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Potential Effects of the WTO Framework Agreement on U.S. Agriculture

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Introduction

The 147 members of the World Trade Organization (WTO) reached an agreement July 31, 2004, on the framework for the final phase of the Doha Development Agenda of global trade talks. After failing to reach such an agreement at the Cancun ministerial meeting in September, 2003, this framework agreement puts the Doha Round back on-track. Negotiations on the details will begin in September 2004. The original deadline to complete talks by January 1, 2005, has been postponed, and the next WTO Ministerial Conference will be held in Hong Kong in December 2005, at which point the talks could near their conclusion.

The objective of this report is to analyze the potential impact of the framework agreement on U.S. agriculture. Most of the details of the agreement have not yet been determined, so an in-depth empirical analysis of the Doha Round is not possible. The agreement does, however, provide a number of objectives and a framework for the final agreement which can be analyzed.

What the WTO Agreement Says for Agriculture

The three pillars for the WTO negotiations for agriculture are domestic support, export competition, and market access. With regard to domestic support, the framework agreement calls for each member's total trade-distorting support to be cut by 20 percent from currently allowed levels in the first year of implementation. The level of permitted trade-distorting support targeted for reduction includes the Final Bound Total Aggregate Measure of Support (AMS) plus the permitted de minimus level and blue box support. Further reductions will take place in subsequent years according to a yet-to-be-determined tiered formula. Under the tiered formula, countries having higher levels of trade-distorting support will make greater overall reductions in order to achieve a harmonizing result. Final bound total AMS will also be reduced according to a tiered formula, and product-specific AMSs will be capped at their respective average levels according to a methodology to be agreed on. According to the agreement, blue box support will not exceed 5 percent of a country's average total value of agricultural production during a historical period, and green box criteria will be reviewed and clarified to ensure that green box measures have no, or at most minimal, trade-distorting effects or effects on production.

Under the pillar of export competition, the framework agreement calls for the elimination of export subsidies, as well as export credits with repayment periods beyond 180 days. The schedule for the elimination of these export subsidies and credits has not yet been determined. The framework also calls for greater discipline and transparency of state trading enterprises (STEs).

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Trade distorting practices with respect to exporting STEs are to be eliminated, including export subsidies provided to or by them, government financing, and the underwriting of losses.

Finally, greater market access will occur through the reduction of tariffs. Tariff reductions will be made through a tiered formula that takes into account different tariff structures. Deeper cuts will be made for higher tariffs, which should lead to greater harmonization in tariff levels across countries. Reductions will remain flexible, however, for sensitive products.

Special and differential treatment for developing countries exists throughout the agreement. Developing countries will be allowed longer implementation periods for the reduction of tariffs and domestic support and the phasing out of export subsidies, as well as other special considerations.

Disadvantages for U.S. Agriculture

The plan to reduce domestic support could affect future U.S. farm programs. The allowable limit of trade-distorting domestic support is reduced by 20 percent in the first year of the agreement, with future cuts to come in subsequent years. It is important to note that this is a 20 percent cut in permitted spending levels - not actual spending levels. U.S. Trade Representative Robert Zoelick has said that the 20 percent cut would not affect current U.S. farm-spending levels because of the way it is structured.[1] Under this structure, the cut applies not just to amber box payments but to total allowable trade-distorting payments, including the de minimus and the blue box. The agreement states that "the overall base level of all trade-distorting domestic support, as measured as the Final Bound Total AMS plus permitted de minimus level and the level agreed...for Blue Box payments, will be reduced according to a tiered formula" and "as the first installment of the overall cut...the sum of all trade-distorting support will not exceed 80 percent of the sum of Final Bound Total AMS plus permitted de minimus plus the Blue Box."[2] The current de minimus exemption rule permits product-specific support to be excluded from the AMS calculation if the total outlay is less than 5 percent of the value of that product's production, and non-product specific support outlays may be exempted from the AMS calculation if they fail to exceed 5 percent of the total value of a country's agricultural production.[3]

The United States is permitted to spend $49 billion per year on total trade-distorting domestic support but has actually been spending considerably less than that. Over the last three years, the United States has spent about $23 billion annually on trade-distorting farm subsidies.[4] Therefore, a 20 percent reduction in allowable trade-distorting subsidies from $49 billion to $39 billion would not affect current U.S. farm spending levels. It would restrict the amount the United States could spend on farm subsidies, however, if prices were to fall to a level where more than $39 billion would be paid out under the current farm program.

[1]Reuters, "Sen. Daschle Wrong on WTO Farm Deal - USTR Zoelick." August 5, 2004.

[2]World Trade Organization, "Doha Work Programme: Draft General Council Decision of 31 July 2004." WT/GC/W/535, July 31, 2004. p. A-2.

[3]Paggi, Mechel S. "Meeting the U.S. WTO Commitments." Beltwide Cotton Conference, January 11, 2002.

[4]Allowable trade-distorting support and actual spending is according to U.S. trade officials as referenced by Reuters in "Sen. Daschle Wrong on WTO Farm Deal - USTR Zoelick," August 5, 2004.

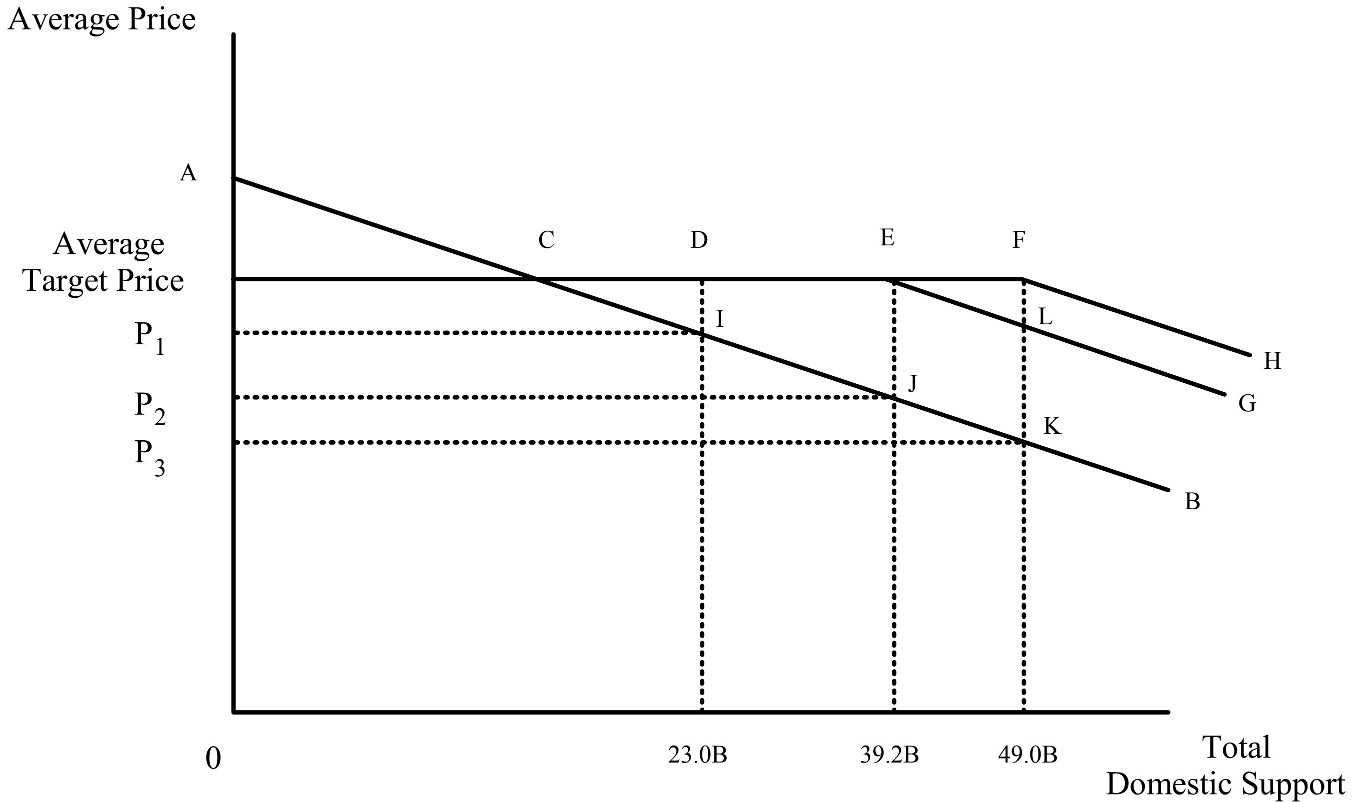

Figure 1. Federal Domestic Support Level Limits and Relative Prices

Figure 1 is a graph depicting the operation of the U.S. target price system and the restrictions of the bounded domestic support level currently allowed by the WTO. Line A-B represents the relationship between the market price and government spending. Current total federal trade-distorting payments for all crops equal $23 billion annually at an average price level of P_1. When the average price decreases from P_1 to P_3, total government payments would increase to $49 billion, which represents the current bounded subsidy level allowed by the WTO. A 20 percent reduction in the bounded domestic support would place the level at $39.2 billion. If the price level drops to P_2, average domestic support will be $39.2 billion. As long as the price level is maintained above P_2, the reduction in permitted domestic support will not have any effect on producers. If the price level drops below P_2, total return for the producers will be reduced. With the current level of federal payments limits, the potential producer return is represented by line ACFH, as prices drop. With a 20 percent reduction in allowable domestic support, the potential producers total return is line ACEG. The price level P_2 is the point when the reduction begins to affect producer return.

Table 1 shows an estimation of various federal payment levels and average price levels. National counter-cyclical payments were estimated at various price levels to determine when and if federal support would exceed the new limit. Current spending is about $23 billion, which is shown in column 3. Recent prices for the major commodities are also shown in column 3. The next columns represent 95 percent, 90 percent, 85 percent, and 80 percent of current price levels. It was assumed

Table 1. Counter-cyclical and other Trade Distorting Payments for the Past Three Years
Average Price and Alternative Prices of Major Program Crops

		Average Price	95%	90%	85%	80%
Wheat	$/bu	3.17	3.01	2.85	2.69	2.54
Corn	$/bu	2.15	2.04	1.93	1.82	1.72
Soybeans	$/bu	4.96	4.71	4.46	4.21	3.96
Rice	$/cwt	4.23	4.01	3.80	3.59	3.38
Cotton	$/lbs	0.40	0.38	0.36	0.34	0.32
Total Subsidy Payments	$ million	22,958	27,305	31,653	36,001	40,348
Times National Wheat Price was Below Average Level		12	10	9	7	3

that all prices move together. As commodity prices drop, federal spending increases. A 95 percent price level requires federal spending of $27 billion. At an 80 percent price level, federal spending exceeds the lower bounded support level of $39.2 billion. At that point, the representative prices are $2.54 for wheat, $1.72 for corn, and $3.96 for soybeans. The last row in the table shows the number of years during the past three decades that the national price of wheat was lower than the recent average price. For example, 12 times during the past 30 years, the national price was lower than the current average of $3.17. The price for wheat was lower than the 80 percent level of $2.54 only three times during the past 30 years.

A 20 percent reduction in the allowed domestic support level would most likely not have any effect on U.S. producers. In only three years (1977, 1986, and 1999), prices of wheat were lower than that level. However, if the amount of the reduction were increased in the future, effects of the reduction would be felt more often as the market price fell below the maximum payment limit prices.

The 20 percent reduction in allowable spending is just the beginning of cuts. While the initial reduction in permitted farm subsidies may not have any effect on actual U.S. farm spending levels, future cuts under the WTO agreement could result in a reduction in actual farm spending levels. The degree of those future cuts is not yet known. The agreement also says that in addition to cutting total permitted trade-distorting support, final bound total AMS will also be substantially reduced. This cut would likely affect the level of U.S. amber box payments and could lead to a restructuring of farm program payments.

In theory, cuts in domestic subsidies could reduce production in marginal land in most countries, which would increase world prices of subsidized crops. However, this may not happen, mainly because agricultural production is not sensitive to subsidy levels in these countries.

The elimination of export credits with repayment periods beyond 180 days could have a negative effect on U.S. exports. The U.S. Department of Agriculture's (USDA) export credit programs offer loan guarantees for markets that many commercial lenders consider too risky. Much of the credit is on terms of up to three years. These USDA programs underwrite credit extended by the private banking sector in the United States to approved foreign banks. The Export Credit Guarantee Program (GSM-102) covers credit from 90 days to three years, and the Intermediate Export Credit Guarantee Program (GSM-103) covers longer credit terms up to 10 years. In recent years, the USDA has offered about $4.5 billion in loan guarantees per year under GSM-102 and about $150 - $200 million per year under GSM-103. The level of actual exporter applications received for the GSM-102 program has averaged about $3 billion per year in recent years. Almost all of the export credit under the GSM-102 program is on terms of 24 months or 36 months.[5] Limiting the repayment period to 180 days or less could have some negative effects on exports, but it was a concession the U.S. negotiators were willing to give in order to get the European Union (EU) to agree to the elimination of exports subsidies.

Benefits for U.S. Agriculture

Benefits for U.S. agriculture from this framework agreement include the elimination of export subsidies, the harmonization of trade-distorting domestic support, cuts in tariffs and the harmonization of tariffs rates, and greater discipline over STEs. These measures should create a more even playing field.

The United States is sure to benefit from the elimination of export subsidies since the European Union is the only major user of export subsidies. The formula to harmonize trade-distorting domestic support should also help the United States since the EU's domestic support levels are much higher than those in the United States. The EU currently spends about $71 billion per year on total trade-distorting domestic support, and its allowable limit is $127 billion. The initial reduction in allowable spending will not affect the current EU spending level, but future cuts could affect EU farm subsidy spending since the tiered formula for domestic support reduction will require WTO members with higher levels of trade-distorting domestic support to make greater overall reductions.

Increases in market access throughout the world will benefit U.S. agriculture. U.S. tariffs on agricultural products are among the lowest in the world, so a reduction in tariffs will likely increase U.S. exports more than imports. The tariff reduction formula also calls for deeper cuts in higher tariffs, which would benefit the United States. Special and differential treatment given to developing countries could somewhat lessen the increase in market access, but the agreement calls for substantial improvements in market access for all products.

Finally, the United States could benefit from greater discipline over STEs. The agreement could force the Canadian Wheat Board to become more transparent, and it would eliminate any trade-distorting practices used by the Canadian Wheat Board or other exporting STEs.

[5]Information on the USDA credit guarantee programs was obtained from the Foreign Agricultural Service online at http://www.fas.usda.gov/excredits/exp-cred-guar.html . Accessed August 2004.

Conclusions

Although a lack of details about the WTO agreement limits the ability to complete any in-depth empirical analysis, some general analysis can be conducted on the recent framework agreement agreed to by the WTO members. Possible negative effects for U.S. agriculture include a reduction in farm subsidies and restrictions on the use of export credits. The initial 20 percent cut in allowable trade-distorting domestic support will not affect current U.S. farm spending levels, though future spending levels could be affected if prices fall low enough or if the WTO agreement calls for significant future cuts in domestic support. The agreement will call for future reductions in allowable spending on trade-distorting domestic support, but the exact amount is not yet known. The effect of the WTO agreement on U.S. farm programs will depend largely on the details of the agreement, which have not yet been negotiated. Negotiations on the details begin in September 2004. Restricting the repayment period to 180 days or less on export credits could have a negative effect on U.S. exports, but the elimination of export subsidies by the EU - the only major user of export subsidies - and greater discipline over the Canadian Wheat Board could make U.S. agricultural exports more competitive. The United States would also benefit from increased market access and greater harmonization between the United States and the EU in trade-distorting domestic support.