



**CATPRN**

Canadian Agricultural Trade Policy Research Network

# **Implications of the July 2004 WTO Framework Agreement for Canadian Agriculture**

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**James Rude**

Assistant Professor

Department of Agribusiness and Agricultural Economics

University of Manitoba

**Karl D. Meilke**

Professor

Department of Agricultural Economics and Business

University of Guelph

**<http://www.catrade.org>**

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## 1.0 Background

In July 2004 a “framework agreement” for the Doha Development Agenda (DDA) was accepted as a guide for remainder of the negotiations. The negotiators had hoped to reach agreement on the modalities for the agricultural negotiations by July 2005, leaving only the most difficult issues to be resolved at the Hong Kong Ministerial meeting in December 2005. Unfortunately, the negotiators missed the July 2005 deadline, leaving the Chairman of the WTO Committee on Agriculture to declare...“*The agricultural negotiations are stalled – there is no way to conceal that reality.*” As a result, the Framework Agreement remains the best guide to the final negotiated outcome. The purpose of this brief is to provide a Canadian perspective of the negotiations and to highlight some of the expected challenges and opportunities.

As a starting point, it is useful to recall Canada’s negotiating position. The basic objectives are: the elimination of export subsidies, maximum possible reductions in trade distorting domestic subsidies and improvements in market access for Canada’s exports of agri-food products. At the same time, Canada’s negotiators will attempt to maintain the high import tariffs that underpin our supply managed sectors; and to maintain the core functions of the Canadian Wheat Board. The Framework Agreement would appear to be flexible enough to accomplish all of the above, although many key issues are yet to be resolved.

## 2.0 Export Subsidy Elimination

The export subsidy provisions of the Framework Agreement are the most detailed and well developed. The negotiators have agreed that all direct and indirect export subsidies will be eliminated. The only Canadian commodities receiving direct export subsidies are dairy products. In 2003, Canada’s exports of dairy products were valued at \$314.5 million and most of these sales will be lost as export subsidies are eliminated. However, to put this into perspective Canada’s farm cash receipts from the sale of milk and cream are about \$4.5 billion. While Canada’s dairy industry will not welcome the loss of subsidized dairy exports this development can be accommodated with relatively modest reductions in milk output.

Historically, Canada’s exports of grains and oilseeds have had to compete with EU and US commodities sold with the aid of export subsidies. However, the reform of US and EU agricultural policies since 1995 has eliminated the use of direct grain and oilseed export subsidies by the US, and sharply reduced the use of export subsidies by the EU. However, even with the EU’s recent policy reforms they may need export subsidies at some point in the future, especially if there is a significant revaluation of the euro with respect to the US dollar. So, there is value in the eventual elimination of the use of explicit export subsidies.

What about indirect export subsidies? The most obvious form of indirect subsidization is through the use of government sponsored credit programs. The largest user of export credit programs is the US and this will be the first time any disciplines are applied to these programs – this will represent a significant win for Canadian grain and oilseed producers.

When will the elimination of export subsidies occur? The requirement for the parallel elimination of all forms of export subsidies is likely to prolong the process. However, a larger obstacle is the fact that the reform of the EU’s agricultural policy will not be completed until 2013. Consequently, the most likely date for the complete elimination of export subsidies is around 2017, corresponding to about a ten year implementation period for the DDA.

The elimination of export subsidies will have a small positive impact on world grain and oilseed prices. The impact on international dairy prices is potentially much larger. However, the most fundamental benefit is that the reform will bring agriculture into conformity with the rules for all other products and prevent any backsliding with respect to the use of export subsidies. The price increases resulting from the elimination of export subsidies will not solve Canada's perceived income problems in agriculture but it is a long overdue reform of international trading rules.

## **2.1 The Canadian Wheat Board**

The CWB is western Canada's exclusive exporter of wheat and barley and is considered a State Trading Exporter (STE) by the WTO. The operations of the CWB are based on three principles: single desk selling, price pooling and a government guarantee of the initial payment to producers. The Framework Agreement calls for the end of "trade distorting practices with respect to exporting STEs including eliminating export subsidies provided to or by them, government financing, and the underwriting of losses". This means the Canadian government will no longer be able to guarantee the CWBs initial payments and its borrowing activities. As a result, the CWBs borrowing costs and its cost of risk management will go up. Although the CWB will face higher borrowing costs and need to engage in market based risk management strategies the Framework Agreement will not put the core activities of the CWB in jeopardy.

The Framework Agreement also states that the elimination of STEs is under negotiation. Canada, has argued strenuously that domestic marketing arrangements should not be a concern of the WTO, as long as their activities are not trade distorting. More likely, the issue of monopoly elimination will be used as a bargaining chip in the negotiations but the final agreement will not call for the elimination of monopoly STEs.

## **3.0 Sensitive and Special Products**

Improved market access is the key to any successful trade negotiation. In this area many issues remain to be determined as the negotiators work towards the "substantial" tariff cuts called for in the Framework Agreement. Products (tariff lines) will be divided into three groups: 1) ordinary, 2) sensitive and 3) special. Most products will fall into the ordinary category and for this group there will be 4 or 5 tariff bands with larger tariff cuts required for the products in the higher tariff bands. Yet to be negotiated is the size of the average tariff cut (overall and in each band), if any "flexibility" will be allowed in cutting tariffs in each band, and if there will be a maximum allowed tariff. Given Canada's export orientation, large cuts and limited flexibility is in its best interest.

Developed countries will be allowed to self select an *appropriate number* of sensitive products that will be given special consideration in the application of the tariff cuts. Presumably the list of "sensitive" products will include, at most, those products already protected by tariff rate quotas (TRQs). Although TRQs cover only six percent of the tariff lines they are prevalent for dairy, sugar, meats and cereals. The required tariff cuts for sensitive products will be smaller than for ordinary products but additional market access will have to be provided through an expansion of tariff rate quotas. Essentially, the smaller the tariff cut the bigger the expansion of the tariff rate quota. This trade-off between tariff cuts and TRQ expansion will be one of the most difficult negotiators have to specify. It is through the selection of sensitive products that Canada hopes to spare it supply managed commodities from significant new import competition, although a minimum access commitment of at least 7-10 percent of a recent consumption level is likely to be required.

As a major agrifood exporter Canada has large stake in pushing for improved market access especially for consumer ready products. This means Canada should be a strong proponent for using

a harmonization formula for tariff reductions and for rules to reduce tariff escalation. From this perspective the creation of a new class of “special” and “sensitive” products is troubling. While Canada’s producers of supply managed commodities have a vested interest in maintaining protection for their commodities, the creation of a set of “special and sensitive” products risks creating a permanent set of commodities where serious trade liberalization will be delayed for decades. Since sugar and rice will be prominent among the list of sensitive products in developed countries it also sends the wrong signal to developing countries that have a comparative advantage in producing these crops. At the very least, the number of tariff lines treated differently must be very limited, in-quota tariffs for these commodities should be reduced to zero and meaningful minimum access commitments created.

#### **4.0 Domestic Support**

The Uruguay Round Agreement on Agriculture (AoA) introduced disciplines on domestic support for the first time. The nomenclature used to describe domestic support in the WTO is complex and at times confusing. In the AoA certain types of support were exempt from reductions: 1) minimally trade distorting support (green box programs); 2) direct payments linked to production limiting programs (blue box programs); and 3) commodity specific and non-commodity specific support that fell below a threshold level (*de minimis*). Domestic support that distorted trade was accounted for using an aggregate measurement of support (AMS) and the AMS (amber box programs) had to be reduced by 20 percent, from a 1986-88 base level. The Framework Agreement maintains and extends the discipline on domestic support by requiring that in the first year of implementation there is to be a 20 percent reduction in total support (that is the sum of final bound total AMS plus both *de minimis* exemptions and blue box support). Additional cuts in total support will follow and these cuts will be guided by a harmonization formula that requires larger cuts for Members with higher levels of support. Finally, there will be specific cuts in AMS support and *de minimis* support; blue box support will be capped at five percent of the total value of production and green box criteria will be reviewed to further remove trade distorting elements. Caps on the support provided to individual commodities are also to be negotiated.

For Canada, and most developing countries the success of the domestic support provisions will be judged by how much discipline they exert on US and EU spending levels. While a definitive assessment of the domestic support provisions is difficult without knowing the size of the reductions, it appears that reforms to EU and US agricultural policies provide them with considerable flexibility in dealing with the new disciplines. The EU has reduced its intervention prices and this will lower the support provided under AMS programs and much of its blue box support can be transferred to the green box. The redefinition of the blue box will allow the US to transfer its countercyclical payments to the blue box. Unless world commodity prices decline sharply there should be enough room in a revised AMS for the US to cover its loan deficiency payments and its support to dairy and sugar.

The impact of potential new WTO disciplines on Canada’s domestic support expenditures is more difficult to assess. In 2000, Canada only used 20 percent of its AMS but since then expenditures for BSE related programs and the introduction of CAIS have increased program spending. It is unclear how Canada will notify CAIS but it does not appear to meet the green box criteria. Historically, Canada has notified most of its safety net spending as non-product specific *de minimis* spending, but with cuts in *de minimis* levels there will not be as much opportunity to use this option.

The Framework Agreement has added more structure to the existing domestic support disciplines with constraints on overall trade distorting support and limits on blue box expenditures. How effective the disciplines will be in limiting trade distorting support is yet to be determined and it will depend on how aggressive the formula reductions are for overall and total AMS support. However, the domestic

support disciplines will not sharply limit spending on the agricultural sector by developed countries willing to shift support from the most trade distorting programs into less trade distorting programs. As a result, subsidy envy by producers in some developed countries and most developing countries will continue unabated.

## 5.0 Conclusions

The Framework Agreement provides the basic building blocks on which the DDA will be constructed but much remains to be decided and the time remaining prior to the Hong Kong Ministerial is short. Without knowledge of the degree of ambition it is impossible to provide a final judgment, but it appears that the Framework is ambitious enough to keep the process of trade liberalization going while reflecting politicians desire to continue protection for special interests.

What does the Framework mean for Canada? The Canadian negotiators were seeking an overall limit on all types of domestic support (green, blue and amber programs) and the maximum possible reduction in amber and blue box support. The Framework will discipline the total amount of AMS, blue box, and *de minimis* support. This is potentially one of the most significant contributions of the Framework Agreement. Also on the plus side, the harmonization approach will be more aggressive in reducing subsidies in those countries that subsidize the most. Product specific caps on amber box support will prevent Members from continuing to provide trade distorting domestic support to selected sectors, as overall support levels are reduced. This may result in Canada moving from administered to negotiated prices for its dairy products, but the discipline should be useful if the total AMS reduction commitments are binding on large agricultural subsidizers. At this time it is not known how large the required reduction in *de minimis* support will be, but a smaller threshold may create a challenge for Canada in terms of meeting its domestic support commitments.

Canadian negotiators were looking for the elimination of all agricultural export subsidies as quickly as possible. The Framework will eventually eliminate direct and indirect export subsidies but this is unlikely to happen before 2017. Disciplines on government involvement in agricultural export credit programs are long awaited and should help to bring agriculture closer to the set of subsidy disciplines that apply to other sectors.

Canada was seeking a variety of market access negotiating techniques that would open foreign markets to the greatest possible extent while still protecting sensitive domestic industries. The Framework introduces a category of sensitive products. Market access liberalization for sensitive products will be made through a combination of tariff reductions and tariff rate quota expansion. It is not, however, in Canada's interest to introduce a plethora of exemptions to market access commitments. It is important that the base for tariff rate quota expansion be established through coherent and equitable criteria. Reducing the dispersion of tariffs and their escalation is a goal that Canadian negotiators should be seeking given the proportion of our exports that are consumer ready.

The Hong Kong Ministerial Meeting is crucial. A failure to reach agreement on the modalities at this meeting would set back the negotiations – potentially for several years.