Discussion FORUM

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The Development Impacts of Agricultural Subsidies

Washington-area professionals gathered on November 13 for the tenth session of the IRG Discussion Forum, "The Development Impacts of Agricultural Subsidies." David Orden of the International Food Policy Research Institute (IFPRI) outlined how agriculture and trade policies of industrialized countries inflict harm on developing countries, reviewed the outcome of the September World Trade Organization ministerial meeting in Cancún, Mexico, and explained what changes are needed to reduce the negative impact of subsidies on developing countries. William Cline of the Institute for International Economics and the Center for Global Development explained the links between agriculture protection and global poverty, stating that trade liberalization can contribute to economic growth and poverty reduction.

Global annual subsidy payments to farmers total $327 billion and exceed the value of foreign aid offered to poorer countries by a factor of six. The distortion effects on the global agricultural sector created by these huge payments are enormous, as is their negative impact on developing countries. The inability to address this issue was a key element in the recently failed trade talks in Cancun. What exactly are the development impacts of agriculture subsidies? Where do we go from here to reconcile politics and policy?

A Subsidy Primer

In the aftermath of the 1930s Depression, when commodity prices collapsed, many governments resorted to market price support—raising farm prices administratively. The objective was to increase domestic agricultural production to feed growing populations and maintain a balance between rural and urban incomes. Import restrictions ensured that domestic production could continue to be sold. However, expanded production of certain agricultural products not only replaced imports completely, but resulted in structural surpluses. Export subsidies were increasingly used to dump surpluses onto the world market, thus depressing world market prices. This, coupled with the effects of overvalued exchange rates and low food price policies that favored urban consumers, led to a reduced incentive for farmers in developing countries to increase or even maintain their agricultural production levels.

The result of all this was a proliferation of impediments to agricultural trade, including import bans and quotas, variable import levies, minimum import prices, and non-tariff measures maintained by state trading enterprises. Major agricultural products such as cereals, meat, dairy products, sugar and a range of fruits and vegetables have faced barriers to trade on a scale uncommon in other merchandise sectors.

Impact of Subsidies and Protectionism

Research has quantified the impact on developing countries of industrialized nations' agricultural subsidies and protectionist policies. According to a study released by the International Food Policy Research Institute (IFPRI), the cost to developing countries is about $24 billion annually in lost agricultural and agro-industrial income. Other studies put the resulting loss of rural income as high as $60 billion annually. Trade-distorting measures of industrialized nations also displace

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> *—David Orden, IFPRI senior research fellow*

For More Information...

IFPRI: www.ifpri.org

Institute for International Economics: www.iie.com

Center for Global Development: www.cgdev.org/

World Trade Organization: www.wto.org

Carnegie Endowment for International Peace/Trade, Equity, and Development: www.ceip.org/files/projects/gfted/gfted_home.ASP

U.S. Farm Bill: www.usda.gov/farmbill/

WTO Agreement on Agriculture: www.wto.org/english/tratop_e/agric_e/ag_intro01_intro_e.htm

more than $40 billion of net agricultural exports per year from developing countries.

"The trade policies of the industrialized countries cause great harm to the economies of many developing nations which depend heavily upon agriculture," said David Orden, IFPRI senior research fellow. The IFPRI study concluded that, "Small-scale farmers in developing countries have a hard time competing against subsidized products that are dumped on their local markets. One more kilogram of subsidized sugar in the European Union could very well mean one less kilogram produced in Kenya or Guatemala. Another bale of subsidized cotton in the United States may mean less production in Mali. Or another ton of subsidized rice in Japan can have the same displacement effect in Vietnam."

In 2001, for example, U.S. government support to the cotton industry totaled $3.4 billion. Because the U.S. accounts for about 40 percent of the global cotton market, West Africa lost $190 million as a result of low cotton prices. This loss exacerbated their foreign debts and balance-of-payment constraints.

Studies also show that damage done to farmers has a ripple effect throughout the economy. Since the economies in most developing countries are highly dependent on agriculture, the spillover effect is very pronounced. Conversely, strategies to increase agricultural growth can produce a multiplier effect on the economy of the poorest countries, particularly in regards to employment, productive land, capital investment, and advances in technology.

Need for Agricultural Trade

Agricultural trade, an important part of overall economic activity in many countries, continues to play a major role in domestic agricultural production and employment. The trading system also plays an important role in global food security; for example, by ensuring that temporary or protracted food deficits arising from adverse climatic and other conditions can be met from world markets.

WTO Agreement on Agriculture

Agriculture traditionally has been treated as a special case and outside the multilateral trade-liberalizing process that began with the General Agreement on Tariffs and Trade (GATT) after World War II. It was not until the Uruguay Round negotiations of 1986–1994 that governments started to bring agriculture into the process and address the distortions of production, consumption, and trade in the sector.

The Uruguay Round looked at all measures affecting trade in agriculture, including domestic agricultural policies and the subsidization of agricultural exports. Clearer rules for sanitary and phytosanitary measures were also considered necessary, both in their own right and to prevent circumvention of stricter rules on import access through unjustified, protectionist use of food safety as well as animal and plant health measures. The Agreement on Agriculture and the Agreement on the Application of Sanitary and Phytosanitary Measures were negotiated in parallel, and a Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-developed and Net Food-importing

"Progress in reducing agricultural support and protection among the world's wealthy countries would be an important accomplishment for development and strengthening of the multilateral trade regime."

—Trade, Equity, and Development. *Issue 6. 2003.Carnegie Endowment for International Peace.*

Developing Countries also formed part of the overall outcome.

The WTO Agreement on Agriculture, which came into force in 1995, aims to establish a fair and market-oriented agricultural trading system. This comprises specific, but limited, commitments to reduce support and protection in the areas of domestic support, export subsidies, and market access, and through the establishment of strengthened and more operationally effective GATT rules and disciplines. The Agreement also takes into account non-trade concerns, including food security and the need to protect the environment, and provides special and differential treatment for developing countries, including an improvement in the opportunities and terms of access for agricultural products of particular export interest.

The WTO Ministerial Conference in Cancún in September 2003 provided an opportunity for world governments to agree on a more far-reaching plan to make agricultural trade more equitable. The breakdown of those negotiations, and an earlier increase in subsidies in the 2002 U.S. Farm Bill, have slowed the liberalization process.

Liberalization and Poverty Reduction

It is estimated that liberalizing trade, reducing subsidies, and minimizing protectionism would reduce poverty and triple developing countries' net agricultural trade. See Table 1.

Table 1

Combined Long-term Static and Dynamic Effects of Free Trade on Poverty in Selected Countries Preliminary Estimates

(millions, change from baseline)

	Static		Dynamic		Total	
	Central	High[1]	Productivity Effect	1/2 Additional Steady State Effect[2]	Central	High
Asia						
Bangladesh	-4.1	-13.3	-35.6	-12.3	-51.9	-61.2
China	-24.7	-87.2	-47.1	-13.4	-85.2	-147.7
India	-28.3	-74.8	-74.6	-127.4	-230.4	-276.9
Indonesia	-6.1	-15.1	-8.8	-15.2	-30.2	-39.1
Malaysia	-0.2	-0.2	-0.4	-1.1	-1.7	-1.7
Pakistan	-7.9	-13.0	-22.9	-52.1	-82.8	-87.9
Philippines	-2.3	-2.0	-2.9	-3.3	-8.5	-8.3
Thailand	-4.1	-4.0	-0.7	-10.8	-15.6	-15.5
Latin America						
Argentina	-0.7	0.1	-0.1	-0.5	-1.4	-0.5
Brazil	-1.0	-0.4	0.0	-0.8	-1.8	-1.2
Cen. Am.& Carib.	-3.2	-2.9	-1.1	-4.4	-8.7	-8.4
Mexico	-0.4	0.4	-0.2	-0.7	-1.3	-0.5
Sub-Saharan Africa						
Mozambique	-0.8	-0.4	-0.3	-1.0	-2.1	-1.7
South Africa	-0.6	-1.1	0.1	-1.0	-1.5	-2.0
Tanzania	-1.4	-3.1	0.0	-1.6	-3.1	-4.8
Uganda	-0.7	-2.5	-0.1	-1.0	-1.7	-3.6

1 Adjusts for chapter 3 agricultural sector estimates

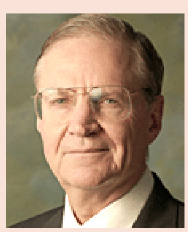
2 One-half increment of steady state (induced capital investment) effects above static

Source: William Cline. Trade Policy and Global Poverty, *Center for Global Development and Institute for International Economics, forthcoming*

About the Speakers

David Orden

David Orden conducts research at IFPRI on agricultural policy and international trade, including the impact of industrialized country agricultural subsidies on developing countries. Before joining IFPRI in 2003, Dr. Orden was professor of agricultural and applied economics at Virginia Polytechnic Institute and State University. Previously, he was a visiting professor at the University of New South Wales and at Stanford University. He is the author of many publications, including coauthor of the book *Policy Reform in American Agriculture: Analysis and Prognosis.*



William Cline

William Cline has been a senior fellow at the Institute for International Economics since its inception in 1981. During a leave from the Institute, Dr. Cline served as deputy managing director and chief economist of the Institute of International Finance. Previously, he was a senior fellow at the Brookings Institution; deputy director of development and trade research at the U.S. Treasury Department; a Ford Foundation visiting professor in Brazil; and a lecturer and assistant professor of economics at Princeton University. He is the author and editor of more than 20 publications on international economics and trade policy.

What Can Be Done?

A diverse group of development and trade liberalization advocates agree that reduction of agricultural protection and subsidization in the world's wealthy countries is necessary to strengthen both international growth opportunities and the global trade regime. According to the consensus reached among participants attending a conference cosponsored by the Carnegie Endowment for International Peace and the Cordell Hull Institute, WTO Doha Round negotiations on agriculture should compel policy changes in industrialized countries to limit trade-distorting domestic subsidies for agricultural products, lower tariffs, increase market access, and eliminate export subsidies. Wealthy nations also need to invest more aid resources to developing countries, particularly in agriculture and human development

Industrialized nations may need to make major changes, but studies estimate that as much as 80 percent of liberalizing gains will come from developing countries liberalizing their own markets. Developing countries must look to reform their own policies, eliminating biases against agriculture and investing in agricultural research and development. Internal protectionist measures on agriculture, if reduced, will actually decrease the cost of food for poor consumers who spend more than half their income on food. Increased investments in health, education, roads, land reform, water access, farmers' organizations, and other forms of social capital are needed. Given limited financial resources in these countries, however, those investments will need to come in the form of aid from the industrialized world.

About the IRG Discussion Forum

The IRG Discussion Forum, a monthly event hosted by Henri-Claude Bailly (chairman of IRG's Board of Advisors), addresses issues affecting international development. Each session is informal, with guest speakers and attendees participating in a personal capacity. For comments, questions, or information on the Discussion Forum, contact discussionforum@irgltd.com or call IRG at 202-289-0100.

2004 Schedule

January 22	February 19
March 18	April 15
May 20	June 17

Forum Feedback

- Agricultural liberalization would likely have the added effect of reducing urban migration since it would encourage small farmers in the developing world to remain in the agricultural sector.
- One projection of trade liberalization is that global income would increase $24 billion annually. Assuming 3 billion people live in poverty, this equates to only $8.00 per person increase, which would seem to have little impact. However, the effects would not be evenly distributed across the population because this formula does not account for other changes that may occur simultaneously. Trade liberalization is just one tool for achieving poverty reduction, but could be a catalyst for other policy changes or technology solutions.
- Utilizing land for production of crops, such as corn, for ethanol production needs to be carefully examined. For example, utilizing productive land for ethanol rather than food could actually increase agriculture prices and increase poverty.
- Market mechanisms exist that can smooth out short-term volatility, but long-term volatility (3–4 years) is more problematical.
- One opinion favored subsidies for developing countries, but not industrialized nations. However, it was pointed out that subsidies in developing nations currently only help the rich farmers, not the small landholders. ■

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