



Building on the July Framework Agreement: Words of Advice and Words of Caution

WTO agricultural negotiators are currently working toward a “first approximation” of the detailed modalities to be agreed in Hong Kong in December 2005 based on the July Framework Agreement concluded last year. **On many levels, the July Framework offers innovations and improvements earlier negotiating texts and the Uruguay Round Agreement on Agriculture. Countries now have an opportunity to make meaningful reductions in trade-distorting domestic support, expansions in market access and eliminations in subsidized export competition.** An analysis of the July Framework Agreement commissioned by the International Policy Council points to several areas where such progress is possible, if countries have sufficient ambition. This analysis also points to areas where progress on paper may not translate into progress in reality.

DOMESTIC SUPPORT

The July Framework Agreement expands the domestic support measures to be reduced to include all forms of trade-distorting support (Amber Box, product and non-product specific *de minimis*) and it caps moderately trade-distorting support (Blue Box). **A reduction in the overall level of trade-distorting support is a very positive innovation and has the potential to exert greater discipline on actual support than did the Uruguay Round Agreement. However, by widening the support to be disciplined, the July Framework Agreement also substantially increases the base of support from which reductions will be made.** For example, countries not using certain forms of trade-distorting support could theoretically count the allowances for each of these measures (up to a total of 15 percent to 25 percent of the total value of production) in their Overall Trade Distorting Support ceiling.

If countries can count these allowances toward their overall level of trade-distorting support, then the level of trade-distorting support permitted under the July Framework Agreement will be much higher than their permitted levels of trade-distorting support in the Uruguay Round. According to the International Policy Council's analysis, if the United States were allowed to count all of its allowed levels of support (permitted Amber, Blue Box, product and non-product specific *de minimis*) in the Overall Level of Trade Distorting Support, the United States base could be twice as high as its current level of trade-distorting support. In the case of the European Union, this new support base could be one and a half times larger than its current level of trade-distorting support.

Since the base level of support will be much higher under the July Framework, the reduction in the permitted level of Overall Trade Distorting Support will need to be significant if it is to be effective. The International Policy Council's analysis indicates that cuts on the order of 60 percent or more will be needed to result in even minimal reductions in actual levels of trade-distorting support. Countries that have reformed their agricultural policies by moving toward less distorting subsidies will have less to do than countries that have moved in the opposite direction. With the exception of a few smaller countries with extremely high levels of support, cuts of this magnitude will go a long way towards both reducing and harmonizing the share of overall trade distorting support to the overall value of production.

In order to reduce the most trade-distorting subsidies, the percentage cuts in the most trade-distorting subsidies should be at least as large as cuts in Overall Trade Distorting Support. The cuts in each component of support may, in some cases, be more binding than the cut in Overall Trade Distorting Support. Similarly, if countries agree to reduce commodity-specific support the reduction formula for each product would need to be of similar magnitude to the reduction percentages for Overall Trade Distorting Support to ensure that trade-distorting support is reduced proportionately across commodities. If the final agreement raises the level of permitted support, caps Blue Box subsidies, and caps commodity-specific subsidies, there is a risk that some countries will see these maximum levels as “entitlements” that must be fully utilized, rather than as the basis for continued reductions in trade-distorting support. For this reason, **defining appropriate Blue Box criteria, reducing *de minimis* levels, and capping commodity-specific support are crucial to prevent countries from circumventing the objectives of reducing Overall Trade Distorting Support.**

Payments with “no, or at most minimal, trade-distorting effects or effects on production” were exempted from cuts in the Uruguay Round. As a result, these decoupled payments (Green Box) have become significant for many developed countries. Increasingly countries want to link producer support to particular production methods, environmental protection and conservation, as opposed to simply providing farmers with direct payments that are not contingent on fulfilling other objectives. WTO rules currently limit such payments to covering the cost of compliance or

the opportunity costs of the resource. While the WTO should remain neutral on the rationales a country uses to provide payments to farmers, if such payments become a new mechanism for supporting agriculture, these payments must also be minimally trade distorting. **The WTO should establish a process under the auspices of the standing Committee on Agriculture to evaluate new programs and policies to ensure they are non- or minimally-trade distorting.** Such a process would provide a degree of certainty to countries that new Green Box policies would not be challenged under subsequent dispute panels.

EXPORT COMPETITION

In perhaps its greatest step forward, the July Framework Agreement makes clear that all forms of subsidized export competition will be eliminated. Export subsidies for non-agricultural products have been banned since the early days of the GATT because they are the most directly trade distorting. So, **even though economic analysis indicates the gains from eliminating subsidized export competition may be modest compared to other pillars, it is important not to underestimate the impact that elimination will have on the political dynamics of the negotiations, on certain product sectors, and indeed on the domestic programs that necessitate export subsidies.** The elimination of export subsidies will be a very real and tangible impact of the Doha Development Agenda. The elimination of subsidized export competition is particularly important for countries (many developing) that cannot compete with the treasuries of the industrialized countries. It is also a *sine qua non* for countries protecting their markets from subsidized imports.

Because the WTO has long banned export subsidies on non-agricultural goods, an argument could be made for a relatively rapid phase-out of these measures. At a minimum, **there is a strong case for a down payment in export subsidies, along the lines of the down payment on domestic supports contained in the July Framework Package (with parallel commitments in other forms of export competition).** And, while there have been various proposals on fast-tracking some commodities, given the complexities of establishing parallel disciplines across all forms of subsidized export competition, it seems most practical to **establish one deadline for all commodities and encourage countries to phase out export subsidies more rapidly on products where this is feasible.**

The July Framework Agreement calls for an end to export credits granted beyond 180 days, and for negotiations on export credit terms. Rather than create disciplines for each credit term, **the most straightforward way to discipline export credit programs would be to phase down, and out, the dollar value of transactions covered over the implementation period.**

The proposals in the July Framework Agreement to eliminate export subsidies, to eliminate government financing and to eliminate underwriting of losses by state trading entities will eliminate many of the trade-distorting practices of state trading entities. Most controversial is whether the exercise of monopoly power by state trading entities should be eliminated. **If it is agreed that their monopoly status is inherently trade-distorting and should be revoked, the approach used in China's WTO accession, to gradually mandate co-existence with the private sector, seems to be a reasonable way to facilitate the adjustment to a new marketing system.**

Disciplines on food aid should forbid the use of food aid programs for market development, and require monies expended for market development to count against a country's export subsidy commitments. **Food aid donations from stocks, which tend to be erratic and high when food aid is less needed, should be channeled through the World Food Program to reduce the market impacts on individual countries, while ensuring the beneficial use of stocks.** Similarly, reducing the size of programme food aid donations, which tend to be extremely variable, relatively large and generally sold in local markets, over time, and prohibiting programme food aid from being sold (monetized) would reduce the disruption of commercial imports and local markets alike.

MARKET ACCESS

The expansion of market access will be the main indication of the level of ambition of the agricultural talks. Though it is possible that the negotiations could still survive with modest ambitions in market access, the political support for such an agreement would quickly fade. Many recent analyses demonstrate that the vast majority of the gains from trade liberalization come from reducing tariffs and other market access barriers because all countries rely on tariffs to protect producers. Tariff cuts generate large benefits because they are effectively taxes on food, so consumers stand to gain from lower food costs. **Most of the gains to developed countries come from reducing their own tariff barriers, not from gaining access to developing country markets, and most of the gains to developing countries come from reducing their own barriers. Improving market access is crucial to developing countries both because of potential North-South trade, and growing South-South trade.** The importance of market access for developing countries makes a strong result on the market access pillar central to the achievement of the Doha Development Agenda.

Of the three pillars of the agricultural negotiations, market access is also the least developed in the Framework Agreement. **Most worrying are the many opportunities for countries to avoid increased market access through a combination of Special and Sensitive Products and, Special Safeguards and Special Safeguard Measures.** The level of ambition on the formulas for tariff reductions will be intricately related to the designation of

Sensitive and Special Products. It will be difficult for countries to agree to formula reductions if they don't know the flexibility countries will have to designate Sensitive and Special Products.

The agreement to reduce higher tariffs by a greater percentage than lower tariffs is a positive step in the July Framework Agreement. As with domestic support, **many countries maintain actual tariffs far below the level allowed in the Uruguay Round Agreement. This means that fairly large reductions in bound tariffs would be required before any improvements in real market access could occur.** In some cases, the "tariff overhang" is over 100 percent, so a large reduction in bound tariffs would be required to have any impact on actual tariffs.

The choice of tariff reduction formulas within the bands is broadly between a linear cut or a Swiss Formula cut. As the tiered approach provides some degree of harmonization, a series of Swiss Formula cuts specific to each band does not appear to be necessary. **A series of percentage cuts increasing with the height of the initial tariff will harmonize tariff rates. The same percentage cut should be applied to all tariff lines within each band, not the average/minimum cut formulation used in the Uruguay Round.**

Establishing the bands raises a practical issue. Countries' tariff profiles differ enormously, both between developed and developing countries, and within each group of countries. While tariff distribution in developed countries follows a curved path, in the developing countries, it is either a straight line or a set of consecutive straight lines in a "staircase" format. The more bands selected, the "smoother" the harmonization of tariffs, but too many bands will add little to the final result. **Creating four bands is probably adequate to address the varied tariff profiles of both developed and developing countries.**

The July Framework Agreement calls for countries to discuss a cap on tariffs. A tariff cap remains the best way to deal with extremely high (or peak) tariffs. Analysis indicates that to affect a substantial number of peak tariffs, the cap would need to be set at 100 percent (particularly when a number of these products will be classified as "Sensitive" or "Special" Products.) **If it were impossible to set a tariff cap low enough to capture most tariff peaks, it would be desirable to create an extra tier subject to steeper reductions rather than settle for an ineffective cap.**

The July Framework Agreement leaves open the selection and number of Sensitive Products (for all WTO members). Ideally, tariff-cutting formulas should be agreed before the number Sensitive Products is established. The level of ambition on tariff reduction would then determine the flexibility needed on Sensitive Products. The selection of Sensitive Products will be a matter for individual countries. But, **the number of Sensitive Products should be limited to an established and low percent of total production or consumption** to ensure that the category is not used for widespread protection. According to the International Policy Council's analysis, even exempting two percent of tariff lines from formula cuts would substantially reduce the expected gains from market access improvements. And, unfortunately, the very products which developed countries will likely designate as Sensitive (sugar, dairy, rice and a few others) are precisely the commodities of interest to developing country exporters.

Tariff rate quotas should be established on Sensitive Products that do not already have them, consistent with the July Framework's call for improved access on all products. Countries should reduce above-quota tariffs on Sensitive Products as well as increase TRQs, although the above-quota tariff reductions could be lower than the reduction for other products in the same tariff band. To encourage "substantial improvements in market access for all products" the modalities should establish a relationship between the reduction in tariffs for Sensitive Products and the increase in tariff rate quotas. For example, if a country implements only half of the required formula reduction on a Sensitive Product, then it should increase its tariff rate quota by half over the implementation period.

The July Framework Agreement implies that only Sensitive Products be subject to tariff rate quota expansion. Discontinuing quota expansion for non-Sensitive products with high tariffs reverses improvements in market access, and abandons an important innovation from the Uruguay Round Agreement. **To compensate for not continuing to expand TRQs on products subject to prohibitive tariffs, meaningful reductions in peak tariffs and/or an effective tariff cap must be agreed.** If significant progress cannot be made in reducing or capping peak tariffs, negotiators should continue to expand TRQs by some percentage of domestic consumption, even though this would go beyond the terms of the July Framework Agreement.

The Framework suggests cutting or eliminating within-quota tariffs as a way to "give the flexibility required to reach a final balanced result." As quotas increase over time, the benefits of duty-free access will also increase. Moreover, as internal prices fall due to policy reforms in some markets, the level of protection offered by in-quota tariffs increases. For both reasons, **reducing and, if possible, eliminating in-quota tariffs is desirable.** The progressive tariff reductions in the tiered approach do not guarantee that the trade distortions caused by tariff escalation will be addressed. The Harbinson draft proposal to reduce tariffs on processed goods by some multiple of the tariff cut for raw materials is a simple and straightforward approach that avoids commodity-by-commodity negotiations.

Developing countries can specify a number of Special Products, based on criteria of food security, livelihood security and rural development needs. Tariff reductions for Special Products might only need to be half of that for other agricultural products. **As with Sensitive Products, individual countries will determine which products to designate as Special Products based on their internal situation. As with Sensitive Products, the number of products should be limited to a certain percentage of trade or consumption, although this percentage could be**

higher than for Sensitive Products. Concrete criteria, such as the contribution of the product to caloric intake, the share of the product grown by subsistence farmers, and the contribution of the product to the national income or employment should be established.

The erosion of preferences is a natural and generally desirable consequence of trade liberalization, at all levels: multilateral, regional and bilateral. Preferences have locked countries into certain commodities for which they might not have a comparative advantage, have stifled innovation so sheltered producers cannot compete on world markets and are inefficient ways to transfer incomes to farmers. However, given the very real political and economic ramifications of the short-term disruptions that might be created by the erosion of preferences, **preference-granting countries and multilateral lending institutions should provide financial resources to assist countries in diversifying their production, and those countries offer additional market access for all products from the current preference holders.**

The July Framework provides for Special and Differential Treatment for developing countries. Because developing countries stand to benefit from expanding their own market access, as well as from expanded access to developed country markets, **developing countries should choose between making the same commitments as developed countries on tariff reductions, but phased in over a longer time frame, or making shallower cuts, but over the same implementation period.** Their development interests would be better served by the first option. The Framework also calls on developed countries and some developing countries to provide duty- and quota-free access to the Least Developed Countries (LDCs), but places no requirements on the LDCs to open their markets. These provisions reflect a widespread view that LDCs are not able to open their markets. In fact, LDCs may well have much to gain by open markets, so **it is important to provide LDCs with the same possibility of reducing tariffs that other developing countries have. This may be done on a case-by-case basis**, as not all LDCs will be in the same position to make such commitments.

ISSUES OF INTEREST BUT NOT AGREED

Differential Export Taxes. Export taxes are used primarily by developing countries as a source of fiscal revenue, to reduce relative domestic prices for food, and to reduce exports in times of domestic shortfalls. Differential export taxes effectively subsidize domestic processors reducing the cost of raw materials more than it reduces their selling price for finished products. Just as export subsidies distort markets by reducing world market prices, export taxes distort markets by reducing domestic prices, and subsidizing domestic processing industries. These policies penalize producers in developing countries, who are already disadvantaged by adverse terms of trade and urban policy bias. As other policies that distort export and domestic markets will be addressed in the Doha Round, differential export taxes should also be disciplined alongside them.

Sectoral Initiatives. Sectoral initiatives are possible within the Framework, and could still be suggested by one or more members at any time. A sectoral initiative might include a higher -than-average tariff cut coupled with an agreement to end export and domestic subsidies ahead of the implementation deadline. Such agreements that go beyond the modalities in particular sectors should be encouraged, as they could eventually convince other sectors to follow suit.

Geographic Indications. The European Union originally raised the issue of geographic indications as one element of market access. A discussion on Geographic Indications should be launched under the auspices of the TRIPS Council, regarding whether and how the WTO might reconcile the differences between national systems for the protection of intellectual property in foods.

CONCLUSION

Modalities are a means to an end, and the end is the offer that countries table in the final stage of the negotiations. While governments need flexibility to deal with sensitive agricultural products and policies in all three pillars, this flexibility has been granted within the July Framework Agreement and negotiators should be careful to maintain a balance between flexibility and progress on trade reform. A clear conclusion from the International Policy Council's analysis emerges: progress must be made on each pillar in tandem because, for any given commodity, reductions in domestic support may not be sufficient to decrease trade distortions, but reductions in border measures might. For other commodities, the binding constraint will be domestic support, not export subsidies or market access.

Negotiators have a short four to six months to deliver the first approximation and the modalities text that will form the basis for a final Doha Round Agreement. A general statement of progress will not be sufficient to allow negotiators to make progress in Hong Kong. With impending debates on farm policy and the expiration of negotiating authority in the United States and with worrisome disputes emerging over textiles and industrial products, it is vitally important that the momentum established last year that led to the 2004 July Framework Agreement is regained so that the negotiations can continue to make real progress in 2005.