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Agricultural Trade Liberalisation: Its Ambiguous Consequences on Developing Countries

Protectionism and public intervention in agriculture by Northern countries is often accused of blocking the development of the South. From this point of view, certain organisations, including the World Bank, argue that multilateral trade liberalisation could be very beneficial. Simulations carried out by the CEPII qualify this view significantly. The data used take into account trade preferences and the recent reforms of agricultural policies. The simulations also account for the fact that commitments made by WTO member states relate to bound customs duties ("ceilings") and not to duties actually applied. The impact of liberalisation would thus seem to be weaker than is generally estimated. In particular, the data and the methods of calculation used indicate that countries which presently benefit from preferential market access will lose some of their competitive advantage. Overall, the impact of multilateral liberalisation on developing countries appears to be highly differentiated, and in some cases negative. The Doha Round, which received renewed impetus from the framework agreement signed in Geneva by WTO member states, must address this problem more satisfactorily than has been the case in the past.*

At the end of July, the member states of the World Trade Organisation (WTO) were able to reach a framework agreement relating to the multilateral liberalisation of trade, after much effort, and one day past the original deadline. Though qualified as "historic" by the WTO's Director General, the text remains vague on essential issues and postpones the most difficult decisions to a later date. Very few figures were given and no timetable has been established. However, the Geneva compromise brought the Doha Round multilateral negotiations out of the cul-de-sac they had entered at the Cancun summit, ten months before. Brazil and India, along with the European Union, the United States and Australia, were part of the Group of Five which laid the basis for the final agreement. This underlies the influence acquired by the large, middle-income countries, which follows in particular from their alliance within the G-20.[1] The fact that their confrontation with the rich countries this time led to a compromise was mainly due to an agreement being reached on a framework for negotiating the liberalisation of trade in agricultural products.

Agriculture has been a central and highly sensitive issue in the negotiations. The sector has largely remained outside the field of trade liberalisation over the last fifty years. In 2001, the average rate of protection throughout the world stood at 20%, compared to 4.6% in industry and extractive industries.[2] The OECD countries also support domestic production and subsidise exports. Overall, it is estimated that producers in the OECD countries received on average $248 billion per year in farm support during the years 1999-2001.[3]

This situation is all the more problematical given that developing countries generally have a comparative advantage in agricultural and food products. Protectionism and intervention in the North are often accused of blocking development in the South. Would agricultural trade liberalisation be beneficial from this point of view?

Some organisations, especially the World Bank, give a very optimistic answer to this question. The position taken here is more nuanced: agricultural liberalisation will have contrasting effects for developing countries and would be very beneficial for some developed countries. It would

* For more details concerning the quantitative analysis, see A. Bouët, J.-C. Bureau, Y. Decreux & S. Jean (2004), "Multilateral Agricultural Trade Liberalization: the Contrasting Fortunes of Developing Countries in the Doha Round", *Cepii Working Paper*, forthcoming.

1. See L. Fontagné & S. Jean, (2003), "The WTO: In the Trough of the Trade Round", *La Lettre du CEPII*, No 226, September.
2. Calculations based on the CEPII's MAcMap database.
3. OECD, *Producer and Consumer Support Estimates*, OECD Database 1996-2003.

favour exports from the major developing agricultural countries of the Cairns Group (Brazil, Argentina, Thailand *etc.*). However, countries which are among the world's poorest would lose out.

The World Bank's Optimism

According to the World Bank, ambitious agricultural trade liberalisation would have a very significant impact on development. It would lead to annual world gains of $358 billion (1997 prices), of which more than two-thirds ($240 billion) would accrue to the developing countries.[4]

The Bank also argues that agricultural liberalisation would have beneficial consequences for poverty. On the one hand, in exporting developing countries, domestic agricultural production should increase, and the real return to factors (agricultural labour, land) associated with it should benefit. On the other hand, cuts in import protection are a factor in reducing domestic prices of basic essentials.

This assessment, however, is not wholly convincing. There are a number of reasons to qualify the Bank's optimism.

The first concerns the simulations carried out by the Bank. As with all other simulations to date, they estimate the consequences of cutting import duties by implementing tariff reduction formulae on applied MFN duties, and not for the bound MFN duties which are actually being negotiated by the WTO. Yet such bound duties, which importers have committed not to exceed, may be significantly higher than the real applied rates. As long as trade liberalisation does not bring the bound duties below applied duties, there will be no real cut in levels of protection. Simulations which use applied rates as the basis for their calculations over-estimate the effects of liberalisation.

Second, developing countries are treated as a homogeneous group, which is clearly not the case. Developing countries have highly varied production structures and trade specialisations. At the same time, levels of protection and intervention are extremely heterogeneous from one product to another. Agricultural trade liberalisation will therefore not affect all developing countries in the same way. Its impact on exports from Brazil, a large exporter of meat, sugar and cereals (all of which are heavily protected throughout the world), will be very different to the impact on Côte d'Ivoire, whose exports are made up of cocoa, coffee and pineapples (products that are very little protected).

Conditions of market access to rich countries are also an important source of differences between developing countries. Historic relations or geographic proximity have often been reinforced by trade preferences, and more recently by free-trade agreements (the NAFTA, the agreements between the EU and the Mediterranean countries, *etc.*). Trade preferences are widely used as an instrument of development aid. This is true for the Generalised System of Preferences framework, as it is for the more recent "Everything But Arms" initiative of the European Union in favour of the least developed countries (LDCs), and of US measures favouring African countries (the African Growth Opportunity Act, AGOA).

As a result, for countries which presently benefit from preferential market access, cuts in bound MFN duties actually hold out unfavourable consequences when such cuts also lead to cuts in applied MFN customs rates. These countries will suffer a deterioration, or even an end to their preference margins and hence their competitive advantage. The simulations carried out by the World Bank, which are based on incomplete tariff data, do not take preferential trade regimes into account, and so cannot account for the erosion of this advantage.

A More Qualified Assessment

To provide a better assessment of the consequences of multilateral liberalisation in agriculture, the CEPII has carried out simulations using the MIRAGE general equilibrium model and data from a unique database on protection[5] which incorporates all trade preferences and all regional arrangements. It also takes into account recent reforms of agricultural policy in the US (the Farm Security and Rural Investment Act, 2002) and Europe (the Agenda 2000 and the Mid-Term Review of June 2003).

As the framework agreement of 31 July 2004 does not include any specific figures, the proposal formulated in March 2003 by Stuart Harbinson, Chairman of the Committee directing the agricultural negotiations at the time, has been used in this work. This is the last set of quantified proposals put forward by someone responsible for organising the negotiations, as opposed to proposals from a specific (group of) member state(s). The trade liberalisation simulated corresponds exactly to this proposal: the formula is applied separately to each product of each member state, and determines the evolution of the bound MFN duties (Table 1). The applied MFN rate is only reduced if the new bound customs rate is lower than the applied, initial tariff. Harbinson's proposal implies cutting export subsidies, reducing domestic support linked to production by 50%, and progressive cuts in import duties. The developing countries benefit from Special and

4. World Bank, *Global Economic Prospects 2004*, page 51. This figure relates to a scenario which includes a drastic cut in import protection and the elimination of export subsidies and of non-decoupled domestic support measures by both developed and developing countries.
5. MAcMap database. For further information see: <http://www.cepii.fr/francgraph/bdd/macmap.htm>.

Differentiated Treatment (SDT), in that the commitments they are required to undertake are lower.

Table 1 – Cuts in customs duties in the Harbinson proposal

Developed countries		Developing countries	
Level of initial tariffs (%)	Reduction rate (%)	Level of initial tariffs (%)	Reduction rate (%)
t > 90	60	t > 120	40
15 < t ≤ 90	50	60 < t ≤ 120	35
		20 < t ≤ 60	30
t ≤ 15	40	t ≤ 20	25

Source: World Trade Organisation, March 2003.

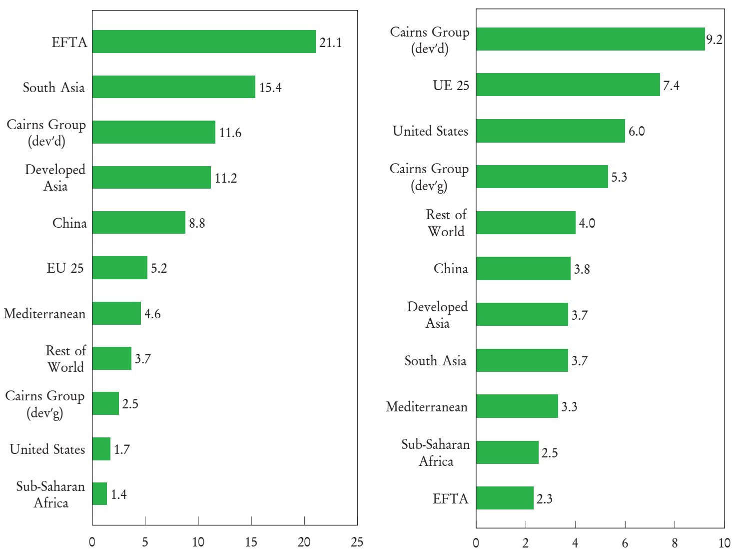
The European Free Trade Association (EFTA), the most protectionist zone among the rich countries, is set to open its borders most, as cuts in customs duties are greatest where duties are highest (Graph 1). In contrast, the lowest cuts in average customs duties will be in the United States (which has the lowest levels of initial agricultural protection) and Sub-Saharan Africa (due to SDT).

Access to foreign agricultural markets is improved for exporting zones to varying degrees (Graph 2). The improvements are especially strong for the developed countries of the Cairns Group and, to a lesser extent, for the European Union and the United States. In contrast, improved access is limited for those zones which benefited significantly from preferential access prior to liberalisation: EFTA (in the EU market) and Sub-Saharan Africa.

Graphs 1 & 2 – Cuts in tariff protection according to the Harbinson scenario

1 – Cuts in customs duties agreed by the various zones, in percentage points

2 – Cuts in customs duties faced by various zones, in percentage points



Source: Authors' calculations using the MAcMap database (CEPII & ITC).

The expected gains from liberalisation for different countries do not just depend on cuts in their customs duties or those of their partners. Reductions in domestic support and export subsidies will also affect output, volumes traded, world prices and hence real incomes. Table 2 sets out all the economic consequences of a liberalisation scenario based on the Harbinson proposal.

Table 2 – The effects of agricultural trade liberalisation (Harbinson proposal)

Zones classified according to the change in real income	*Agricultural exports (in volume)*		*Terms of trade*	*Real income*
	Initial level in USD millions	*Change in %*	*Change in %*	*Change in %*
EFTA	6 428	0.5	-0.17	0.62
South Asia	7 513	10.0	-0.28	0.41
Developed Asia	5 716	39.3	-0.40	0.24
EU 25	61 642	7.0	0.09	0.14
United States	69 969	1.0	0.39	0.06
Cairns Group (dev'd)	38 875	15.6	0.27	0.05
Cairns Goup (dev'g)	54 934	11.2	0.17	-0.01
Rest of World	35 074	6.6	-0.20	-0.05
China	11 947	12.3	-0.10	-0.11
Sub-Saharan Africa*	12 420	1.1	0.01	-0.12
Mediterranean	8 304	11.0	-0.57	-0.13
World	**312 822**	**8.0**	**0.00**	**0.11**
Rich countries	182 630	7.3	0.06	0.11
Developing countries	130 192	9.0	-0.10	-0.03
*of which least developed countries***	*19 933*	*4.5*	*-0.15*	0.08

* Excluding the Republic of South Africa.
** The least-developed countries are those of South Asia and Sub-Saharan Africa.
Source: Authors' calculations.

In volume terms, world trade in agriculture would rise by 8% on average if the Harbinson proposals were followed. If the same simulation were carried out not on bound duties (as is the case here), but on applied duties, it would lead to an increase in agricultural trade of 15%. This discrepancy indicates the extent to which the impact of liberalisation may be over-estimated when calculated using applied MFN rates.

Overall, export volumes from the rich countries increase by 7.3%, and those of developing countries by 9%. Among the main agricultural exporters, the countries in the Cairns Group (developed and developing) stand to gain most from liberalisation, as these are the countries for which access to foreign markets has improved the most. In contrast, exports from the EU and especially those from the United States will rise least, as they will suffer from reductions in domestic support and in export subsidies. For the EFTA as well as the countries of Sub-Saharan Africa, the weak increase in exports may be explained by the erosion of their preferential margins. Thus, growth in exports will be very varied, both in the North and in the South. Taking into account the diversity of initial circumstances in terms of market access substantially qualifies the most optimistic forecasts. The idea that countries which initially have a comparative advantage in agricultural products will be the main beneficiaries of liberalisation must be reconsidered: for some of these countries, this advantage was partly linked to a preferential margin that that is eroded.

Preference erosion is not the only phenomenon which certain developing countries fear. A "Harbinson" type scenario implies a rise in world agricultural prices. The abolition of present agricultural support mechanisms will lead to a rise in world demand and a fall in supply. The results of the CEPII's simulation indicate that world food prices will rise by around 3% on average. This will alter the global terms of trade (the prices of exports relative to the prices of imports of all goods). The rise in agricultural prices will vary across products, favouring or penalising countries depending on whether they are net exporters or importers. For example, cuts in subsidies for cotton production in the United States will raise the world price of cotton, which is favourable to Sub-Saharan Africa. In contrast, the Mediterranean countries will see their terms of trade deteriorate, especially because of the higher prices of the cereals they import. Overall, four out of six developing zones would suffer from a worsening terms of trade (Table 2). From this point of view, the developing countries as a whole are losers (-0.10%), especially the poorest (-0.15%), though the richer ones will benefit (+0.06%).

The change in real incomes provides a global measure of the impact of liberalisation: it combines the impact of the shift in the terms of trade with the sectoral relocation of resources induced by the reduction of distortions created by tariffs or subsidies. This overall impact would be positive at the world level. Given the importance of the initial distortions eliminated by liberalisation, the impact is positive for all industrialised regions as well as for South Asia. The other developing zones, however, will lose out. In the model, these are characterised as having dual labour markets, with wages being lower in the agricultural sector than elsewhere. Within this framework, greater specialisation in agriculture will have a negative impact on real wages.

As always, these global results, which are provided by a general equilibrium assessment, should be treated with caution. In particular, while the MIRAGE model strives to take into account certain characteristics specific to developing countries, it does not fully grasp the complexity of their economies and the role which agriculture could have in their development processes. Nevertheless, this overall result is useful in drawing attention to the fact that progress in agricultural exports, even when accompanied by improved terms of trade, may not, under certain circumstances, lead to improvements in real wages.

Policy Implications

The highly differentiated and, in some cases, negative impact which multilateral trade liberalisation may have on developing countries is often masked within the general debate on trade. While some countries will gain market share, others will be penalised not only by the erosion of trade preferences, but also by the rise in world agricultural prices. Poor countries with few resources to develop industries or services may suffer from liberalisation along the lines proposed so far.

This conclusion should not lead to the rejection of the liberalisation process. By improving the geographical allocation of agricultural production, liberalisation provides global benefits, and will help certain developing countries, whose populations are in part very poor. But attention should be paid to formulating liberalisation in a manner which limits the erosion of preferential margins or which provides financial compensation to those zones, such as Sub-Saharan Africa, which are vulnerable to agricultural liberalisation. The global gains mean that the resources are there to provide this compensation.

The Geneva agreement proposes exempting 47 least-developed countries from any commitments in the agricultural trade negotiations, thus echoing the letter circulated by EU Commissioners Fischler and Lamy in May 2004. This is a step forward in taking into account the vulnerability of certain countries, but it only solves the problem partially. It will not prevent these countries suffering from greater competition in markets where they benefit from trade preferences. It also neglects other poor countries which do not have the status of being "least developed".

Antoine Bouët, Jean-Christophe Bureau,
Yvan Decreux & Sébastien Jean
bouet@cepii.fr

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EDITORIAL OFFICES

Centre d'études prospectives
et d'informations internationales,
9, rue Georges-Pitard
75015 Paris.
Tél. : 33 (0)1 53 68 55 14
Fax : 33 (0)1 53 68 55 03

PUBLISHER:
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Director of the CEPII

CHIEF EDITORS:
Agnès Chevallier
Bronka Rzepkowski

TRANSLATION:
Nicholas Sowels

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