

Barking Up the Wrong Tree: Agricultural Subsidies, Dumping and Policy Reform

Timothy A. Wise

Are US farm subsidies responsible for the alleged 'dumping' of US corn in Mexico at prices below US farmers' costs of production? According to a series of new studies, agricultural dumping is indeed occurring, but Mexico's small-scale maize farmers are unlikely to benefit much from subsidy reductions in the United States unless there is a more sweeping reform of both US farm policy and the way the international community addresses agricultural dumping.

World trade talks have foundered recently, in part due to developing country demands that industrialised countries reduce their large farm support programmes to allow poor farmers in the global South to compete more fairly. But are subsidies really the problem? For some crops – most notably cotton and sugar – Northern subsidies clearly *are* a root cause of low international prices and unfair competition. In its victorious WTO claim against US cotton subsidies, Brazil showed that eliminating subsidies would reduce US production 29 percent, US exports 41 percent, and this would lead to a rise in international prices of 13 percent.

But it would be a mistake to generalise this to all crops. In fact, even though US corn subsidies are higher than those for any other crop, studies show that their elimination would do little to improve the plight of small corn farmers in Mexico drowning since NAFTA in a flood of US corn exported at prices below the costs of production. Behind the confusion lie misunderstandings about the definition and measurement of subsidies and some predictable overselling of the benefits of trade liberalisation.

What Are Subsidies?

Part of the problem relates to the widely varying interpretations of the term 'subsidies.' The OECD, which estimates agricultural subsidies, uses a very broad definition that includes any government policy that distorts the market such that prices do not reflect marginal costs. So a tariff on corn imports, which taxes consumers by raising the price of imported corn to benefit producers, is a subsidy, just like a direct payment to a corn farmer.

This is not the common understanding of subsidy, however, nor does it seem to be that chosen by policy-makers. Their definition is narrower, referring only to government payments that allow prices to remain below marginal costs. Some are direct, such as payments to farmers; others are indirect, such as government support for irrigation infrastructure, which allows producers to exclude that cost from their prices. But tariffs or price supports are definitely excluded.

The distinction became quite public recently when EU Trade Commissioner Pascal Lamy criticised WTO Director General Supachai Panitchpakdi for using misleading figures to justify the call for steep cuts in rich country agricultural support. Lamy correctly pointed out that Supachai's figure of US\$300 billion in annual rich country farm subsidies includes many categories of support the public would not generally consider subsidies. He said the true subsidy figure is closer to US\$100 billion.

This semantic distinction is only the most visible part of a larger debate on the measurement of agricultural support programs and their impact. The figures come from the OECD, which is responsible for estimating agriculture support for trade negotiations under the Uruguay Round Agreement on Agriculture.

The Producer Support Estimate (PSE) uses the broad definition of subsidies (including tariffs etc.) but quantifies only specific support to producers (as opposed to agriculture generally). This is the most widely referenced producer subsidy estimate; it totaled US\$234 billion in 2002. The PSE is the source for the frequently quoted statement that the average European cow gets more than two dollars a day in subsidies, a number derived from the OECD's estimate of the EU's dairy subsidies under the broad definition.

There are several important flaws in the application and interpretation of the PSE. These can cause particular problems in measuring the levels of farm support in developing countries whose economies may not be fully integrated with the world economy. First of all, two-thirds of the PSE come not from subsidies – government payments or direct support to producers – but from 'market price support' – an estimate of the non-subsidy support for producers. This most commonly includes tariffs, price supports, and quotas. Even though none are true subsidies, the OECD is charged with trying to establish the dollar-value 'subsidy equivalence' of such support. The estimate is derived directly from the difference between the international 'reference price' and a higher domestic price, the assumption being that in fully functioning markets domestic prices will align with international prices. If they don't, the difference is assumed to be a good estimate of 'market price support' measures by the government, that is, policies such as tariffs, quotas, and price supports that impose higher prices on consumers to the benefit of producers.

So one problem is semantic, but substantive. When the WTO's top official calls for reductions in rich countries' farm subsidies, it turns out he's not just talking about payments to farmers, even though this is what most of us think he means.

Beyond this important distinction, there are a variety of more subtle flaws in the OECD's calculations of the PSE. Reference prices are often very low, even below farmers' costs of production. This makes the PSEs of other countries appear unfairly high. For developing countries that are less fully integrated into the world economy, domestic prices often do not align with international prices, for reasons that have nothing to do with gov-

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ernment support policies. *For these countries, the PSE methodology can produce the perverse result that higher farm support in an exporting country, if it leads to lower international prices, raises not only the exporter's PSE but that of other importing countries.*

Mexico's Maize Farmers

Such is the case for Mexico's PSE for maize. Following the implementation of NAFTA in 1994, Mexico eliminated most of the government policies that would constitute market price support. Yet the OECD's PSE figures for Mexico show consistently high market price support despite the absence of support policies. This results in a PSE – 43 percent of maize farm income from 1998-2001 – that exceeds that of the US for its highly subsidised corn farmers.

What could explain this absurd result? According to a new study by the Institute for Agriculture and Trade Policy (IATP), during that same period US corn was exported at a price 20-33 percent below the true costs of production.¹ We recalculated Mexico's maize PSE, adjusting the US export price to correct for this 'dumping margin.' Because this raised the reference price in the calculation of market price support (to a presumed non-dumping level), the price gap between US exports and domestic prices in Mexico was dramatically reduced, cutting the PSE from 43 percent to just 16 percent for the 1998-2001 period.

The data suggests, in fact, that Mexican producers are not being subsidised by such market support policies but are instead *subsidising consumers*, as farmers drive down their own prices in an attempt to compete with under-priced US exports. Anyone who has spoken with small corn farmers in Mexico will recognise this as a much more accurate description of reality than the PSE-driven suggestion that these farmers are receiving support on a par with US farmers.

Do Subsidies Cause Poverty and Low Farm Prices?

But this still leaves us with the question we began with: Will eliminating subsidies raise chronically low agricultural commodity prices and address the resulting poverty in the developing world? Predictably, those advocating deep trade liberalisation have claimed such sweeping benefits.

In preparation for WTO negotiations in Cancun, there was a flurry of research using complex economic models to assess the impact of trade liberalisation and subsidy reduction. In perhaps the most widely quoted study, the World Bank modeled the impacts of reductions in both developed and developing country agricultural tariffs (to 10 percent and 15 percent respectively), the elimination of export subsidies, and the 'decoupling' of domestic subsidies from production. The authors projected over US\$500 billion in additional world income by 2015, with US\$350 billion going to developing countries. The number of people living on less than US\$2 per day was projected to drop by 144 million people.²

The implied connections were clear: liberalisation improves farm prices, reduces dumping, and thereby cuts rural poverty. But developing country agriculture is in fact only a small source of such presumed benefits, only 6 percent (US\$20 billion) of the US\$350 billion comes from agricultural liberalisation. As with most such models, the bulk of the presumed benefits are for consumers through 'own country' reforms that lower consumer prices generally. Of course, low agricultural prices are precisely what prompted developing country farmers to demand subsidy reductions in the first place, so lower consumer prices are more the problem than the solution to dumping.

Other studies were more careful (and transparent) in trying to project the impacts of specific agricultural trade liberalisation measures, including subsidy reductions, on production and prices for specific commodities. Overwhelmingly, they show that such reforms are unlikely to raise producer prices to a sufficient degree to bring relief to Southern farmers from alleged agricultural dumping. For corn, none of the models suggests that subsidy reduction will reduce overproduction and thereby increase prices to levels that could eliminate dumping margins estimated as high as 20-33 percent. One study found only a three percent price rise over 15 years.³ A US Department of Agriculture study found that agricultural prices overall would rise by only 2 percent if all rich country agricultural subsidies were eliminated.⁴

Why don't prices automatically rise when subsidies go down? Farmers often do not respond to lower prices by taking land out of production. They sometimes switch to other crops, but they rarely allow the land, their most valuable asset, to lie idle. And if they go bankrupt, the land is generally taken over by larger farm interests and kept in production. If production does not go down, prices do not rise and dumping margins remain untouched.

Policy Reforms

One alternative policy blueprint suggests that government policies should return to recently-abandoned models of supply and stock management in an effort to take land out of cultivation, reduce production, and raise farm prices.⁵ This analysis identifies the source of low prices not in subsidies but in the oligopolistic nature of agricultural trade. In corn, for example, two firms, Cargill-Continental and Archer Daniels Midland, control 70 percent of US corn trade. This gives them tremendous market power to keep producer prices low. In the end, they, and the firms that use corn as an ever-cheaper input in their operations (feedlots, corn sweeteners, etc.), are the largest beneficiaries of US corn subsidies.

Subsidy reduction in the US may help Brazilian cotton farmers, but it is unlikely to reduce economic pressures on Mexican maize producers from below-cost US exports. Nor are such measures in other rich countries likely to improve the economic prospects for similar small-scale farmers growing food primarily for subsistence and the internal market. Some developing country farmers will benefit from subsidy reduction in the North, notably those farming cotton, sugar, and perhaps rice and a few other crops. But the poverty-reducing potential of subsidies reduction is not nearly as large as its promoters have suggested.

Instead of focusing narrowly on subsidies, policy reforms should focus on ending agricultural dumping. Whether its source is Northern subsidies or corporate oligopolies, there is no reason the international community should tolerate the dumping of products on international markets at below the costs of production. In the North, policy reforms should aim to reduce global commodity overproduction in key crops. This would require greater, not less, government intervention to reduce the structural tendencies toward overproduction and price depression. Finally, measures need to be taken internationally to reduce the market power of agribusiness

conglomerates. One simple proposal calls for the WTO to apply the same transparency measures to private firms that it does to state trading enterprises. Such disclosures are intended to reduce undue market power by state agencies. They could similarly cut into the enormous market power wielded by large agricultural traders.

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ENDNOTES

¹ Ritchie, M., Murphy, S. et al. 2003. *United States Dumping on World Agricultural Markets*. Minneapolis, MN, Institute for Agriculture and Trade Policy.

² World Bank. 2003. *Global Economic Prospects 2004: Realizing the Development Promise of the Doha Agenda*. Washington, World Bank.

³ IFPRI (2003). *Impact of Alternative Agricultural Trade Policies on Developing Countries*. Washington D.C., International Food Policy Research Institute (IFPRI).

⁴ Diao, X., A. Somwaru et al. 2001. A Global Analysis of Agricultural Reform in WTO Member Countries. *Agricultural Policy Reform in the WTO – The Road Ahead*. M. Burfisher, Economic Research Service: 25-40.

⁵ See Ray, D., D. de la Torre Ugarte, et al. 2003. *Rethinking US Agricultural Policy: Changing Course to Secure Farmer Livelihoods Worldwide*. Knoxville, Tenn., Agricultural Policy Analysis Center, University of Tennessee: 59.

Differentiating Tariffs in the Banana Trade – Towards Sustainable Production?

James Harrison and Liz Parker

A system of tariffs that are differentiated according to social, environmental or economic criteria could provide an important incentive for producers to improve conditions in the banana industry. This article considers what such a system would look like and whether it is compatible with current WTO rules.

The race to the bottom in the banana industry is now well documented. Wages and working conditions across Latin American and West African plantations are being eroded as the handful of multinationals controlling the international fruit trade relocate their production or sourcing to countries with the lowest labour and environmental standards in order to supply 'cheaper' bananas to consumers.

Since the inception of the European single market in 1993, the European Communities (EC) has controlled its banana imports through a complex system of tariffs, licences and quotas, designed in part to protect exports from its former colonies in the African, Caribbean and Pacific (ACP) group of countries from cheaper bananas from large monoculture plantations in Latin America. All that is about to change as the EC moves towards a tariff-only banana regime, prompted by a decision of the WTO Appellate Body in 1997.

ACP countries will continue to get preferential tariff treatment under a waiver agreed at the WTO Doha Ministerial Conference in 2001. The waiver allows ACP bananas tariff free market access until 2008 when the new WTO compatible trading arrangements between the EC and the ACP countries will come into force. However, by 2006 the EC must remove its import quotas, which have limited the volumes of bananas that can be imported over its borders. Without the protection of quotas, it is likely that working conditions will be driven further down in plantations and that more small producers that dominate the Caribbean industry will be forced out of the banana market, joining the 15,000 Windward Island farmers who have already gone out of business in the past ten years. For small island developing states such as Dominica, which rely upon bananas for nearly 50 percent of their export earnings, it is nothing short of disaster, unless the growing fair trade market proves viable in the long term.

Until now, most of the discussions on the new European banana regime have centred on the level of the tariff. However, the real challenge is for policy-makers to take a step back and see how they can marry sustainable production, fair trade and ethical consumption with international trade policy.

Indeed, this is increasingly what consumers are demanding. Fair trade banana sales across Europe are growing and the multinational banana companies are responding with their own

social and environmental codes of conduct. However, voluntary schemes will not halt the race to the bottom. What is needed is an innovative trade policy solution that prioritises sustainable development over the supply of cheap yet unsustainable bananas.

Standards and Verification

A system of differentiated tariffs could take the form of a single level of tariff reduction or a multiple tier of standards, providing an incremental incentive to countries and companies to improve their social and environmental policies and terms of trade. For example, bananas produced according to fundamental ILO labour standards could be subject to a 50 percent tariff reduction from the most-favoured nation level and bananas produced according to fair trade criteria might benefit from duty-free treatment.

Designing such a scheme entails a number of difficult political decisions about what standards to use, how to monitor and verify them, the levels of tariff reduction and how to ensure that the workers and farmers at the end of the banana chain do not bear the costs of any system.

In the case of bananas, it is clear that simply limiting additional tariff benefits to state

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