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WINNER, GLOBAL FOOD SECURITY CATEGORY

Moving Agricultural Trade Liberalization Forward to Improve Global Food Security

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***ABSTRACT*:** The recent food crisis and the associated spike in commodity prices heightened concerns about global access to safe and stable food supplies. In an ideal world, high prices would signal to increase production in countries that have the resources to do so. Yet, modern agriculture is capital intensive and requires significant investments in infrastructures, so there may be considerable lags between when production plans are carried out and additional output is marketed. This essay argues that agricultural trade liberalization is the most efficient tool to improve global food security. It would allow countries to shift resources in sectors for which they have a comparative advantage. It would establish an environment favorable to expanding agricultural production by disciplining agricultural subsidies and increasing market access. Unfortunately, protectionism in agriculture is still pervasive and agricultural trade negotiations are in a deadlock. Moving negotiations away from commitments on policies such as tariffs and subsidies, and focusing directly on market access would remove some of the obstacles to liberalizing trade. In a first stage, negotiations should entail binding policies at their current applied levels while allowing duty-free access for current import levels. Further liberalization would be undertaken by expanding duty-free market access. Domestic subsidies and import tariffs would be tied together, allowing countries to revise these policies as they see fit (perhaps to achieve some non-economic objectives) as long as it does not violate market access commitments. Anchoring future trade liberalization negotiations on market access commitments could ultimately deliver a relatively free agricultural trading system that would contribute to secure the world's food supply.
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Introduction

Agriculture is going through a critical transition period. To some, the recent spike in commodity prices is indicative of a significant shift in volatility; to others, it signifies a break in the long-run declining trend of agricultural real prices. In either case, the recent food crisis raised significant food security concerns across the globe.

Food security implies a stable access to sufficient and safe food supplies. On that basis, low world inventories of major grains and expectations of future increases in the demand of developing economies considerably diminished food security. In theory, high prices are a signal to increase production. In a frictionless world, countries with a comparative advantage in agricultural commodity production should move resources away from declining sectors and into agriculture. Under that scenario, the food crisis should slowly subside and concerns about food security progressively fade as production increases. Food aid programs can be implemented while waiting for world agricultural supplies to relieve market pressures. The current global economic recession calmed inflationary pressures in international commodity markets, but many indicators suggest that the food crisis and resulting food security concerns are still very much alive. The underlying factors of the crisis are still present.

Since early 2008, there has been quite a bit of effervescence in agricultural markets but trade liberalization negotiations have remained idle. Including agriculture in normal trade disciplines at the conclusion of the Uruguay Round (UR) was a major achievement, yet protectionism in agriculture is still pervasive. In contrast, industrial product trade is more opened as successive trade liberalization efforts since the end of World War II have brought the average tariff to around 4% (OECD, 2003). Trade liberalization in the industrial sector conveys valuable lessons for agriculture, but there are also major differences that bring a whole new set of challenges for policy makers.

While markets provide price signals and point stakeholders toward the most profitable activities, specialization and investments may be hindered by underdeveloped infrastructures that make it costly for agricultural output to reach the market. Alternatively, productivity gains may be difficult to realize because of poor credit conditions in countries that have the potential to increase output and thus alleviate food security concerns. It is unfair to ask developing economies to make significant investments in expanding production under the threat of developed countries' agricultural subsidies. Producers in developing economies must be assured that an increase in production that would ease inflationary pressures on commodity prices will not trigger agricultural subsidies that would further depress prices.

This essay focuses on moving agricultural trade liberalization to maximize output and help countries reach their production potential as a solution to food security concerns. It starts from the premise that trade liberalization would increase world production by allowing countries to specialize in sectors for which they have a comparative advantage. As such, the central policy issue is how World Trade Organization (WTO) members can deliver a new trade agreement that will further liberalize trade and remove distortions from agricultural markets while recognizing the need to address non-economic objectives[1] such as rural development. While the Uruguay Round Agreement on Agriculture (URAA) was a significant step in the right direction, the Doha Round must deliver significant benefits for developing economies if world leaders are serious about improving food security globally. But trade negotiations are stalled, and WTO members have made little progress toward framing the modalities of a new agreement. A trade negotiation round is an arduous endeavor, so it is not entirely surprising that negotiations are dragging. Yet some countries are starting to vent frustration at the lack of progress, while others are pushing for a new approach, worrying that the process of negotiating modalities is leading nowhere.[2]

The roadmap to further liberalizing trade offered in this essay is based on the observation that current policy options imply asymmetric market access concessions in agriculture and perhaps other sectors, as well. It focuses on market access instead of the policy instruments (mainly tariffs and subsidies) because trade volumes are directly impacting world welfare. The distinction between tariff and subsidies is mostly unimportant because an import tariff can always be decomposed into an equivalent production subsidy and consumption tax. What

[1] A non-economic objective refers to giving up some income (welfare) in order to achieve a specific objective (Bhagwati and Srinivasan, 1969).

[2] The negotiation model proposed by the U.S. and Canadian governments is one example. It seeks to explicitly outline outcomes of a potential trade agreement [New Doha Approach Floated as Delegates Consider Late-Autumn Ministerial. Available at: http://ictsd.net/i/news/bridgesweekly/46289/].

matters is the market access implied by tariff bindings and subsidy reductions. Countries have long recognized that tariff bindings are not sufficient to reach an efficient trade agreement because policy active countries can always replicate the market equilibrium under a tariff using a proper combination of production subsidies and consumption taxes.

The solution to the trade negotiation impasse is to direct WTO members' focus on market access commitments. Bagwell and Staiger's 2001 model of trade negotiations involves two countries negotiating over a tariff and a domestic subsidy. Countries determine a tariff binding given a pre-determined domestic policy. The governments are then allowed to adjust the domestic subsidy and tariff subject to the market access commitment implied by the tariff decision and the initial domestic policy. In essence, countries are free to deliver market access through the policy mix of their choice as long as it respects tariff bindings and does not erode established market access concessions. Because their framework is developed under full information, governments actually commit to trade flows through commitments on tariffs and domestic policies. Bagwell and Staiger argue that Article XXIII of the General Agreement on Tariff and Trade (GATT) already establishes a framework to deal with the above issues.

However, it is quite difficult in agriculture to determine the market access implied by a tariff binding and domestic policy. Imports are defined by the difference between domestic demand and supply schedules. Evaluation is needed of the implied market access at the negotiation stage under expected output.[3] The degree of risk in agricultural markets makes the latter task quite difficult. This is why WTO members must first offer some tariff-free access to their markets and later bind their tariff considering the expected level of imports. This has the advantage of guaranteeing some form of market access to exporting countries. Subsequently, countries would have the option to adjust their import tariff as long as it is explicitly tied to their subsidies.

A Roadmap to Liberalize Trade in Agriculture

When discussing trade liberalization, economists always seek the elusive and somewhat abstract gains from trade. But what really are those gains? The consensus is that trade gains emerge

[3] Gervais, Larue and Lapan (2008) identify other agriculture-specific issues that hinder the relationship between market access and policy bindings.

through the surplus or utility resulting from the expansion of production and consumption. These gains can be expressed as a function of trade volumes. Unlike the mercantilist view of trade, in which exports are good and imports are bad, export and import volumes determine a country's terms of trade, and ultimately the overall welfare level of the country. Hence, this essay's approach to trade liberalization focuses directly on trade flows.

It has been suggested that a WTO agreement on agriculture may have been within reach in July 2008. Major obstacles to an agreement included the failure of developing and developed countries to agree on the use of safeguards; non-agricultural market access, cotton, and sensitive products. Examining safeguards helps to understand where disagreements in agricultural trade negotiations can emerge.

Trade agreements are devices countries use to make commitments to their trade partners and their domestic sectors. Countries have a unilateral incentive to use domestic and trade policies to manipulate terms of trade in response to concerns of domestic industries and/or to raise welfare (the beggar-thy-neighbor motive of protection).[4] In that framework, trade negotiations are all about ways to solve a prisoner's dilemma as governments try to extract rents or payments from their trade partners, i.e. shift the cost of protection to foreign partners. Safeguards are generally recognized as a helpful tool in the trade liberalization arena. Safeguards can reassure reluctant policy makers in taking steps toward liberalizing trade, knowing they will be able to slow down growth in imports if need be. Indeed, Bagwell and Staiger (1990) argued that safeguards can be seen as a measure to avoid reversion to a non-cooperative equilibrium (where tariffs are set extremely high) when trade volume is unexpectedly high. In that case, safeguards allow countries to offer temporary protection to domestic industries during a transition phase, temporary shock or when the political cost of freer trade is relatively high.

From the perspective of countries that have a positive trade balance, safeguards in effect set a ceiling on trade flows. Under certain conditions yet to be agreed upon in the Doha Round,

[4] Historically, there has been quite a bit of skepticism regarding the terms-of-trade argument for protection (Gervais and Larue, 2007). Most economists acknowledge the theoretical possibility that trade policy could be used to extract terms of trade gains from partners, but express doubt about the application of the principle. Recent research (Bagwell and Staiger, 2006; Broda *et al.*, 2008) tends to support the argument that countries use tariffs because they can manipulate their terms-of-trade and are able to shift the cost of protection onto their trade partners.

exports can be held back if a special safeguard mechanism is triggered. It is important to note that there is no equivalent policy that establishes a floor on the volume of trade. From that viewpoint, a trade agreement that includes strong safeguard provisions represents an asymmetric compromise that is not favorable to net exporting countries. This may explain why a country like the United States may not be inclined to relinquish its ability to subsidize production if market access is threatened. Tighter market access depresses prices and thus is likely to be met with production and/or export subsidies in a non-cooperative setting. Unfortunately, agricultural subsidies lower food security by deterring developing economies from making the investments in production and infrastructure needed to increase production.

Hence, the question is: How can the Doha Round be moved past the modality stage and trade liberalized in a way that allows countries to specialize in the sectors for which they have a comparative advantage? The answer is to adopt the Bagwell-Staiger principle outlined above with a few adjustments. Since gains from trade arise from increased trade flows, the first focus should be on market access. That would require determining the implied level of market access in agriculture under current *applied* policies. The next step would involve committing to duty-free access for the first stage trade volume, and binding domestic subsidies and import tariffs in each sector to the current applied level. In a subsequent stage, countries could revise the applied tariff on quantities exceeding the duty-free volume as long as counter-directional and proportional changes were made to the production subsidies. This would have the advantage of securing minimum trade flows for net exporting countries, allowing safeguard measures that are essential from the developing economies' perspective, and disciplining agricultural subsidies that have weakened food security.

Addressing Objections

The pragmatic approach to trade liberalization outlined above would work well because of its predictability. Tariff-Rate Quotas (TRQs) are in essence similar to the liberalization procedure outlined above. However, the proposed policy would tie tariffs and domestic subsidies together. If a country does not apply an import tariff on a commodity, as is the case in the United States for most grains, it would have no room to raise domestic subsidies unless it was willing to subsidize imports—a highly unlikely outcome.

One major objection to market access commitments is the idea that this is a not-well disguised form of managed trade. It can be seen as blocking the natural patterns of global production and trade instead of letting natural forces of comparative advantage determine trade flows. This is a legitimate concern, but it needs to be evaluated in the broad context of trade negotiations in agriculture. Direct market access commitments set a floor on imports provided certain conditions are met. This lower bound condition on trade flows is critically lacking in the current bargaining phase in the Doha Round. It would reinstate a semblance of symmetry in market access concessions while maintaining governments' flexibility to use domestic policy to achieve non-economic goals. Granting duty-free market access is the key of the proposed strategy.

Even if market access commitments turn out to be pure managed trade mechanisms, there are examples in which managed trade has been reasonably successful in promoting freer trade. In the case of textiles and apparel, the Multi-Fibre Arrangement (MFA) was somewhat successful in managing the rate of import growth in developed markets while securing market access for developing economies. The United States once negotiated a quasi-cartel with the Japanese government that allocated market shares in the semi-conductor industry. While the agreement failed to produce the market share that U.S. firms envisioned in the Japanese market, it still opened up trade in semiconductors.

Another objection might be that such a market-access oriented system creates rents or payments that firms will certainly try to capture. For example, the MFA was a complex web of product and country-specific quotas that in some instances impeded the efficiency of the overall trading system (Krishna and Tan, 1998). Import licensing procedures have also been abused in agriculture. In the long-run, new market access should not be tied to any particular country, and country-specific allocations should be slowly unwound to introduce competition. In the short-run, preferential access at the duty-free rate could be set aside for developing economies. In the long-run, administrative procedures that tie historical market shares to current access should be phased out, especially in the case of developed economies.

Conclusion

Agricultural trade liberalization has the greatest potential to raise food security globally. It would allow countries to specialize in sectors where they have a comparative advantage, and would remove the specter of agricultural subsidies that work against capacity investments in developing economies. This would raise output at the world level and ease inflationary pressures on commodity prices due to income growth, negative supply shocks and biofuels. It would lower the reluctance of some countries to increase production when they lack credible guarantees from major trading partners that market access will be stable. Increased trade would raise world welfare.

Focusing the Doha Round of negotiations directly on market access would involve countries delivering duty-free market access (the larger the volume, the better) and binding import tariffs and domestic subsidies at the current applied level. Recognizing that an import tariff includes an equivalent production subsidy component, the two types of instrument could then be linked together. Anchoring future trade liberalization negotiations on market access commitments could ultimately deliver a relatively free agricultural trading system that would contribute to secure the world's food supply.

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