be beneficial. The negotiated agreement would then be mutually beneficial. Surprisingly, the co-operative aspect of the WTO has hardly been addressed by researchers. An academically significant interpretation of this rationality has been provided by Bagwell and Staiger (1999), as far as the GATT is concerned. Large countries have the ability to influence world prices

through their own policies and they can be tempted to set their trade policies strategically to improve their terms of trade. A multilateral agreement is necessary (and sufficient) to prevent this kind of non-cooperative behaviour, and it would be mutually beneficial. It is, for instance, more efficient than a pile of bilateral agreements (see Maggi, 1999; Bown, 2004; Horstmann et al., 2005). With agriculture, the decoupling of producer payments from production and prices should be looked at in this way, so that negotiators can see whether the gains expected are for the domestic country or for other countries, and understand what happens in the presence of externalities and joint public goods. What is its rationality? And where do the gains go? In addition, according to this co-operative interpretation of the GATT (and WTO), why should small countries be subject to any compulsory rules, since they cannot influence world prices and therefore cannot behave strategically?

The non-cooperative interpretation of liberalisation rules ("each country should liberalise its agriculture because it is good for it, regardless of what other countries do") is much more documented and intuitive (see Anderson & Josling, 2005). Nevertheless, its rationality does not account completely for WTO rules. Why do countries need international rules to do something that is in their interest anyway? For instance, many authors consider that the actual definition of the green box is not flexible enough to enable the use of appropriate policies in favour of the local non-trade needs of populations. Why do countries impose such constraints on themselves? What kind of gains do they expect in exchange? Even with this non-cooperative interpretation, it is still necessary to understand better where the gains come from and who bears the losses.

In practice, WTO research is probably a combination of these two types of rationality, but this ambiguity does not help negotiators. A lot of the opposition to the boxes comes from the lack of clarity regarding the meaning and legitimacy of this reform process. With the way that the aggregated measure of support (AMS) itself is calculated, there is no differentiation between imported products and exported products, multifunctional and commercial production, developed and developing countries, or environmentally sound and bad practices. It also does not take into consideration the impact of the history of the agricultural policies, which is probably fundamental. These research efforts could be used to design a more comprehensive way to calculate support for producers, which is presently based on the Producer Support Estimate (PSE; see Legg, 2003). This idea goes hand in hand with the present question in the EU about how to re-couple payments (to the environment or to land?; under what conditions?). It might also be considered that real co-operation should include a multilateral code of conduct regarding the use of instruments that depends on their effect on world prices in particular, and not only on the extent of their decoupling. The emergence of collective preferences could also be explored as a basis for more co-operative disciplines on domestic policies (see Lamy, 2004). New instruments for multilateral co-operation, such as international compensation or side payments, might also be devised (see Kowalczyk & Sjöström, 1994).

Protectionism, trade policy and domestic policy

The welfare effects of trade policies have been discussed for years and are quite well known in standard cases from a domestic point of view (Bhagwati, 1982; Corden, 1997; François & Martin, 2004). In the presence of local environmental externalities, there is a

considerable amount of literature comparing trade policy and environmental policy. A great deal of quantitative analyses, theoretical models, and comprehensive research have helped understand relationships between trade and domestic policies (see Mahé & Ortalo-Magné (2001) for a comprehensive view of the European agricultural model; Guyomard & Lebris (2003) for an evaluation of possible scenarios for the CAP; and Tangerman (2002) for a general evaluation of the effectiveness of the AoA). It is generally argued that liberalisation does not threaten the environment, the first-best policy being a targeted domestic subsidy or tax as opposed to a trade policy (trade barriers or export subsidies, for instance). This trade-off also depends on the cost of implementing environmental policies, however, and the state's institutional ability to do so. There is a lack of research findings on these two points. The dominant view on the virtues of liberalisation and targeted policies largely results from mistrust of untargeted policies, but cannot unambiguously arise from trade theory when these two conditions are not met.

The consequences of trade liberalisation for developing countries are a matter of increasing interest to researchers, who are often faced with a great deal of heterogeneity among countries (Bouet et al., 2004; Hoekman & Ozden, 2005). Academic research on agricultural protectionism in Southern countries is not very conclusive, although the need for research is probably more critical in Northern countries than it is for protectionism. This research should probably concentrate on the institutional conditions required for liberalisation to be successful (see Mallaby, 2004). Impact assessments exist (see Einarsson for the FAO) but they should be enlarged and put together in a coherent framework in order to build a common vision of liberalisation based on facts (see IFPRI, 2003).

Political economy and the AoA

An alternative way of understanding agricultural policies and transfers is to look into the behaviour of governments in relation to special interest groups and voters (see De Gorter & Swinnen (1994) for a review of this literature). The Agreement on Agriculture can also be interpreted as a guide to help countries make reforms that would be politically more difficult to carry out on a unilateral basis because of the structure of the representation of interest groups in the decision making process (see Mahé & Ortalo-Magné for the CAP case). For a general overview of this political economy perspective, see Rodrik (1996). A stark ambiguity remains on the perceived role of the Agreement on Agriculture in this respect. One economic justification for the Agreement on Agriculture is the need to help states design their agricultural policies without overestimating the farmers' influence on public welfare. But negotiations follow a market share based process as if domestic farmers were virtually the main interest to defend.

One could also question the fact that the Agreement on Agriculture is built in such a way as to discipline domestic support, which is probably appropriate for certain Northern countries, but not for Southern countries where agricultural policies are sometimes based on the taxation of agriculture and not on support, for budgetary purposes (see Olson (1990) for an explanation of farm policies through special interest groups).

Multifunctionality

In general, the best policy for taking any environmental effects or other societal expectations into account can be derived from classical environmental economics theory. How-

ever, the specificity of agriculture challenges these broad conclusions. Agricultural technologies depend greatly on commodity prices, but also on local conditions, state investments, and the economic and institutional environment, and they generate various types of externalities and public goods. For this reason, the economic analysis of the relationship between agricultural production and domestic socio-environmental goals (a relationship called multifunctionality) is specific. Several authors, such as Burrell (2002); Mahé & Ortalo Magné (2001); Vatn (2002) and Vermersch (2001), give a global view of the different stakes implied by trade and multifunctionality (welfare, public goods, transaction costs, rights efficiency). Peterson, Boisvert & de Gorter, (2002), Paarlberg (2002) and Peerlings & Polman (2004) model some of the policy implications of taking multifunctionality into account in national welfare. The OECD framework clarifies the microeconomic characteristics of multifunctionality (notably the connection between food and public goods) which could eventually justify some form of specific public intervention, and provides a policy design framework (OECD, 2000; 2003). Nevertheless, these efforts often conclude that empirical analyses are needed to justify public intervention, and domestic support in particular. National justifications for subsidy-like policy will therefore continue to be challenged. Furthermore, political interest in multifunctionality has decreased in recent years, although there is still a pronounced need for balanced policies that meet societal goals and international competition.

Conclusions

The solution to agricultural trade negotiations will likely call for the building of original multilateral knowledge on the relationship between multilateral trade objectives and domestic needs and specificities (multifunctionality, ethics, animal welfare, quality, etc. in an open world). The difficulty of the present negotiations will probably require a gradual decrease in market share based arguments and an increase in international co-operation arguments. Trade is not the only thing that must be dealt with multilaterally, but the way countries deal with their societal goals as well. The EU will probably have a central role to play in future debates on these issues: how to protect national values, cultures, public goods, small farmers, etc., in a trade liberalisation context. It is therefore necessary to develop research from this perspective: how to design future domestic and international policies that are both more efficient in terms of non-trade goals in Europe and abroad, and more efficient in terms of trade goals.

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