SUBSTANTIAL REDUCTION OF BORDER PROTECTION UNDER THE DOHA ROUND

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The mandate for agriculture in the Doha Round negotiations is frequently described as calls for gains to each of the "three pillars" of support: the eventual elimination of export subsidies; significant reductions in domestic support; and a significant increase in market access. Progress on all three fronts is needed. But the Doha mandate also calls for a more market-oriented world agriculture trading system through a programme of fundamental reform. Securing more market access is the priority to achieve this outcome and the payoff of benefits is potentially much greater than from reform of domestic and export subsidies.

The criteria for a successful outcome from the Doha Round should be how close average tariffs (and tariff quota equivalents) and their dispersion for agriculture converge to those of other manufactured goods over the decade following the completion of talks. There is virtually no chance that the current 'blended formula' for removing barriers at the border will lead to a meaningful reduction of average tariffs and the dispersion of tariffs. Indeed, there is a chance that the dispersion of tariffs (and hence economic costs) could worsen.

Complicated formulae such as the 'blended formula' are potentially deceitful devices to conceal the lack of meaningful progress and obviate the need for policymakers to face up to hard decisions. If countries do not want to liberalize, they won't, and no formula will get around that fact. Real progress can only come from changing political will and the best way to change that is by open, independent and transparent economywide analysis that identifies the economic benefits and costs for all stakeholders from agricultural trade liberalisation.

Market access is the priority

For commodities such as beef, sugar, dairy products and rice, securing improved access to markets in the Doha Round negotiations is more important than the removal of export subsidies or the lowering of trade-distorting domestic subsidies. Besides the economic gains, there are eight reasons why greater market access is more beneficial to the world trading system than lowering export subsidies or domestic support. The reasons are grounded in good economics as well as good politics.

First, policymakers seem to be unaware that the three pillars of agricultural policy are inter-elated. Changing one area has implications for the others. Removing barriers at the border and thereby increasing market access automatically eliminates export subsidies — two beneficial reductions are achieved for the price of one. Indeed, there is the danger that emphasizing reductions in export subsidies as an indication of success will lead to domestic supply controls being imposed in order to control the surpluses that will be capitalized into land values or other licenses and make domestic reform more difficult later on.

Second, lowering trade barriers also puts extra pressure and transparency on domestic supports. It makes the real costs of support more obvious to taxpayers. In this way, greater market access sets up adynamic leading to further reform — three beneficial results could be had for the price of one. Budgetary pressure to reform domestic support policies is already intense in Germany, France, Japan and the United States.

Third, removing barriers at the border (tariffs and quotas) has the advantage of being simple, clean and easy to measure, as well as being transparent and easy to police and enforce. By comparison, removing domestic supports — whether they are "green box"[1] or not — can be complicated, non-transparent and difficult to enforce. It is easy to substitute one domestic program for another. But this is not the case for border measures. Either they exist or they do not. To test for their existence an exporter can always just load up a container.

Fourth, unlike removing domestic subsidies, lowering trade barriers does not as obviously impinge on national sovereignty. This helps avoid the sovereignty argument used by anti-globalizers that one country should not tell other countries how they should conduct their internal affairs.

Fifth, given that agriculture stands out as the most highly protected sector in the world economy, lowering trade barriers eliminates the value of preferential access to markets that is granted to developing countries. These preferential trade arrangements are "poisoning" multilateral trade negotiations in the WTO system and creating a perverse incentive for some [developing] countries to block trade liberalization.[2]

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[1] "Green box" support measures are those that are exempt from commitments to reduce domestic support. The green-box measures agreed in the Uruguay Round negotiations minimally trade distorting – as with spending on research and development.

[2] See Andrew Stoeckel and Brent Borrell, *Preferential Trade and Developing Countries: Bad Aid, Bad Trade*, a report prepared for the meeting of the Cairns Group Farm Leaders, Montevideo, Uruguay, in 2001.

Sixth, freeing trade at the border on a multilateral basis, if achieved for agriculture, could set a precedent for other industries and so eliminate the need for negotiations on a regional or bilateral basis. Multilateral free trade would make free trade areas (FTAs) pointless.

Seventh, lowering barriers at the border introduces competition. This is one of the major planks of a sound competition policy, judged to be important by some of the major players. An open non-discriminatory world trading system for agriculture is only possible if barriers to trade at the border are removed.

Finally, securing greater market access for agricultural products and other protected industries also makes political sense — it is the "bread and butter" of the old GATT system and now the new WTO system.

These eight reasons demonstrate why securing market access is likely to be far more productive as a priority in achieving the liberalization of agricultural trade. .
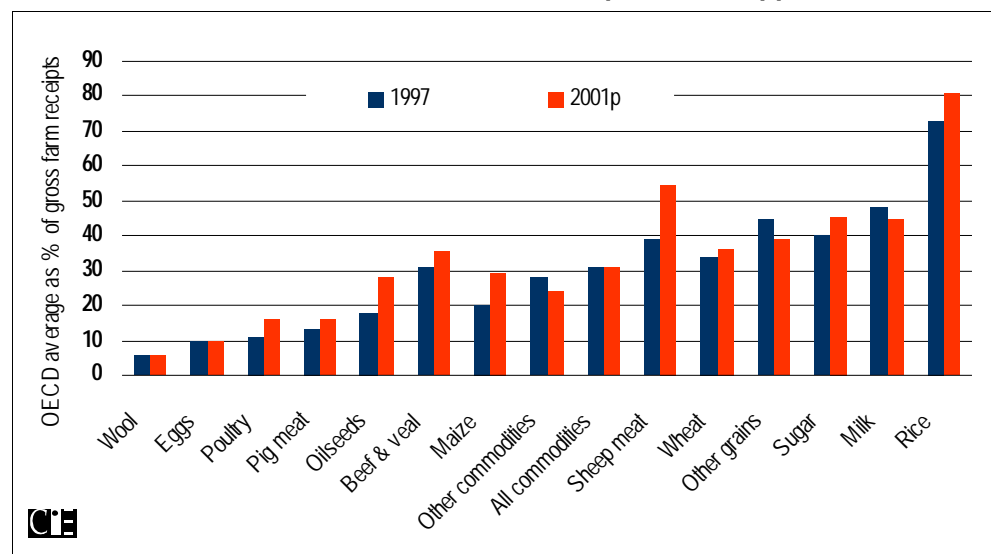
Criteria for success in the Doha Round

The Doha Round mandate calls for the reduction of export subsidies, with a view to phasing them out, and substantial reductions in border protection and domestic supports that distort trade. The goal for export subsidies is clear — their eventual elimination. But how can success be judged for "substantial reductions"? For some WTO members, "substantial" means the virtual elimination of barriers to trade and trade-distorting domestic subsidies, but for others it means only modest reductions. Faced with this dilemma, the criteria for success should be based on first principles — what the multilateral trading system is all about.

The aim of the WTO system, as reiterated in the Doha Round mandate for agriculture, is about achieving an open and non-discriminatory world trading system. Open trade leads to a system that makes the best use of the world's scarce resources. It encourages competition, spurs innovation and leads to the most efficient economic outcome. It delivers the greatest amount of global prosperity at least cost. That means that a long-term goal, say a decade out, should be to get agricultural tariffs (and their quota equivalents) as low as possible, if not to zero. Already, the average tariff for non-agricultural manufacturing worldwide small of the order of a few percent. Average industrial tariffs are set to fall further in the WTO negotiations if current proposals by the majors for manufactured goods are adopted.

A second profound but subtle point is that it is the *dispersion* of tariffs around the average that matters. The dispersion of tariffs is potentially more important than the *level* of average tariffs. The economic cost of protecting an industry arises from the distortion of *relative* prices. It is the relative advantage conferred on one industry over another that leads to the misuse and unnecessary waste of resources. Indeed, under theoretical conditions (that would not exist in the real world), equal protection for all industries can be shown to be equivalent to free trade. Therefore it is essential that the dispersion of tariffs around the average level of protection be reduced if the Doha Round negotiations are to be considered a success. But reduced to what? Not only should the dispersion of agricultural tariffs be reduced *within* the agricultural sector, the dispersion *between* agriculture and non-agriculture activities should also be reduced.

Chart 1 **Some commodities receive a lot more producer support than others**

Data source: OECD personal communications, Paris.

The only trade-liberalizing goal for the Doha Round negotiations that makes economic sense, and is consistent with the declared mandate, is to lower in due course the level of protection for agriculture to what it is expected to be for manufacturing, which is close to zero. Thus the criteria for success in the WTO negotiations is how close, and by when, can they achieve that long-term objective of near zero protection for agriculture.

State of play and the "blended formula"

The WTO ministerial conference in Cancun in September 2003 failed to produce a consensus on a framework for negotiations. Left on the table, however, was the Revised Draft Cancun Ministerial Text released by the

chairman of the conference, the Mexican Minister of Foreign Affairs, Luis Ernesto Derbez. This text, now known as the "Derbez text", contained among other things a framework for securing increased market access. At the heart of the section on market access for developed countries (where most of the world's distortions to agricultural production and consumption occur[3]) was a "blended formula".

The blended formula

The formula proposed by Derbez was to distinguish three categories of agricultural tariff lines, each containing components in square brackets that were to be negotiated. The formula proposed, with the blanks to be filled in later, was as follows.

(i)   […]% of tariff lines shall be subject to a […]% average tariff cut and a minimum of […]%; for these import-sensitive tariff lines market access increase will result from a combination of tariff cuts and tariff-rate quotas.

(ii) […]% of tariff lines shall be subject to a Swiss formula with a coefficient […].

(iii) […]% of tariff lines shall be duty-free.

[The resulting simple average tariff reduction for all agricultural products shall be no less than […]%.]

Why the blended formula is dead — or should be

The blended formula will not succeed in bringing about substantial improvements in market access. Nor will it lead to a lower dispersion of tariffs that lie at the heart of the economic cost of agricultural protection. The fundamental flaw is that the formula contains the Uruguay Round provision — the first component of the Derbez text.

It has been well established that the Uruguay Round negotiations failed to produce a meaningful reduction in tariffs.[4] Putting it simply, as is well

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[3] See Stoeckel, "Removing the Hidden Taxes on Exports", in Stoeckel and Hugh Corbet (eds), *Reason versus Emotion: Requirements for a Successful WTO Round*, papers for a conference in Seattle on December 1, 1999 (Canberra: Rural Industries Research and Development Corporation, 1999), pp. 77–102.

[4] See Joseph Francois and Will Martin, *A Formula for Success? Potential Approaches to Market Access Negotiations;* and Stoeckel, *Termites in the Basement: To Free Up*

known, an average tariff cut (as called for in the Derbez text) is not the same as a cut in the average tariff.[5]

The simple example of how little can be done, set out in the World Bank's *Global Economic Prospects* for 2004 (cited in footnote 5), relies on the distribution of tariffs in each country's tariff schedule. But analyzing the implications of the Derbez text for what it might mean for the majors – the European Union, Japan and the United States -- is extremely difficult and time consuming. To start with, there are thousands of tariff lines — some 4770 in the case of the European Union at the ten-digit level. Roughly half of them are either specific or a mix of *ad valorem* and specific tariffs. But for each specific tariff, a conversion has to be made, for it to be analyzed, to an *ad valorem* equivalent. That means a representative price for each tariff line has be obtained before aggregation to six-digit tariff lines — which is usually the case in trade-liberalizing negotiations.

To illustrate the issue, we can consider the effect if all tariff lines for the United States were included in Category 1 of the blended formula. The relationship between the average cut in tariffs and the cut in the average tariff is shown in Chart 2 when there is no minimum cut of 20 percent. The assumption is that countries will make the least cuts to their most protected and sensitive industries.

Clearly, when all tariffs are cut completely, the average cut and the cut in the average are the same. But it can be seen from Chart 2 that, without any minimum cut, a substantial average cut in tariffs has to be made to the U.S. schedule before any meaningful cut in the average tariff is achieved. In fact, in order to achieve a cut in the average tariff of 30 percent in the United States for agriculture and food, an average cut of over 90 percent would have to be negotiated. With a minimum cut of 20 percent, things are a little better, but an average cut in tariffs of 84 percent would be required to achieve the same 30 percent decrease in average tariffs.
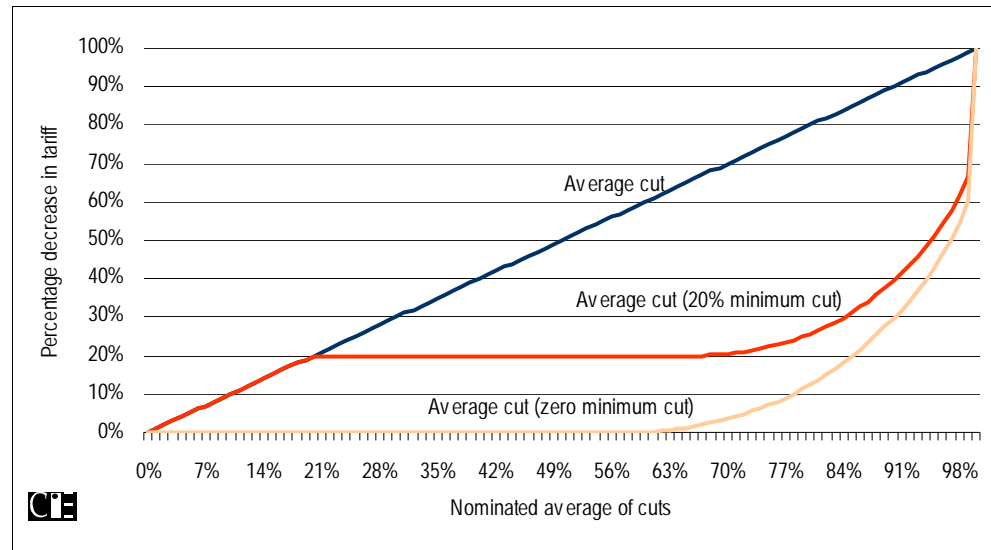
From Chart 3 it can be seen that the dispersion of tariffs can actually increase when the circumstances applying to Chart 2 apply. As the "tall poppies" are left alone, in deference to political sensitivities, the dispersion

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Trade, Fix the WTO's Foundations (Canberra: Rural Industries Research and Development Corporation, 2004).

[5] *Global Economic Prospects for 2004,* World Bank, Washington, DC, p. 92, gives a simple example of an agreement for an average cut in tariffs of 50 percent for a country with two agricultural tariffs — one at 1 percent and the other at 100 percent. A cut of 100 percent in the 1 percent tariff, and of zero in the 100 percent tariff, yields the necessary 50 percent average cut tariffs — great for the headlines. But in reality, virtually nothing has been done. The average tariff has fallen from 50.5 to 50 per cent.

rises until the last remaining high tariff is cut when the coefficient of variation crashes to zero. But the importance of the minimum cut can be seen also in Chart 3 — it only makes a minor impact on the dispersion of tariffs to a point.
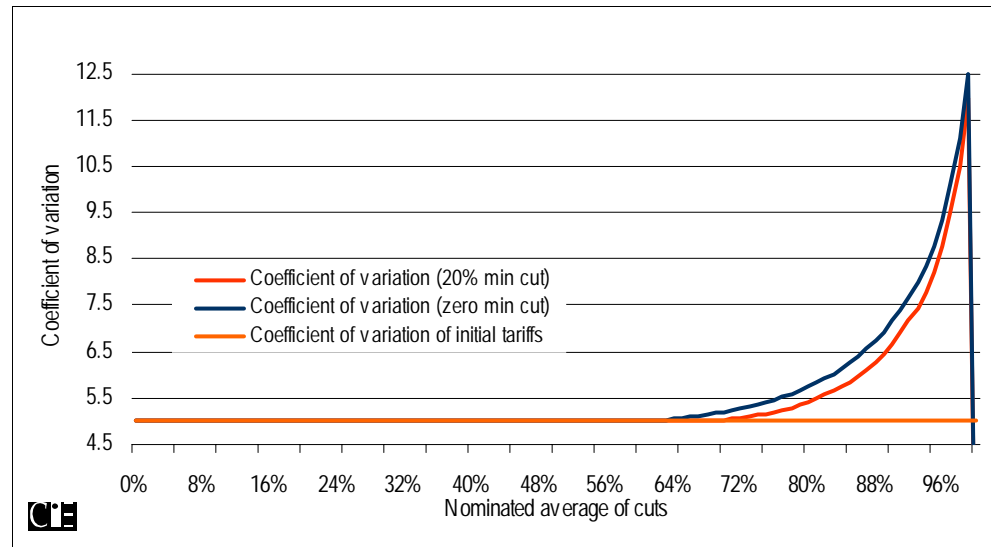
Chart 2 **Relationship between average cuts and cut in the average[a], USA**

[a] All tariff lines at six digits in Category 1.
Data source: CIE calculations.

Chart 3 **Dispersion of agricultural tariffs with average cut in tariff [a], USA**

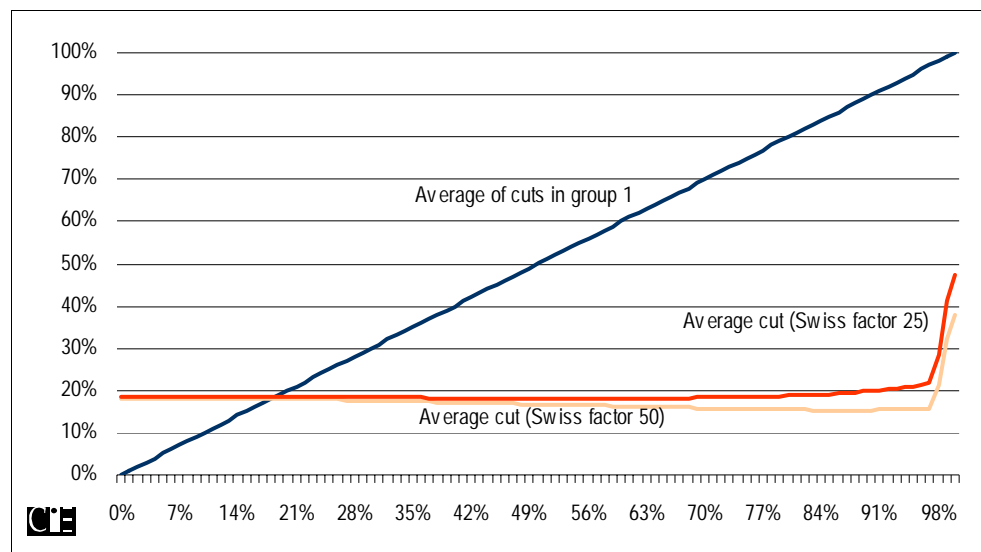[a] All tariff lines at six digits in category 1.
Data source: CIE calculations.

Some complications

The previous charts demonstrated the relationship between the average cut in tariff and the cut in the average and the dispersion of tariffs for the United States when all tariff lines were subject to the Uruguay Round approach. But the Derbez text envisages some blend of the Swiss formula as well as a proportion of tariffs bound at zero. Around 30 percent of tariffs are already zero and so we assume this proportion in Category 3. We further assume that 50 percent of tariff lines are in Category 2 subject to the Swiss formula, which could have a coefficient of 25 (proposed by the United States) or 50 (as proposed for developing countries). The effect is shown in Chart 4 and the effect on dispersion is shown in Chart 5.
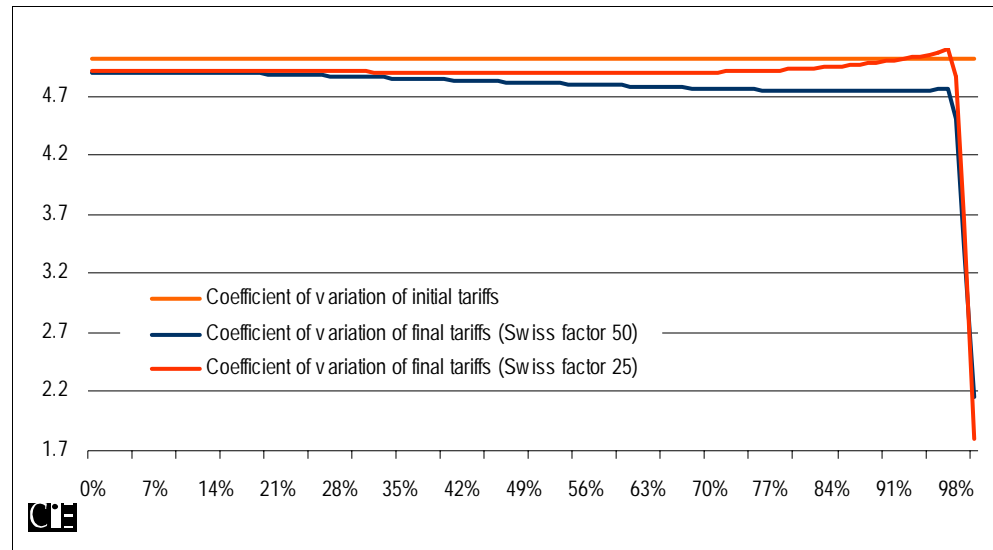
These charts show that subjecting tariff lines to the Swiss formula causes little harmonization of U.S. tariffs. Because of the existence of a few tariff peaks — notably for sugar, which would be put in Category 1 (since sugar is politically sensitive in the United States) — there is little harmonizing effect from subjecting 50 percent of tariff lines in the United Statres to the Swiss formula and the size of the coefficient — either 25 or 50 — matters little at the proportions chosen for categories of tariff lines under the three categories.

Chart 4 **Relationship between average cut in tariff and cut in average tariffs with 50 per cent of lines in category 2**

Data source: CIE calculations.

Chart 5 **Dispersion of tariffs with average cuts in tariffs with 50 per cent of lines in category 2**

Data source: CIE calculations.

Generalizing the implications of the blended formula

The above examples show just one set of thousands of choices for the parameters in square brackets yet to be negotiated if the blended formula were to survive as a negotiating framework. Proponents of the blended formula will argue that it is yet to be determined what the parameters in square brackets are likely to be and that a favorable outcome is possible.
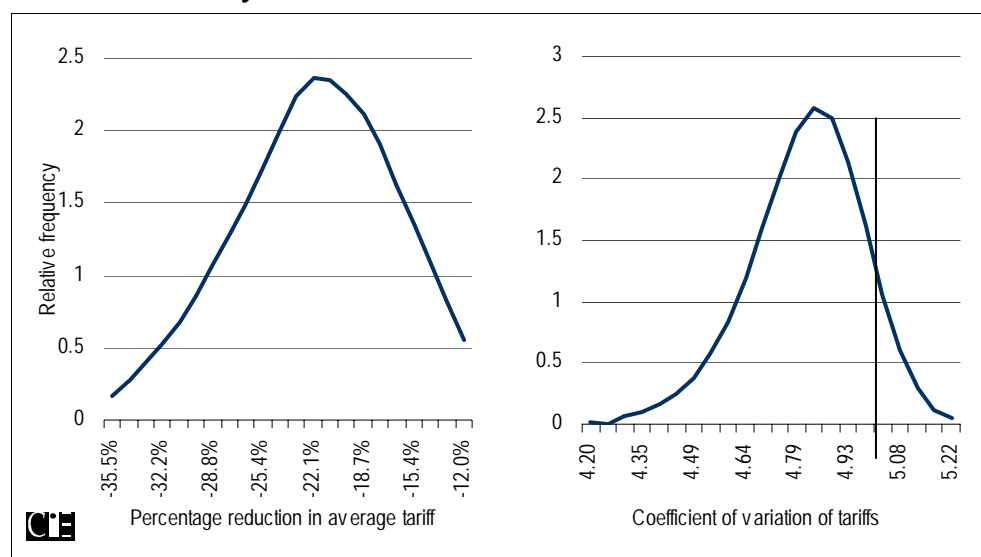
The best way to assess the likelihood of a favorable outcome is to conduct literally thousands of scenarios for different combinations of parameters under the blended formula and see what they imply for outcomes. The possible ranges of variables are set out in Table 1 below with a brief justification for each.

Applying the above range of parameters and their likelihood to the blended formula for the United States tariff schedule for agriculture as faced by Australia gives the following illustrative effects on average tariffs for agriculture and food and the dispersion of those tariffs. These are shown in Chart 6.

Table 2 **Most probable range of parameters under the blended formula**

Item	Range	Most likely	Justification
Proportion of tariff lines in category 1	a) 3 per cent to 40 per cent	20 per cent	US proposes 2–3 per cent
Average cut for category 1	36 per cent to 50 per cent	40 per cent	36 per cent achieved in Uruguay Round so this is a minimum
Minimum cut for category 1	15 per cent to 30 per cent	20 per cent	15 per cent achieved in Uruguay Round
Proportion of tariff lines in category 2	i) $0.7 - (a)$ ii) $0.6 - (a)$		
Swiss formula	25 to 50	37 per cent	USA proposes 25 already rejected. 50 proposed for developing countries
Proportion of tariff lines in category 3	i) 30 per cent ii) 40 per cent		Roughly 30 per cent of tariffs in majors have zero tariffs now

Source: CIE estimates.

Chart 6 **Probability distribution for USA tariffs under the blended formula**

Data source: CIE estimates.

It can be seen that there is only a x percent chance that a 30 percent cut in average tariffs in the United States could be achieved under the blended formula. The changes of a 50 percent cut are much less and are just y per cent. More worrying is that there is virtually no chance that the dispersion of tariffs under the blended formula in the United States will fall at all. And to reiterate, reducing the dispersion is more important than reducing the level of average tariffs, for it is the relative advantages confined to one sector over another that leads to the economic cost of agricultural protection.

The blended formula cannot work and that is why it is stillborn. Countries, in particular the G -20 and the Cairns Group, see the blended formula for what it is -- an excuse for doing nothing, but potentially generating great headlines. The sheer difficulty of analyzing tariff schedules with so many specific tariffs and the large number of permutations and combinations of parameters in square brackets means negotiators cannot have any idea of what the payoffs are. The blended formula itself becomes a non-transparency device capable of concealing little meaningful progress towards achieving a good outcome from the Doha Round.

Are there better alternatives?

Better formula for meaningful reductions exist. One example is the flexible Swiss formula proposed by Francois and Martin.[6] The formula has the advantage of introducing some flexibility into the Swiss formula, which the blended formula is trying to do. The Cairns Group have advanced yet another approach, which could be called a modified Harbinson approach and envisages a three-tier approach or "bands" with different approaches to tariff lines in each of the tiers or bands. Again, like the Francois-Martin formula, it allows some compromise between the rigors imposed by the Swiss formula and the political problems of cutting protection for the "tall poppies".

Other problems must also be reckoned with. Should the focus be on applied rates or bound rates? How much "water in the tariff" is there for meaningful reductions in tariffs to be the end result? Francois and Martin give a good account of these issues and there is no time to repeating it here. The real point is that the scope for devising formulae and approaches is vast and no formula will lead to meaningful reductions in agricultural border protection if countries do not possess the political will to change trade protection policies, particularly for the "tall poppies".

If countries do not want to reduce protection, they won't and no formula will get them over the line. The danger is that debate about the formula to use just ends up complicating things. It ends up as a device to muddy-the-waters and give the appearance of countries doing something when in fact

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[6] Francois and Martin, "A Formula for Success? Potential Approaches to Market Access Negotiations", op. cit. The formula is $T_1=1/(1/a + b/T_0)$ where T_1 is the final tariff, T_0 is the initial tariff, a is the Swiss factor and b is the "compensation factor". When $b=1$, the formula reduces to the Swiss formula. The factor b needs to be greater than 1 and it allows some flexibility in terms of how "severe" the application of the Swiss formula might be for highly protected sensitive sectors.

they are not. To see meaningful liberalization of agricultural tariffs requires political will. That introduces the final subject: how to change political will.

Changing political will: the key role of transparency

Protection is a political game. Narrow vested interests lobby politicians for special treatment as the gains can be enormous. But the burden is spread thinly and it does not pay the losers to organize and lobby for change. Then why is agricultural trade protection not even higher than it is? After all, farmers would like even higher returns. The answer is that something is holding the excesses of agricultural protection in check. That 'something' is a disparate group of interests, notably taxpayers, consumers, other users, exporters (who ultimately pay the price of import restrictions) and external pressure from exporting countries such as the Cairns Group.

The key to past successes of GATT/WTO negotiations is that it changes the political dynamic. It pits the interests of those exporters facing barriers in overseas markets against the protectionist interests of those industries competing against imports. It pits the Japanese carmaker who wants access to another market against the interests of the Japanese beef farmer who wants to keep beef imports out. The Japanese carmaker says 'let some more beef into Japan and we will be able to secure more access for cars into the United States'.

That politics, it has to be admitted, may have worked in the past. It is less likely to work now for two reasons.

One is that the low manufacturing tariffs mean there is little to gain for the Japanese carmaker. There is not enough in it for traditional groups looking for access to overseas markets since, except for agriculture, they already have access to the major markets that really matter.

The second problem with the political negotiating game is more subtle. The implicit message when the Japanese beef farmer concedes some extra beef imports from the United States is that this is a cost to Japan. Japan is "giving something up". But that is dead wrong. Japan is the main gainer from allowing cheaper beef imports in from the United States. Sure the United States (and others) gain, but the biggest gain is for Japanese consumers *and* Japanese exporters. For, if Japan imports more, she will export more because the *only* purpose of exports is to earn the foreign exchange to pay for valuable welfare enhancing imports. The second problem with the negotiations is that they send out this implicit 'exports good, imports bad' message that is dead wrong.

But there is a way to appeal to exporters generally that it is in their interest to lobby for greater imports into their own country, even if they face no particular barriers to export themselves. That way is to conduct the economy-wide analysis of import protection and show the exporters what they stand to gain if barriers to imports are removed.

This method has been tried elsewhere, most notably in Australia, and it has been shown to work.[7] A program of open, independent economy-wide analysis was a major force causing coalitions of interest to lobby for the removal of tariff protection. Australia is one of the few countries in the world to unilaterally liberalize trade over the last two decades.

Just two small changes are required to bring about this additional transparency. The existing Trade Policy Review Mechanism of the WTO needs amending in two respects. The reviews that are done now should be conducted by an independent body (rather than the departments of trade) and they should contain economy-wide analysis of the cost and benefits of the trade policies they describe.

Summary

Reform of agriculture can only occur if there is a political will to change. Political will can be changed, but it is unlikely that a formula can be found to achieve that. The danger is that formulae, particularly complicated ones, can be used as concealment devices to hide the lack of meaningful progress in trade reform yet generate great media headlines and a false sense of progress. The blended formula proposed in the Derbez text will not work: it can achieve little by way of cuts in average tariffs or in reducing the disparities in tariffs. Indeed, it could make matters worse in an economic sense. The search for a simple, transparent formula for a meaningful outcome from the Doha Round must be supplemented by moves to improve the transparency of the economy-wide effects of protection.

The debate should be about the desired outcome from the negotiations rather than the means. In a way the means to the end do not matter as long as the desired outcome is achieved. Open, independent and transparent cost benefit analysis will focus debate on the desired outcome, it will change the politics of protection and will shift the balance in favor of trade liberalization.

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[7] A description of the role of transparency and the Australian experience is in Stoeckel, A. 2004, *Termites in the Basement: To Free Up Trade, Fix the WTO's Foundations*, prepared for the Rural Industries Research and Development Corporation, Canberra.