View metadata, citation and similar papers at core.ac.uk
brought to you by CORE
provided by Research Papers in Economics

2nd Quarter 2011 | 26(2)

TRADE ISSUES IN THE 2012 FARM BILL

Tim Josling
JEL Classifications: Q18, Q17, F13, F53
Keywords: Farm Bill, Agricultural Trade, WTO Doha Round, Preferential Trade Agreements

This article is part of a series of Policy Issues articles on the 2012 Farm Bill. You can also find articles on The Environment of the Next Farm Bill Debate, External Factors That Will Drive the Next Farm Bill Debate, Farm Bill Stakeholders: Competitors or Collaborators?, and Food and Nutrition Programs in the Next Farm Bill as part of this theme.

Trade conditions provide an important part of the economic environment in which the 2012 Farm Bill will be debated. Among these conditions are the health of the world economy, the strength of the dollar, the path of world commodity prices, and the situation in energy markets. In addition, the political and diplomatic activities resulting in trade disputes, negotiations, and agreements will also be a factor in the prospects for expanding markets overseas and the degree of competition faced by U.S. farmers at home and abroad. These elements will provide the backdrop for the domestic legislative process even if not directly reflected in the bill itself.

This article offers a perspective on the international aspects of the environment in which the farm bill will be decided. The emphasis will be on issues related to world agricultural trade, trade agreements, trade disputes, and international standards. These matters are at least, in part, subject to sensible speculation. The rate of growth in the world economy over the life of the next Farm Bill, and the fate of the dollar over that period, are matters for metaphysical conjecture as much as economic analysis.

World Agricultural Markets

The past five years has seen a remarkable amount of volatility in world agricultural and food markets, as well as in commodity and energy markets. Not since the 1970s has there been such a series of price surges driven by real or anticipated shortages. Stocks have been inadequate to smooth markets, and futures markets have on occasions added to instability rather than dampening market volatility. These issues have received high-level attention, appearing on the agenda for meetings of the world's political leaders. Intergovernmental institutions have been called upon to monitor and report on the twin issues of food security and price instability. And beneath the surface are concerns about the capacity of the world's agricultural and food system to meet the future demands of an expanding global population. If output fails to keep up with growing demand, then relative prices of foodstuffs will rise, reversing the trend for the last four decades of the twentieth century.

This period of instability and concern about future food security has been reflected in the ongoing debates about domestic farm and food policy. At one level it has led to proclamations that support for farmers in developed countries, such as the United States and Europe, should be continued for the purposes of ensuring that supplies are adequate in the future. So far, this argument has not achieved much traction: during a period of high prices it is less easy to make the case that farmers require subsidies in order to stay in business. So the more constructive aspects of the discussion have been on the impact of price instability on hunger and the need to absorb some of risks inherent in farming.

With respect to the impact of food prices on hunger, it should be emphasized that the United States has in place a massive program of food assistance, now called the Supplemental Nutritional Assistance Program (SNAP) and formerly known as the Food Stamp program that reaches over 40 million consumers. Its cost is currently estimated at $75.3 billion for 2011, a sum that accounts for over 75% of the Farm Program costs. But the United States also is involved in assistance to overseas consumers. The Food Aid budget runs at $2.8 billion each year and the President

has launched a Feed the Future initiative that aims to help developing countries institute their own solutions to food insecurity. These programs cost more when prices are high, but are also subject to being cut at times of budget stringency and they face scrutiny in the multinational trade negotiations.

To the extent that domestic markets in many countries are now closely connected with world markets, instability of farm product prices can pose serious problems for farmers. Each country has its own remedy for this. In the United States, crop insurance has become a major component of the "safety net" as price supports such as loan deficiency and countercyclical payments recede in importance. In the EU, the consolidated "single farm payments" act as a stable income source enabling farmers to take risks in adapting to market openings. Though questions remain about the distribution of such payments, there is no move to curtail them at this time.

In addition to influencing the terms of the domestic debate, world prices influence US agriculture, and thus the context for the Farm Bill, through export performance. US exports have been growing rapidly in the past few years, providing much needed income at a time when domestic sales were flagging. This year the value of exports is expected to be over $135 billion (USDA, 2011). The current expansive situation depends however on the continuation of the growth of the global economy, particularly the larger emerging economies such as India, China, and Brazil.

Growing demand for food in other countries does not guarantee expansion of U.S. farm exports. The competitiveness of such exports is determined in part by developments abroad but in part by domestic policy decisions and economic conditions. Competition from Argentina and Brazil for crops, as well as Australia and New Zealand for livestock products, has intensified in the past decade, though medium term currency movements often hide changes in underlying costs. Fuel and fertilizer costs have also become significant constraints for U.S. farmers as they expand exports, though many of these cost increases are shared with competitors.

Among the domestic policy determinants of competition are the costs associated with regulations. The farm sector has become concerned about the expansion of regulations relating to dust and air pollution, ground water contamination and greenhouse gas emissions. The issue has taken on a political dimension that makes resolution more difficult. The Environmental Protection Agency (EPA) has taken the brunt of the criticism, and is often seen as being less than sympathetic to farm concerns. The EPA, as with other agencies, is vulnerable to cuts in the appropriation of funds to operate its programs.

Perhaps the most significant impact of world prices on U.S. farm policy is manifest through the budget available for farm programs. When world prices are high, spending on farm programs declines. One might think that this would be welcomed, as the opposition to such programs would be muted. But the baseline for future programs is also reduced, limiting the funds that would be available in a subsequent period of low prices. Much of the farm bill debate is about spending priorities—such as between commodity programs, crop insurance, conservation and food stamps—with the amount of expenditure available being in part a function of world price developments. If farm program proponents become convinced that the world is likely to experience high commodity prices for the next decade or so, then direct payments that are not price-linked may be the preferred instrument. If the feeling is that farm prices are likely to fall back in a year or two, then price-linked payments and insurance instruments would be more attractive.

The Doha Round

The WTO Doha Round of trade negotiations has staggered on for close to a decade. The agricultural talks have been largely, though not entirely, responsible for the slow progress. Other areas of the talks, such as tariffs on manufactured goods and further opening up of service sectors, were virtually neglected for the first years of the negotiations. As a result, the crafting of a "package" acceptable to all WTO members has so far proved impossible. In agriculture, the main issues have been the depth of tariff cuts for farm products, the elimination of export subsidies and the tightening of the allowable limits of trade-distorting domestic support (WTO, 2008). Currently the agricultural talks are virtually complete with only a small number of items where tough political decisions will have to be made. In the meantime, trade officials are considering what limited agreements could be reached in December 2011 to ensure that the Round does not grind to a complete halt.

For agriculture the outcome of the Doha Round, if agreement can eventually be reached, can be assessed with some degree of confidence. Translating that into actual impacts on particular markets or trade flows is much more difficult because that requires speculation on the actions of other countries and the reactions of competitors.

One certain outcome is that export prospects for the major U.S. farm and food sectors are likely to improve steadily if not dramatically with the conclusion of the Round. The most significant aspect of the agricultural talks is that of market access. The Uruguay Round provided a more transparent basis for trade negotiations by obliging the

conversion of virtually all non-tariff trade measures into tariffs. However, the cuts in those newly bound tariffs were minimal, 36% on average for developed countries, but, in effect, rather less. The Doha Round would cut developed country agricultural tariffs by 50-70%, with the higher cuts applied to higher tariffs (Martin and Mattoo, 2011). However, countries could designate up to 4% of tariff lines as "sensitive" and compensate for smaller tariff cuts by offering more reduced tariff rate quotas (TRQs). Though this would modify the impact of tariff cuts, it would not offset their effect entirely: the minimum average cut across products would have to be 54%.

Somewhat less ambitious cuts are likely to be made in tariffs in developing countries. Part of this is a result of the fact that WTO negotiations center on bound, or maximum, duty rates rather than the applied rates that are often much lower. Developing importing countries prefer to keep high bound rates, enabling them to raise tariffs if circumstances require. Exporters seek to lower these bound rates even when there is little immediate impact on market access. In addition, the bound rates apply to non-preferred suppliers: most countries are members of one or more preferential regional or bilateral trade pacts that have reduced or eliminated tariffs among themselves. In these cases, reductions in bound tariffs may still not be enough to make nonpreferred suppliers competitive. In spite of all these caveats, developing country tariffs on agricultural products will be reduced in a Doha agreement, though by a maximum of 36% on average.

As with most trade negotiations, tariff reductions are reciprocal. The United States has a significant market that other countries wish to supply. U.S. imports of agricultural goods are estimated to be about $88 billion this year. Tariffs on imported agricultural and food products are generally low, but some product markets are still protected by significant tariffs and TRQs. From the viewpoint of the Farm Bill, a cut in tariffs for sugar and dairy would restrict the ability of domestic policy to maintain high prices. Dairy producers are already contemplating an alternative policy and sugar producers have been under notice for some years that this program may eventually be wound up. Lower tariffs and expanded TRQs, if the United States were to designate these commodities as sensitive, would increase the pressure for change.

Though less immediately significant in terms of trade expansion, the constraints on export subsidies are of systemic importance. Export subsidies were limited in the Uruguay Round, but it was not until the Doha Round that their elimination became politically possible to negotiate. The EU has been the major user of export subsidies for the past few years, and the United States' export enhancement programs have largely been phased out or made consistent with WTO rules. One export program that could be affected, however, is food aid. The United States is a significant contributor to in-kind programs that are based on U.S. products and that allow recipient governments and nongovernmental organizations (NGOs) to sell the products in the marketplace. Other food aid donors prefer cash contributions that allow recipient governments to purchase supplies from the most convenient source, often a country in their own region. The Doha restraints on food aid will not cut the provision of emergency aid or hunger relief efforts, but may make the United States change its distribution policies.

The constraints put on domestic farm support programs by the Uruguay Round were major steps towards limiting the use of subsidies that distort trade. As the major champion of this approach, the United States saw it as a way of keeping the EU and other developed countries from undercutting market access gains with domestic subsidies. The Doha Round provides an opportunity to scale back all price-related programs to 20-30% of their current limits. The projections for the United States, Japan and the EU are for domestic support payments to be below these new Doha limits; but, in the case of the United States, the picture could change with sharply lower world prices (Orden, Blandford and Josling, 2011). For U.S. agriculture, the question is whether to take the risk that U.S. policy spending on price-related programs may be constrained in the future in order to get the assurance that competitors cannot increase their own spending on such programs.

One important product that has given a boost to U.S. corn prices, and land prices, in recent years is not subject to the same WTO disciplines in the Doha Round. Ethanol is classified as an agricultural product, but the U.S. "special duty" on ethanol imports is not included in the agricultural tariff schedule that would be subject to cuts in the Doha Round. And the subsidies to ethanol—the volumetric tax credit given to blenders to encourage them to use ethanol and meet Congressional mandates—are not included in the domestic support that would be subject to reduction. The issue of subsidies that encourage consumption have not been a concern in the past in trade rules. But the concerns about the impact of biofuel mandates on food prices have led to a reconsideration of this neglect.

Bilateral Agreements

The languid pace of the WTO Doha Round is in contrast to the almost frantic activity in the last decade as countries signed some 200 more limited trade agreements on regional or bilateral levels. These agreements have often been dismissed as being of little interest in opening up agricultural markets because countries made certain, through quotas and long transition periods, that their domestic farm sectors were not immediately threatened. But the long

transition periods are coming to an end and only the most sensitive agricultural sectors have been granted continued exemption (Josling, 2009a). The enthusiasm for these preferential trade pacts ebbs and flows, but their cumulative impact is beginning to be a major factor in agricultural markets.

In the United States, the spate of small-but-interesting bilateral agreements came to a halt after the adoption of the Central America Free Trade Agreement (CAFTA) and the inclusion in that agreement of the Dominican Republic. The last three agreements negotiated by the previous Administration—with Korea, Colombia, and Panama—still await Congressional approval. The agreement with Panama is of relatively small significance for agriculture, but would bring some political benefits in the region. That with Colombia is of greater benefit for U.S. agriculture, in particular because some competitors have recently been granted access to that market. Korea is the biggest prize, but again U.S. agriculture could find itself with less free access than competitors if the agreement is not ratified soon. At present there is a disagreement as to whether to link the passage of all three agreements to extension of adjustment assistance for workers whose jobs might be displaced. But it still seems likely that the trade pacts will be ratified within this calendar year.

The latest set of trade negotiations has the most potential for future export growth. In May 2006, four countries—New Zealand, Singapore, Chile, and Brunei—formed an informal group to promote free trade in the Pacific region. Two years later the United States indicated a willingness to join this coalition, and this led to the inclusion of Australia, Peru, and Vietnam in the talks on an expanded free trade agreement. The initiative was renamed the Trans-Pacific Strategic Economic Partnership (TPP) and nine countries—including Malaysia—are currently in negotiations. The aim is to eliminate all tariffs within 12 years, with 90% of trade being free after the first year. The significance of this move is in its value as a framework for others to join. It is seen as a complement to the “unilateral” approach of the Asia Pacific Economic Cooperation (APEC) process that emerged 10 years ago. Agricultural trade would be among the most significant aspect of such an agreement, if progress continues to be made.

Trade Conflicts

Negotiating a trade agreement implies a commitment to reduce trade barriers and to allow more competition. Trade conflicts arise generally within such agreements when political pressures in one country lead to actions that appear to other trade partners to violate those agreements. The WTO has a strong and effective dispute settlement regime and many of the regional and bilateral trade agreements have similar provisions. The United States was broadly in favor of such provisions as a way to put pressure on large trade partners—such as the EU and Japan—to comply with agreed upon rules. Thus the WTO dispute settlement regime took on the task of resolving some contentious agricultural trade disputes that had emerged through the 1980s. But the nature of such conflicts has changed somewhat over the years (Josling, 2009b*)*. Now developing countries often make use of the dispute settlement system when they feel that developed countries are violating the rules. The United States has been challenged by several countries in the WTO for aspects of domestic policy that are arguably at odds with agreed-on commitments. The outcomes of these cases have had a direct impact on domestic farm policy.

This is seen most clearly in the case of cotton. Brazil successfully challenged several aspects of the policy for upland cotton, notably the “step 2” subsidies to processors, the export credit programs, and the price-linked payments under the commodity programs. Direct payments were not found to have caused “serious prejudice” to Brazilian cotton farmers, though the WTO panel did query their compatibility with the rules of the green box. At issue was the provision that prevented the cultivation of fruits, vegetables, and wild rice on land eligible for direct payments. A more general challenge was later mounted by both Brazil and Canada on the designation of direct payments and certain other subsidies as green box support. These countries claimed that with correct notification, the United States would have exceeded its commitment for trade-distorting support, also known as total aggregate measures of support (Total AMS), in several recent years. This case is ongoing, but its significance depends on whether the Doha Round is concluded. Other WTO cases are likely to impinge on U.S. farm policy and the writing of the Farm Bill. One of these is the requirement for country-of-origin labeling (COOL) that has been challenged by Canada and Mexico as an undue impediment to their livestock sectors (Sawka and Kerr, 2010*).*

Concluding Comments

The international economic outlook for U.S. agriculture is essentially positive. If emerging economies continue their impressive growth then farm and food exports should continue their strong upward trends. A conclusion of the Doha Round would contribute to this export expansion even though some protected sectors, such as sugar and dairy, would face increased competition from abroad. In addition, the completion of the Round would meet many of the objectives that U.S. agriculture has had over the decades, limiting high levels of domestic support in other developed countries and eliminating the practice of subsidizing exports. It would be somewhat perverse if these desirable

outcomes were to be ignored in favor of keeping a little more flexibility for domestic policy. But perversity is not unknown in the area of farm policy.

Ratification of the three pending trade agreements would also confirm the willingness of the United States to pursue a policy of open markets in farm goods. The agreements with Colombia and Panama would fit in with a hemispheric approach to trade policy aimed at countering competition from Argentina, Brazil, and Chile in the region. Ratification of the agreement with Korea would have more significant trade implications and could be the turning point in the Asian region, where agricultural trade liberalization still meets strong resistance.

But how significantly the conclusion of the Doha Round and a ratification of the three bilateral agreements would influence the farm bill is less than clear. The Doha Round would certainly put additional constraints on trade-distorting subsidies, but the new rules might only be felt if world prices were to collapse. The nature of export policies, including export credits and food aid, would have to adjust, but this may have been the direction of policy in any case. Tariffs would be reduced, but these are not generally decided as part of the farm bill. So the direct impact of a Doha conclusion is not so much on the 2012 Farm Bill as on the nature of the world market onto which the United States sells so much in the way of products. Whether these benefits will be enough to convince the agricultural sector to support multilateral trade liberalization is not certain. Farmers cannot “take to the bank” trade agreements that promise the ability to compete for somewhat larger markets in future years. But combined with market expansion through income and population growth, reduced trade barriers would be an important guarantee that countries could not slam the door on imports when domestic pressures mount. So the Doha Round and the bilateral agreements provide a valuable insurance policy for farmers and ease the way for a shift from income support to risk management.

For More Information

Josling, T. (2009a). Agriculture, in Simon Lester and Bryan Mercurio, (eds.) *Bilateral and Regional Trade Agreements: Commentary and Analysis*, Cambridge University Press, Cambridge, UK

Josling, T. (2009b). Agricultural Trade Disputes in the WTO, in James C. Hartigan (ed.), *Trade Disputes and the Dispute Settlement Understanding of the WTO: An Interdisciplinary Assessment*, Emerald Press, Bingley, UK.

Martin, W. and Mattoo, A. (2011). *The Doha Development Agenda*, World Bank, Washington, D.C.

Orden, D., Blandford, D. and Josling, T. (eds.), (2011). *WTO Disciplines on Agricultural Support: Seeking a Fair Basis for Trade*. Cambridge University Press, Cambridge, UK.

Sawka, A.L. and Kerr, W.A. (2010). Challenging US Country of Origin Labelling at the World Trade Organization: The Law, The Issues and The Evidence, CATPRN Commissioned Article 2010-01, October.

USDA. (2011). World Agricultural Supply and Demand Estimates. WASDE 492, US Department of Agriculture, March 10.

World Trade Organization (WTO). (2008). Revised draft modalities for agriculture. TN/AG/W/4/Rev.4, December 6. Geneva.

Tim Josling (josling@stanford.edu) is a Senior Fellow at the Freeman Spogli Institute for International Studies, Stanford University, Stanford, California.

© 1999-2011 Choices. All rights reserved. Articles may be reproduced or electronically distributed as long as attribution to Choices and the Agricultural & Applied Economics Association is maintained.

The farmdoc project distributes Choices in partnership with the Agricultural and Applied Economics Association.

click here to visit choicesmagazine.org >>