7 June 2003

Mark Ritchie & Sophia Murphy, Institute for Agriculture and Trade Policy, Minneapolis.
E-mail: mritchie@iatp.org; smurphy@iatp.org; telephone, +1 612 870 3400 or fax + 1 612 870 4846

Supporting Sustainable Agriculture—
The WTO and Structural Distortions in World Agricultural Markets

Talks on agriculture at the World Trade Organization (WTO) have stalled. Following an ambitious timetable set at the fourth WTO Ministerial Conference in Doha, Qatar in November 2003, WTO member states were to have agreed modalities for a revised Agreement on Agriculture (AoA) by 31 March 2003. This has not happened. There is another deadline—January 2005—which is the date governments set to finalize the Doha Agenda negotiations as a single undertaking. Nonetheless, there is anxiety in trade circles that the inability to find common ground in agriculture is a sign that other negotiations will not go well either. To date, agriculture is one of seven areas in which governments have missed the deadlines they set for themselves in Doha. Moreover, agriculture is arguably the most important agreement for many developing countries—it remains a mainstay of many of their economies. However questionable the merits of trading-off different economic sectors against one another, many developed countries hoped that an early deal in agriculture would ensure greater developing country buy-in for negotiations on services, industrial tariffs and, in particular, the so-called Singapore issues, especially investment and competition.

In Doha, WTO Member States agreed to follow the revised Agreement on Agriculture should echo the framework of the existing agreement, which looks at market access, domestic subsidies and export support, with some consideration of non-trade concerns (explained below). Governments also promised in Doha to consider special and differential treatment for developing countries in each part of the agreement. The draft negotiating text proposed by the Chairman of the agricultural negotiations, Stuart Harbinson, in February (and somewhat revised in March) follows this basic framework.

There are widely differing views among member states on what to do within this framework. The Cairns Group (an association of developed and developing countries with large agricultural export interests) continues to push for the elimination of all forms of export subsidies; substantially increased market access, including deep tariff cuts; and major reductions in production-distorting

domestic support.[1] The U.S. claims to be sympathetic to the Cairns Group, but is much less clear on the question of reducing domestic support; they try to distinguish between their programs ("good") and the European Union's and others' ("bad"). The United States is also unwilling to reform either its export credit or food aid programs, both of which contribute to the sale of under priced agricultural goods in world markets at the expense of other exporters.

The European Union, and even more so Japan, South Korea, Norway, and Switzerland have been much less enthusiastic than the Cairns Group and the United States about deeper liberalization of their agricultural sectors. These countries, together with a few others, have made non-trade concerns a central part of their negotiating positions. Under the Uruguay Round Agreement on Agriculture, non-trade concerns included rural development, food security and environmental protection. The European Union has proposed to add animal welfare and eco-labels to the category. Governments invoke non-trade concerns (NTCs) as justification for measures that would otherwise be challenged as protectionist; indeed, many governments, particularly agricultural exporters, complain that NTCs do not belong in the WTO at all. The countries that advocate NTCs are also supporters of multifunctional agriculture, which emerged in an agricultural policy rather than trade context, but has now become part of the trade debate. The US, together with Australia and Argentina in particular, and many developing countries, all reject multifunctional agriculture vehemently. They see as poorly disguised protectionism—a way to reinvent existing programs along new, but as trade-inhibiting, lines.

Fifteen or so developing countries have formed a loose affiliation called the Like Minded Group. The members share an interest in increasing their agricultural exports, but they are also looking for measures to control unwanted imports of dumped produce from world markets. The Like Minded Group has also articulated proposals that aimed at the protection of food security and the livelihoods of low-income farmers.

Small island developing states, such as Mauritius and many of the Caribbean countries, form yet another group of developing countries. This group is concerned that their dependence on one or two commodities for export revenues forces them to rely on unstable world prices. These countries have

---

[1] There are currently 18 members of the Cairns Group: Argentina, Australia, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Fiji, Guatemala, Indonesia, Malaysia, New Zealand, Paraguay, Philippines, South Africa, Thailand, and Uruguay.

been hurt by changes in the terms of preferential access to European markets under the Cotonou Agreement; many of them are not able to compete at low prevailing world commodity prices.[2]

This profusion of views reflects the impossibility of isolating trade from other areas of policy. Many trade commentators claim the AoA is simply about trade rules; that other fora exist to address the non-trade aspects of agriculture. However, as the references to non-trade concerns in the agreement itself show, agriculture does not divide so tidily into trade and non-trade in practice. Policies designed to protect employment, or income levels, or to meet nutrition targets may conflict with policies to ensure absolutely open markets. The trade community cannot avoid grappling with the challenges this reality presents. The AoA allows countries some leeway to determine the support measures they want for their agricultural sectors—measures that would fail a stringent test for zero trade impact. Unlimited spending is allowed for programs that support low income and resource poor farmers in developing countries. All countries are allowed unlimited spending on decoupled income support to farmers; programs linked to production-limiting objectives; insurance programs; infrastructure provision; and, public food stocks (if purchased at world prices). In practice, these exemptions represent billions of dollars of expenditure in Europe and the U.S. Much of the production they support ends up dumped at below cost of production prices in world markets.

International trade is not inherently inimical to sustainable production systems. Trade is a tool that allows production to be concentrated in areas where the natural conditions and available resources are most suitable, while ensuring broad distribution of that production. As the very concentrated nature of some commodity production for export shows (three countries account for over 80 percent of corn exports, over 90 percent of soybean exports, and more than half of world rice and wheat exports), some countries are endowed with the capacity to grow more food than they need. Others must rely on the production of goods they can exchange for food to make up for both temporary and sometimes chronic shortfalls in domestic food production. However, the importance of trade per se does not tell us how best to manage the details of trade. In particular, the management of international trade poses two kinds of challenges for public policy makers interested in promoting sustainable practices. The first set of challenges arises from market distortions that inhibit market forces from maximizing efficient resource use. The second set arises from market failures that require policy interventions to protect the public interest.

---

[2] The Cotonou Agreement is the most recent iteration of the Partnership Agreement between the European Union and countries in Africa, the Caribbean and the Pacific (known as ACP countries).

The following discussion considers the appropriateness of WTO rules in light of these two sets of challenges.

Market Distortions: Are WTO Rules on Track?

Existing WTO disciplines target some important sources of distortion in agricultural markets that undermine sustainability. For example, export subsidies have contributed significantly to the sale of food at less than cost of production prices on world markets, diminishing developing countries development potential and pushing small farmers and traders out of their local markets. Export subsidies and domestic support programs designed to keep commodity prices low have together increased the market power of transnational seed, chemical, grain, processing and retailing companies at the expense of producers around the world. Too often, tariff barriers in developed countries discriminate against value-added processing in developing countries, which discourages badly needed investment in developing countries and perpetuates existing trade patterns that heavily favour the few richer countries over the rest of the world.

Still, the WTO rules fall far short from really tackling market distortions that drive unsustainable practices. The global food production and marketing system is highly concentrated. Chemical companies (which now dominate the seed business) are linked to grain traders and food processors through vertically integrated alliances. The same companies buy, ship, and mill grain, then feed it to livestock or turn it into breakfast cereal, often crossing several national borders in the process. Although trade negotiators have focused on payments to producers as the problem, examination of domestic support programs in the US show that the subsidies actually benefit transnational agribusinesses, who capture the benefits from low commodity prices in their shipping, processing and livestock operations.[3]

A relatively small number of private firms manage the globalized food system. These firms are enormous. The world's largest food and beverage company, Nestlé, employs nearly 230,000 people in about 480 factories worldwide, and sells its products nearly every country in the world.[4] Nestlé grossed some US$50.2 billion in 2002.[5] Cargill, the largest private company in the world and probably

---

[3] A 1998 survey of farm records for southwest Minnesota found that average net farm income was US$ 8,616. The corresponding government subsidy was US$ 30,000. In other words, the money does not stay on the farm.
[4] From Nestlé's website, www.nestle.com/all_about/at_a_glance/index.html
[5] From the Fortune 500 for 2002, on-line at http://www.fortune.com/fortune/global500/snapshot/0,15198,55,00.html

the world's largest commodity trader, had annual sales in 2002 of over US$50 billion.[6] More significant than the fact that three countries dominate world soybean exports—the United States, Brazil and Argentina—is that the same three companies dominate the export of soybeans from all three countries: Cargill, ADM and Bunge. These companies and their practices are at least as significant as the public policies that affect agricultural production and international agricultural trade, not least because of their political influence on the public policies in question. However, multilateral trade rules ignore their market power, assuming that governments are the only source of market distortion.

Another market distortion, this time positively encouraged by the AoA, is the result of legal, unlimited decoupled payments to producers. Decoupled payments are unrelated to either current production levels or crops. The justification for such programs is that they do not provide an incentive to farmers to grow more or less of any particular crop and so proponents of the policy claim the payments do not affect production decisions. The U.S. was the first to adopt such programs on a large scale. The experience has been counter-intuitive. Despite expectations that low prices and the end of support for growing certain crops would reduce production, production has in fact increased. The continuing decline in farm income, low prices affecting all commodities, and the large fixed costs that make it rational to continue production even at a net loss of 30 percent or more, have all inhibited the expected decrease. In many crops, production has actually increased, in the face of declining prices. Since payments are tied to land-use, landowners keep their land, while farmers who want to stay in business look for more and more acres to rent to realize what economies of scale they can. In 1997, the US Department of Agriculture found 41 per cent of US agricultural land in production was rented out, and the trend was increasing.[7]

One of he gaps between rhetoric and reality is the assumption that the only sources of distortion in agricultural markets are caused by governments—high tariffs or high levels of support. In practice, the market dominance of a small number of firms is at least as important a source of distortion. Oligopolies capture the benefits of policies such as tariff reductions, reducing the assumed benefit to consumers by 60 percent or more (of course depending on the degree of control exercised by the oligopoly in question).

What of the second set of concerns—the externalities that markets cannot take account of?

---

[6] From Cargill's website, www.cargill.com/finance/highlights.htm

[7] Wunderlich, G. (1993), "U.S. Farmland Ownership: A Century of Change", *Agricultural Outlook*, December 1993, USDA: USA.

The Limitations of Agricultural Trade Liberalization for Sustainability

The AoA has implications for agricultural production systems beyond rules and exemptions. The agreement is premised on the idea that fewer trade barriers will make it easier to meet demand for food at a fair price for consumers by favouring the most efficient producers.

This assumption ignores the question of purchasing power—millions of people do not have enough money to access the food they need on the market. It ignores dietary preferences—many of the primary sources of calories for people across the planet are not sold in global markets; in fact, much of the food sold in world markets is destined for animal feed. The assumption ignores the importance of agriculture in providing livelihoods—over 50 per cent of the world's population is still rural, most of them dependent on agriculture, either directly or indirectly, for their survival.[8] Productive efficiency is important but unless countries have alternative employment for people displaced from the land, it may not be welfare-maximizing to value productivity over all other economic indicators.

The AoA also ignores important ecological considerations. With the spread of industrial models of agriculture, genetic diversity is threatened. Many of the remarkable production increases in agriculture over the last 50 years have come through focusing production on a small number of plant and animal varieties that have specific attributes—for example, greater yield per plant or a higher lean to fat meat ratio in livestock. Although this has kept supplies of food plentiful in the face of a growing population, it has also created problems by diminishing our genetic resource base.

> "The best available information indicates that currently approximately 30 percent of all livestock breeds are at risk of extinction. Loss of animal genetic resources has been the greatest in developed countries, which have often concentrated on a few high-input breeds to the detriment of their locally adapted breeds."[9]

Given that we face constant uncertainty, related to changing weather and climate patterns, the emergence of new pests, and unprecedented levels of contact between even the most remote places, the protection of our genetic diversity is central to ensuring sustainable development. The development of new species through genetic engineering and the potential, in some cases realized, for these species to cross-breed with wild relatives, has introduced a whole host of new challenges to maintaining a diverse gene pool.

---

[8] Statistics on-line at FAO's statistical database: http://apps.fao.org/page/collections?subset=agriculture.
[9] FAO (2002), on-line resource on Biological Diversity at www.fao.org/biodiversity/default.asp?lang=en

A neo-classical approach to regulating trade in agriculture also ignores some fundamentals about agricultural production and consumption. Demand in agriculture is relatively inelastic. Since people must eat to live, they spend as much as necessary on obtaining a basic caloric intake. Once sated, however, food is of little interest, no matter how low prices may go. Production is also inelastic. Supply is very much dependent on the weather. Over 90 per cent of global rice production depends on the same monsoon system. China's average wheat production is equivalent to all the wheat traded in international markets. World markets tend to be residual—even the most heavily traded crops (except a few tropical commodities such as coffee) only trade about 30 per cent of production over national borders. Only 17 per cent of wheat and 5 per cent of rice is traded internationally. This means that bad weather in a few countries makes an enormous difference to the supply of food available from international markets. Physical stocks are essential to compensate for production shortfalls and to keep a steady supply of food at affordable prices available.

Multilateral trade rules for agriculture are essential. Our world is too interdependent for countries not to take responsibility for the impact of their policies on others. Countries are the result of historical and geographical accidents, not the careful creation of agriculturalists, ensuring ideal conditions to meet all food requirements within national borders. However, to ensure that international trade plays a positive role in ensuring food security, protecting our environment and creating livelihoods, it is essential that trade rules respect the characteristics that distinguish agriculture from other sectors. The review of the Uruguay Round Agreement on Agriculture is a chance to improve what we have; let us hope governments seize it.

New Models

Agricultural markets are not perfect, but instead tend to oligopoly. Production for the world market is heavily concentrated among a few countries. The push to facilitate the movement of goods and capital is encouraging the diffusion of an unsustainable, and unsafe, industrial food system.

The tensions this gives rise too are evident in the debates in Geneva. Some countries are trying to defend a vision of agriculture based on what they call "multifunctionality". Although widely disparaged in trade circles, multifunctionality is not rooted in a trade context. Rather it is an attempt to develop a new paradigm for agriculture that takes into account the non-market roles that agriculture plays. For example,

MFA – new paradigm for ag. Not to protect, and not to defend existing, but to develop a new basis for domestic ag policy that does not damage south, and avoids the damage to water and soil of existing system.