



Cordell Hull Institute

# Trade Policy Analyses

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On November 25, 2003, the Cordell Hull Institute hosted a Trade Policy Roundtable discussion, "Getting the WTO Negotiations Back on Track".

The meeting was held at Arnold & Porter, attorneys-at-law in Washington, DC. Pictured above is the well of the firms building.



Reproduced here is the paper presented by **Andrew Stoeckel** (above).

## About the Author

Andrew Stoeckel is the Executive Director of the Centre for International Economics, Canberra, Australia.

He was previously head of the Bureau of Agricultural Economics, Canberra, now called the Australian Bureau of Agricultural

## PAUSE FOR REFLECTION...

# Tackling the Political Problem of Farm Subsidies

Andrew Stoeckel

AGRICULTURAL trade liberalization is a major political problem. Its resolution has eluded policy makers for fifty years.<sup>1</sup> The reason is well understood, for farmers in highly protected markets are vocal and well organized, while the beneficiaries of trade liberalization are widely dispersed and not organized. A few studies, however, have taken the diagnosis further and examined what can be done about it. In *Solving the Problem*, an analysis prepared for a meeting of the Cairns Group Farm Leaders a few years ago, I examined where the political forces for liberalization might come from.<sup>2</sup> The analysis showed that the powerful political forces keeping agricultural protection in place are not about to change unless more powerful political forces in favor of liberalization are brought to bear on the issue.

## Groups Interested in Trade Liberalization

Many political groups have an interest in liberalizing world agricultural trade. First, there are the consumers in protected markets who could have greater access to better-value-for-money products, but they are mostly unorganized and politically weak. There are the taxpayers in protected markets who could save huge sums by removing subsidies paid out of government budgets. Their hand will strengthen as budget deficits become a major problem in key countries. Other groups with an interest in trade liberalization are developing countries and agricultural exporters, particularly the Cairns Group countries, who would be gainers from greater access to markets.

Yet other groups that stand to gain are the manufacturers and other exporters in protected markets. As economists know full well, but most negotiators seem not to know, the burden of protection for agriculture is borne by export sectors. In Japan, Europe and America those exporters are in the manufacturing and services sectors. By protecting agriculture, costs in manufacturing

Resource Economics (ABARE), the country's largest economics research agency.

Dr Stoeckel is a specialist in policy analysis and the international economy. He has initiated and directed major research programs that have attracted world-wide attention.

Dr Stoeckel, after graduating from the University of Adelaide, received his PhD from Duke University, in the United States, and has over thirty publications to his credit.

### About the Meeting

Efforts are proceeding in Geneva to find a basis on which to get the Doha Round negotiations back on track, even as the "Quad" countries continue to blame others for the Cancún debacle, and others blame the Quads, as if none of them had anything to do with what happened. In the meantime, the multilateral trading system is again drifting, its fragmentation quickening.

So what are the chances of re-starting the WTO negotiations this year? Is it likely to complete them by the end of next year? If that's not on, what about completing them before the trade-negotiating authority of the U.S. Administration expires at the end of June 2007, assuming a two-year extension?

These are the questions that were addressed at this particular meeting of the Cordell Hull Institute's Trade Policy Roundtable.

### Other Speakers

In addition to Andrew Stoeckel, other speakers at

and services are higher than need be, so they lose sales on export markets. They bear the brunt of the burden of agricultural protection.

Still another group with an interest in solving the problem is the environmental movement. Some 80 percent of agricultural subsidies are perverse – they damage both the economy of the country providing the subsidies and the environment.<sup>3</sup> The "greens" have a powerful incentive to eliminate most agricultural subsidies.

Another relevant group is the international community of countries that favor a strong and open rules-based multilateral trading system – as revealed when those countries see the system threatened. Without solving the agricultural trade problem, the combination of that and other deficiencies in the multilateral trading system, such as the one-sided treatment of anti-dumping cases, will see the eventual collapse of the system.

Although each one of these interest groups can be identified, the finding in *Solving the Problem* was that each on its own was not powerful enough to see agricultural protection reformed. The strong conclusion was that the liberalization of world agricultural trade would only occur when *several* interest groups joined forces, if only implicitly. This is yet to happen.

The problem is that the Doha Round negotiations, conducted under the World Trade Organization, appeal to only one group that has an interest in reforming world trade. That group is in countries where agriculture is protected and has exporters of goods and services who face barriers to what they sell in foreign markets. This group can "exchange" barriers to trade. By offering to open their market to agriculture they might be able to secure a concession on something important to them in another market.

### Flaw in the Principle of Reciprocity

Multilateral trade negotiations are based on the principle of reciprocity. This principle is fundamental and works by allowing "concessions", such as the reduction of agricultural support, to be "traded" for something of more-or-less equal value to the country offering the concession. So the interests of protected farmers, who do not want to see concessions made, are traded off by negotiators acting on behalf of other interests who want greater access to someone else's market for their exports (or something else of value). Politically, it pits the interests of exporters facing barriers to trade against those wanting protection from imports.

At least that is how it has worked in the past. But two points need to be made here. One, things have changed and, two, there is a major logical flaw in the notion of reciprocity. The change is that

the meeting included **Rubens Barbosa**, Brazilian Ambassador to the United States, Washington, DC; **Harald B. Malmgren**, President, Malmgren Group, business consultants, Warrenton, Virginia; **Edward Menzies**, President, Canadian Agri-Food Trade Alliance, Ottawa; and **Clayton Yeutter**, Counsel, Hogan & Hartson, attorneys-at-law, Washington, DC.

### Trade Policy Roundtable

The Cordell Hull Institute's Trade Policy Roundtable is sponsored by seven international law firms in Washington, DC: Akin Gump Strauss Hauer & Feld, Arnold & Porter, Hogan & Hartson, O'Melveny & Myers, Sidley Austin Brown & Wood, Steptoe & Johnson and Wilmer Cutler Pickering Hale & Dorr.

the natural political coalition of interests in favor of removing agricultural protection is no longer there – especially in Europe and Japan. The logical flaw is that concessions are not valuable at all. The barriers being traded away mostly hurt the country imposing them. This wrong mercantilist thinking has been known for a long time. Adam Smith and David Ricardo exposed the flaw in the “exports good, imports bad” mentality of a couple of hundred years ago.

But negotiations remain mercantilist in nature because they have worked politically. The problem today is that the political incentive for the one interest group brought into the political equation by Doha Round negotiators – the exporters who face barriers in other markets – to argue for change has been weakened over time with the success in reducing barriers to trade in manufacturing and services in the markets that matter. Therefore, to achieve further trade liberalization, a broader coalition with enough power to outweigh the interests of protected farmers has to be brought into the political equation. Coalitions do not form mainly because the effects of protection are hidden and analysis of the “unseen” is rarely carried out. The best way to identify who bears the burden of protection is economy-wide analysis of the costs and benefits of protection.

### Considering the Secondary Consequences

In one respect, restricting trade is not any different to other areas of bad policy, such as rent controls or commodity price stabilization schemes. The reason why bad policy prevails is that the secondary consequences of policy actions are overlooked or ignored. Only the first-round immediate effects are considered – mostly from standpoint of the special interests pleading for the policy. Henry Hazlitt, the American economist, argued that “ninetenths of the economic fallacies that are working such dreadful harm in the world today are the result of ignoring [secondary consequences]”.<sup>4</sup> Secondary consequences are just another way of saying economy-wide analysis. Bad trade policy falls into this category. In some cases it is even worse than mere oversight. In cases of alleged dumping, for example, the law in practically every country with anti-dumping laws rules out the “unseen” secondary effects (on consumers) being measured.

Economy-wide analysis entails consideration of all linkages and secondary effects when a sector is protected through a policy of government intervention in the market process. It involves looking at the both the costs and the benefits of the policy. There are several ways that can be done. One early technique was to measure the *effective rate* of protection. With this method the penalties imposed on an industry as a result of protection *elsewhere* in the economy are considered along with the benefits the protected industry receives. Today, with advances in computing techniques, economy-wide analysis involves using computable

general equilibrium (CGE) models. Such analyses are routinely done by academics and other researchers. It is particularly relevant in analyzing the effects of the Doha Round negotiations where a raft of changes in policies are being proposed.

Conducting economy-wide analysis of the costs and benefits of trade policy straightens out wrong mercantilist thinking. It can demonstrate to countries at large that they would be better off by unilaterally removing barriers to trade. That would be important for developing countries that wrongly see their plight as the result of actions by others rather than themselves.

Economy-wide analysis automatically includes the consumer in anti-dumping cases and provides a balanced view of the issue. And it can show countries entering into bilateral preferential trade agreements that the net economic gain, if positive at all, would be paltry compared with unilateral reform by removing all barriers to imports. And it can show that the gains from unilateral reform would be only slightly smaller than reform on a multilateral basis.

If countries were convinced about trade reform and "got on with the job", the distorting effects of preferential treatment for developing countries would be removed, along with the perverse incentives they create to block trade liberalization. Multilateral trade reform would also remove the incentives that countries have today to form bilateral preferential trade arrangements (erroneously called "free trade agreements") that are doing so much harm to the multilateral trading system.

If considering the secondary or economy-wide effects is so important, surely they are being exposed now. Not so. Only rarely is that done. Interestingly in those few countries where trade policy has been routinely subjected to this analysis, most notably in Australia, there has been significant unilateral trade liberalization to the great benefit of the country.

### **Economy-wide Analysis in TPRM Reports**

Where economy-wide analysis should be carried out is in the WTO's Trade Policy Review Mechanism (TPRM). But TPRM reports only record the facts about the trade policy of the country being examined. They report on things like the level and incidence of tariffs and other barriers. They contain no analysis of the costs and benefits of the trade-policy regime in question.

The TPRM, introduced in the course of the Uruguay Round negotiations of 1986-94, has been a good a start, but it is still nowhere near enough. The Director-General of the WTO needs to be persuaded, in the interests of trade and development, to extend the WTO trade-policy review process to include economy-wide analysis of the costs and benefits of trade-policy interventions in the market process. And there is something else.

Economy-wide analysis, as implied earlier, takes into account all the linkages in an economy. Thus when, for example, the sugar industry in the United States receives protection, the extra cost to the industries that use sugar, such as the chocolate makers in Chicago, is taken into account. So is the effect on exporters, such as the Boeing Corporation in Seattle, who necessarily bear the burden of the import barriers. If protection for U.S. sugar farmers were removed, Brazil would export more sugar to the United States. The *only* thing Brazil can do with the extra earnings of foreign exchange is purchase more imports, one of which in all likelihood is new aircraft. The economy-wide analysis can be extended to other secondary or downstream effects such as the environment. The sugar industry is having a major adverse impact on the Everglades in Florida and that is of concern to the greens.<sup>5</sup>

This analysis needs to be conducted in the open by an independent agency so that each stakeholder can see the other's point-of-view and comment on it. So, for example, the sugar farmers should be able to comment on the evidence of the greens to ensure that exaggerated claims are not made and *vice versa*. A draft report by the independent agency should be produced and made available for written comment by all concerned.<sup>6</sup> Through this *process*, those who benefit and those who bear the burden of the policy are identified. It causes those losing from the policy – in this case the chocolate makers, the aircraft manufacturers and the greens as well as consumers – to get together to lobby the government for change. *An open process of economy-wide analysis changes the politics of protection.*

Protection is a political game. Indeed, the current WTO negotiations are a political game, for the "exports good, imports bad" mentality of negotiations is economic nonsense. This nonsense is making the politics of removing remaining protection harder. By contrast, economy-wide analysis makes economic sense *and*, when conducted through open, transparent and independent processes, makes political sense as well. Also, the politics is ultimately more powerful. The more the correct analysis is done, the more the public and policymakers are informed about the economics of trade protection, making it harder for narrow vested interests to dominate the national interest. The politics of protection change with the education of public opinion. It changes the mindset of those reviewing claims for assistance and is built into government domestic processes. The hand of central agencies, normally the treasury, is strengthened.

### **Australian Experience with Economy-wide Analysis**

The proposition that open, independently conducted economy-wide analysis of protection changes the politics of protection is not just theorizing. It has been shown to work in practice. The best example is Australia, as work at the Organization for Economic

Cooperation and Development (OECD), in Paris, showed in the 1980s.<sup>7</sup> In the 1970s the Australian Government turned the Tariff Board into an independent agency – which back then was called the Industries Assistance Commission – with a more extensive remit. The task of the Productivity Commission, at it is now called, is to review systematically Australia’s import protection and public assistance to industry. Reviews are conducted through open and transparent processes. All the hidden and unseen secondary effects of policies are traced through economy-wide analysis.

Initially, the politics of protection proved hard to shift. The car-makers and textile manufacturers fought hard to retain their high levels of tariff protection. After a while, however, the politics changed. It became apparent that Australia’s miners and farmers, the two main export groups, were bearing the burden of protection. They joined forces to form a coalition for reform that the government could not resist politically. Australia embarked on a path of unilateral trade liberalization to the benefit of the economy and, although pockets of low protection remain, it is today one of the relatively open economies in the world.

The reduction in protection in Australia was the result of an open, independent process of systematic and repeated economy-wide analysis of protection. The mindset of enough people in Australia had changed to swing the politics in favor of liberalization. Narrow, self-centered vested interests still exist and always will, but, with a few notable exceptions, the economic debate reported to a large extent in the responsible Australian media highlights the secondary benefits of policy choices and portrays a balanced view of the issues.

### **Employ Economy-wide Analysis to Achieve Reform**

Public debate over farm subsidies and the import restrictions required to sustain them is obfuscated by arcane terminology and technical complexities. Matters are not helped in representative democracies by the general decline of the media and lack of leadership in public discussion of public policy issues.

Steps have been taken, though, over the last two decades or so to counter the problem, to make the dimensions of agricultural protection easier to see and understand.

- First, ideas were explored in the OECD,<sup>8</sup> the Long Report<sup>9</sup> and the Leutwiler Report<sup>10</sup> for focusing on the economy-wide costs and benefits of government interventions in the market process on behalf of sectional interests.
- Second, international comparisons of levels of farm support and protection were developed by the OECD in the mid-1980s through “producer subsidy equivalents” and



The **mockingbird** is the state bird of Tennessee. Cordell Hull represented a district of Tennessee in the

Congress of the United States, and was elected a senator from there, before becoming U.S. Secretary of State (1933-44).

"The mockingbird is known for fighting for the protection of his home – falling, if need be, in its defense. Mockingbirds are not intimidated by animals larger than themselves and have been known to attack eagles"

– Diana Wells, *100 Birds and How They Got Their Names* (Chapel Hill, NC: Algonquin, 2002)

### **Trade Policy Analyses**

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"consumer subsidy equivalents", which are updated every year.

- Third, PSEs were developed in the Uruguay Round negotiations into an "aggregate measurement of support" as a basis for negotiating, and also monitoring, reductions in domestic support, border protection and export subsidies (dumping).
- Fourth, it was also agreed in the Uruguay Round negotiations to convert non-tariff measures into tariffs, thereby making protection more transparent, although one of the steps backwards in the Blair House accord was the introduction of tariff quotas.
- Fifth, it was during the Uruguay Round negotiations that the TPRM process was introduced on a provisional basis, straightaway put into effect and made permanent in the final package of agreements.

Overcoming political resistance to the reduction of farm subsidies requires a greater public understanding of their first-round and secondary effects. A start can be made in that direction, even during the Doha Round negotiations, by incorporating economy-wide analysis in the TPRM process. That could be brought about by the WTO's Director-General at the stroke of a pen.

The problem with the existing TPRM process is that it is not open, it is not independent and it does not entail any economy-wide analysis – in fact, it does not entail any analysis at all. Stakeholders cannot make submissions that everyone can scrutinize and comment upon. In addition, the reviews are prepared and vetted by departments of trade, which typically promote exports and resist imports – they are not really bastions of trade liberalization.

More than strengthening the TPRM process, economy-wide analysis needs to be part of the policy-making process in the major economies, not only with respect to agriculture but also with respect to textiles, steel and other industries that rely on public assistance through support and protection.

The politics of protection for resisting agricultural trade liberalization is so strong that relying on the Doha Round negotiations alone, and on the one interest group for change they empower, will not be sufficient to see trade reform actually happen. Other groups have to be brought into the political equation. The best way to do this is through open and independent economy-wide analysis of all the secondary and inter-sectoral effects of protection. Through this process the politics of protection can be got to change. Not only does it make sense. It can work. Even in a representative democracy.

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<sup>1</sup> This paper is based on a section in *Termites in the Basement: To Free up Trade, Fix the WTO's Foundations* (Canberra: Rural Industries Research and Development Corporation, 2003).

<sup>2</sup> Andrew Stoeckel, *Solving the Problem: a Look at the Political Economy of Agricultural Reform*, Publication No. 00/124 (Canberra: RIRDC, 2000).

<sup>3</sup> John Humphreys, Martin van Bueren and Stoeckel, *Greening Farm Subsidies: the Next Step in Removing Perverse Farm Subsidies*, Publication No. 03/040 (Canberra: RIRDC, 2003).

<sup>4</sup> Henry Hazlitt, *Economics in One Lesson* (New York: Three Rivers Press, 1979)

<sup>5</sup> Humphreys, van Bueren and Stoeckel, *op. cit.*

<sup>6</sup> Drawing on Australian experience, the process needs to begin with terms of reference issued to the independent reviewing agency, which then publishes an "issues paper" setting out the framework for the review and identifies the key stakeholders. The agency then needs to call for submissions, hold public hearings, in which anyone can see and comment on the other submissions, and produce draft report. Comments on the draft report, also in the public domain, are then considered, incorporated in the review as necessary, and a final report is published, which must be considered by government.

<sup>7</sup> *Transparency for Positive Adjustment* (Paris: OECD Secretariat, 1983).

<sup>8</sup> See, for example, *Transparency for Positive Adjustment, op. cit.*, and "Improving the Basis for Trade Policy Decisions", *OECD Press Release*, OECD Secretariat, Paris, May 9, 1985, reproduced in the Long Report (cited below).

<sup>9</sup> Olivier Long *et al.*, *Public Scrutiny of Protection: Domestic Policy Transparency and Trade Liberalization* (Aldershot, Hants.: Gower, for the Trade Policy Research Centre, 1989), initially published in mimeograph form in 1984 and circulated among GATT delegations in Geneva. Olivier Long was earlier Director-General of the GATT.

<sup>10</sup> Fritz Leutwiler *et al.*, *Trade Policies for a Better Future*, Report to the Director-General (Geneva: GATT Secretariat, 1985).