

RIETI BBL Seminar on February 14, 2008

## **The February 8, 2008 Falconer Draft Text for the Doha Round WTO Negotiations on Agriculture**

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### **Summary\***

I have distributed a paper on the July 2007 Falconer Draft text for the Doha Round WTO negotiations on Agriculture (See Brett G Williams, “The Falconer Draft Text for the Doha Round WTO Negotiations on Agriculture – A ‘Ha’porth of Tar’ to Save the Vessel from Sinking or Just a Dab of paint on an Irreparably Broken Hull?” (2007) 30(2) UNSWLJ 368-408 and the version available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1032484](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1032484) ). I have also distributed a copy of slides for today’s talk. The paper deals with the version of the Falconer draft text that was released on July 17, 2007. Chairman Falconer released a new draft on February 8, 2008 (6 days ago). The slides contain a number of matters in bold text to indicate that they are new elements of the February 8 text (TN/AG/W/4/Rev.1) which were not in the July 17 text (TN/AG/W/4). Note that the slides contain square bracketed numbers wherever they refer to numbers that are shown in square brackets in the draft text (which denotes that the numbers have not been agreed upon).

Today I will not cover everything in the paper or the slides. I will make some general observations about the function of the General Agreement on Tariffs and Trade (GATT),

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\* This summary was compiled by RIETI Editorial staff with substantial contribution from Dr. Brett Williams.

the problems with applying the GATT to agriculture and the reforms in the Uruguay Round. Then in describing the draft text, I will concentrate on the negotiation on market access and, to a lesser extent, on domestic support, and will do so with some emphasis on explaining how this text would address previous problems and would continue the process of reform started in the Uruguay Round. The essential point of my presentation is that reducing barriers to market access is a much more important function of the GATT than that of reducing domestic support for agriculture. It can be observed from these negotiations on market access that the parties are making exceptions for themselves, instead of trying to reinforce the integrity of the rules on market access. On the other hand, the parties are negotiating very tight rules on domestic support. Putting it bluntly, the negotiation on domestic support is completely over the top: there is no need for all these extra rules and they will achieve only very small welfare gains, if any. On the other hand, the extent of the exceptions to the rules on market access would seriously undermine the ability of the GATT to deliver large welfare gains in this sector.

Tracing back through the history of the application of the GATT to agriculture since 1948, it is evident that there have been substantial deviations from the GATT rules on market access and, consequently, there was a significant failure to bring down import barriers: for example, the United States had a waiver on certain rules on agriculture, and the European Community (EC) applied variable levies, meaning it could apply customs duties as large as it liked on many agricultural products. Prior to the start of the Uruguay Round, the barriers against agricultural products were so high and had caused so much overproduction that countries had introduced export subsidies to the extent that, in 1986, the U.S. and the European Union each were spending about \$35 billion on agricultural export subsidies. In the Uruguay Round, the GATT parties tried to reverse this behavior. Under the new World Trade Organization (WTO) rules, export subsidies were limited, and import quotas were, for the most part, eliminated through conversion to tariffs.

Therefore, we should be conscious of the fact that the only reason there is a separate WTO text for agriculture, the Agreement on Agriculture (AoA), that there is a separate draft text for the Doha Round agricultural negotiations is that for 50 years there have been problems applying the GATT rules to agriculture. The Uruguay Round brought agriculture closer to the rules established for all other areas of trade, but this could not be done in one step. Now we are in a situation where we could take a last step to establish one set of rules that apply to all trade. I stress that the important thing is not specific details on agriculture, but to have an overall set of rules that work for all areas

of trade, including agricultural trade. Four aspects of the rules are particularly important and I will mention each aspect briefly.

The first is tariff reductions and dispersion between rates of protection on different products. Economic theory tells us that liberalization works better if all trade categories are liberalized at the same time; otherwise there remains the possibility that reducing inefficiencies in some areas which are inefficient in a small way simply releases resources into other industries that are inefficient in a big way. Over the years, the GATT parties have tried to reduce rates of dispersion between protection of different products. In the Kennedy Round, there was a move away from the offer-and-request system to linear cuts. In the Tokyo Round there were harmonizing cuts using a formula that reduced the highest tariffs the most. But these efforts have not really worked in a thoroughly effective way because there is still disproportionately high protection for agriculture and also for some other sectors including textile products; in a sense, that means that the system discriminates against certain countries that have a comparative advantage in those areas.

The second aspect relates not to the level of protection but to the government policy instrument that is used to provide that level of protection. In guiding governments to reduce the level of protection, the GATT process protects people from their politicians who would otherwise tend to choose high protection. However, it is also very important to consider the choice of policy instrument and the way in which the GATT process protects people from politicians who would choose to achieve objectives using high cost policy instruments instead of low cost policy instruments. I refer you to the chart entitled “Ranking of Instruments.”

	Economic	Political	Legal
Voluntary Export Restraint	6	1	6
Import quota	5	2	5
Import tariff	4	3	4
Export subsidy	3	4	3
Production subsidy	2	5	2
Input Subsidy	1	6	1

If we consider the advice we receive from the economic theory of trade and the advice

we receive from the economic theory of public choice, there is clear conflict. The first column tells us how economic theory would rank (in order of efficiency or the cost imposed on the rest of the community) the policy instruments that a government could use to transfer some wealth to the providers of a particular productive input. The second column tells us (perhaps roughly) how public choice theory would rank the likelihood that governments would choose among the available policy instruments to achieve that wealth transfer objective. In summary, it seems that politicians are likely to try to achieve their protective objective in the way that maximizes rather than minimizes the cost imposed on the rest of the community. The GATT negotiation process guides politicians away from adopting the most harmful welfare-decreasing conduct and toward welfare-increasing conduct. It encourages politicians to achieve their objectives for their country using the most efficient policy instruments. The GATT now prohibits voluntary export restraints, export subsidies and import quotas, disciplines import tariffs, and limits production subsidies. The third column represents the severity of the legal constraints imposed by the GATT. With these legal rules, perhaps the behaviour of politicians can be changed so that they are more likely to seek to achieve their objectives by adopting the lowest cost policy instrument. Therefore, an important function of the GATT is to guide politicians toward achieving objectives with the lowest cost policy objective and not to resort to import barriers just because they can obtain a lot of political support from doing that.

The third aspect is that this system of modifying the behavior of politicians only works because of reciprocity. If a politician in any given country gains support from exporters, (s)he need not be as fearful of losing support from national producers competing with imports. This system works if all nations contribute to the process by offering reciprocal liberalization commitments. Each Member country can use tariff reductions in other Members to help it overcome political opposition to tariff reductions in the home country. At the same time, each Member country can give tariff reductions which help politicians in other Member countries to overcome political opposition to tariff reductions in those other countries. Over the years, however, there have been various deviations from this idea of reciprocity; the deviation given to developing countries is quite a significant aspect of the system now. It is true that the system should allow some Special and Differential Treatment to avoid forcing some developing countries to implement tariff reductions that would because of their special circumstances be welfare diminishing rather than welfare enhancing. However, we do need to be careful that Special and Differential Treatment (SDT) really is limited to that specific role because,

in general, in order to make the system work effectively, we need the help of as many WTO Members as possible (including Developing Members) to help control protectionism in all of the WTO members (especially the powerful Members).

The fourth aspect is non-discrimination. A rule of non-discrimination, like the MFN rule which binds WTO members, helps to make reciprocal trade liberalization deals possible and helps to maintain the integrity of reciprocal trade liberalization deals once they are made. The more deviations from the non-discrimination rule are allowed, the more the ability to reach reciprocal deals on a multilateral basis is impaired. Discriminatory trade agreements and negotiations (sometimes called “preferential trade agreements” or “free trade agreements”) make it harder for the multilateral system to harness the political lobbying of exporters to make a multilateral trade liberalizing deal possible.

Having stressed those four important elements of the GATT rules, I will now move to consider the agriculture negotiation and will begin by considering the negotiations relating to market access. Based on the four aspects of the rules set out above and in particular the second aspect relating to ranking of policy instruments, I argue that in this negotiation, it is very important that market access barriers are dealt with, and far less important that subsidies are addressed. The ability of each individual state to retain the right to pay some kinds of subsidies is a matter of the sovereignty of each individual state: GATT rules can be created to guide states away from more distorting subsidies to less distorting or non-distorting subsidies, but any nation should be free to rearrange the wealth amongst its participants if it wants to. We need to be conscious that the proliferation of existing discriminatory trade agreements may be making it harder to agree on multilateral liberalization. We should also be conscious that a good multilateral agreement could reduce the trade diversion caused by discriminatory liberalization, that is, reduce the negative effects of discriminatory agreements but achieving that result depends on whether significant multilateral liberalization would apply to all products and all countries where trade diversion is occurring as a result of discriminatory agreements.

On the other hand, market access is critical. This assertion that liberalizing market access is more important than reducing subsidies is supported by some quantitative research. In 2005, the World Bank released a report saying that of all of the economic welfare gains to be obtained from further removal of import barriers and subsidies in agriculture, over 90% of the gains will come from removing import barriers. Less than

10% will come from removing export subsidies or domestic support. (Anderson, K. and W. Martin, eds., *Agricultural Trade Reform and the Doha Development Agenda*, World Bank and Palgrave, 2005) see especially Ch 2 by T. W. Hertel and R. Keeney) Therefore, I argue that the most important part of the negotiation is the negotiation to reduce import barriers. The negotiation to reduce subsidies is really a sideshow to the main negotiation on market access, and will have a trivial impact on economic welfare compared to the potential welfare benefits from liberalizing market access.

### **Provisions on Market Access:**

Let's begin consideration of the market access negotiations by considering the main changes that were adopted in the Uruguay Round and set out in the WTO rules. The Uruguay Round eliminated import quotas, with only four exceptions, one of which was Japan. Subsequently (in 1999), Japan removed the import quota and replaced it with an import tariff. Tariff rates were cut by 36% over 6 years (on average with a minimum cut of 15% on each tariff line, and for developing country members by 24% over 9 years with a minimum cut of 10% on each tariff line). However, the abolition of import quotas and the attempt to transition to a tariff only system was complicated by the introduction of tariff rate quotas (TRQs). As some of the tariffs were still going to be very high, the parties decided to introduce TRQs, a mechanism under which there is a low tariff on a limited volume of trade.

The revised market access regime was also complicated by the introduction of a Special Safeguard Mechanism for agriculture in addition to the ordinary safeguards rules. The European Community and some others sought to be allowed to resort to a special safeguard mechanism which would allow tariff increases to compensate for a fall in the world price for any agricultural product. The rest of the GATT members refused the European Community absolute insulation from a fall in world prices, but agreed to a partial insulation, and this is what is embodied in Article 5 of the Agreement on Agriculture.

Given that start to the reform of agricultural trade in the Uruguay Round, now let us consider the way that the draft Falconer text for the WTO negotiations on agriculture would continue the reform started in the Uruguay Round.

First, does the draft Falconer text complete the move to a tariff only system? Of the WTO Members which invoked the exception to the Uruguay Round tariffication process

(that is, invoking Article 5 of the Agreement on Agriculture), the Republic of Korea, Taiwan, and the Philippines have still not abolished their import quotas, as they were supposed to do. This is really critical. Other members need to ask these countries: do you want to be in the World Trade Organization, or not? If so, one of the fundamental rules that these three countries must comply with is the rule that import quotas are not permitted. The Draft Text does not even mention this issue, but it would be desirable if it stated that these three countries should disavow their resort (under annex 5) to import quotas.

Even with the disinvocation of the exceptions to tariffication, the Falconer Draft Text would not deliver a tariff-only regime because of the continued existence of TRQs. We should recall that TRQs were tried as a temporary measure to advance the liberalization process, but they do have some disadvantages. If there is a very high tariff for the volume above the TRQ, then in effect the binding constraint on imports is the volume of the TRQ. That is exactly what the Uruguay Round reform tried to get away from through the tariffication of import quotas. The limit on volume was not supposed to be the critical factor any more. The Falconer Draft Text still does not really deal with the issue of TRQ. We would still end up with a messy system containing some tariffs and some TRQs. It is hard to tell whether the volume constraints will become completely irrelevant or whether they will still be important. They will probably remain important on some products. So, in terms of the general trend of reform, adoption of the Draft Text may move us a bit closer to the objective of a tariff-only regime, but will still fall a long way short of achieving that outcome.

Second, consider the tariff reductions. The Falconer Draft Text provides for tariff cuts using a tiered formula. A tariff rate above 75% would be subject to a tariff cut of 66-73%. If the tariff rate is a bit lower, the cut will be in the region of 62%-65%. One of the parameters inserted into the new February 8, 2008 version of the Draft Text is that these tariff reductions should be achieved by five equal cuts over five years. These cuts are relatively high: in previous GATT rounds, tariff reductions were only in the order of about 35% (with the exception of some rates resulting from the application of the Swiss formula to industrial tariffs in the Tokyo Round). The reason some Members have sought such large reductions is that some tariff rates in some Members are very high: some developing countries have very high tariffs because in the past rounds of negotiations, import access into those countries did not matter so much, so others did not demand fully reciprocal tariff cuts from them; some Developed Members still have

very high tariffs because their existing rates derive from the Uruguay Round cuts applied to very high rates that arose from tariffication of very restrictive import quotas. So for example, for a country like the U.S. looking to get market access into a Developing Member like India, a 35% decrease in tariff might not make any difference to trade flows because India's bound rates are high, much higher than its applied rates. Similarly for some Developed Members (particularly some G10 countries) a cut of 35% might not make any difference to trade flows because of the height of the existing bindings. The Falconer draft gives Developing countries a concession on the size of the tariff cuts: a two-thirds approach. Developing countries are given a further concession that if they apply these results and it turns out they are reducing by more than 36%, then they can scale reductions back so that their overall reduction is only 36%.

The Draft released on February 8 introduced one new rule: if, after applying these cuts, the average cut for a Developed Member would be less than 54%, then that Member has to make more tariff cuts to bring the average rate of reduction up to 54%. The Draft does not apply a similar rule to Developing country Members.

These proposed tariff cuts are set out in Table 1 below:

**Table 1 Rates of Reductions of Customs Duties**

Developed Members	<b><u>5 equal cuts over 5 years</u></b>	Developing Members	<b><u>8 equal cuts over 8 years</u></b>	
AVE rate between	Rate of Tariff cut		Rate of Tariff cut is the Lesser of A:	Or B (If avg cut exceeds max of 36%)
<20%	48%-52%	R<30%	2/3 x 48-52%	A x 36/Avg
20%<R<50%	55%-60%	30%<R<80%	2/3 x 55-60%	A x 35/Avg
50%<R<75%	62%-65%	80%<R<130%	2/3 x 62-65%	A x 36/Avg
R>75%	66%-73%	R<130%	2/3 x 66-73%	A x 36/Avg
	<b><u>With Min Avg Cut of 54%</u></b>			<b><u>Ie Max avg cut of 36%</u></b>

The draft text provides for a number of exceptions to these tariff reductions. First, there is an exception for products which are categorized as 'sensitive products.' Member countries can choose a percentage of their tariff lines (the Feb 8 text refers to 4%-6% of tariff lines with Developing Members able to designate one third more products as



Sensitive Products) and apply a lower rate of tariff reduction. But if a product is designated as a sensitive product and a lower reduction rate is applied, then the Member has to expand the volume that must be imported at the low rate within the TRQ. This 4%-6% of tariff lines is a critical number in the negotiation. How many products should Members be allowed to exclude from the ordinary tariff reduction process? Going back to that same 2005 World Bank study, the finding was that if 2% of tariff lines were taken as sensitive products, then there would be a loss of two-thirds of the economic welfare gains worldwide that would otherwise be available from liberalization of agricultural trade. That finding was qualified by the assertion that if a maximum of 200% was set as the tariff ceiling, then the loss would only be about one-third. So as the figure rises to 4%-6%, effectively requiring bigger tariff cuts for the products that have lower protection, and insulating those products that have a lot of protection, it seems likely that the parties will almost be missing out on almost all the possible gains. The text allows Members with a large number of products with lower rates of protection to designate even more products as sensitive, that is, up to 6% - 8%, which would have the effect of further reducing the gains from the tariff cuts.

For Developed Members, these lower tariff cuts on sensitive products would be counted in calculating the average cut in order to determine whether an additional cut would be required to bring the average reduction up to 54%. In essence, this means that Developed Members may have to offer compensating tariff cuts on the non-sensitive products (in addition to the compensating expansions of the volumes of TQ on Sensitive products). For Developing Members, there is no similar minimum cut rule so the Developing Members do not face the possibility of having to give compensatory tariff cuts on non-sensitive products. However, there is a proposed rule saying that for Developing Members, if the average cut is greater than 36% then they can scale the reductions back to work out to a 36% cut. The text does not say whether the calculation of the average should take into account the rate of cuts on sensitive products. If they are not counted, it would skew the average downward and make it more likely that they could reduce the reductions on non-sensitive products.

The text provides for larger increases in TQ volumes depending on the extent of the deviation from the ordinary tariff cut. Table 2 summarizes the provisions on the TRQ volume expansions (though leaves out some complications).

**Table 2 TRQ Volume Expansions for Sensitive Products**

	Developed Member	D'ed Member with 30% of tariff lines , 20%	Developing Member	D'ing member with >30% of tariff lines below 30%
Maximum Number of tariff lines	<b>4-6%</b>	6-8%	[4-6%] x 4/3	[6-8%] x 4/3
If deviation from applicable rate of reduction is: (below)	New volume of TRQ as % of consumption is: (below)	New volume of TRQ for products in excess of limit of [4-6%] of tariff lines	New volume of TRQ as % of consumption is (below)	New volume of TRQ for products in excess of the limit of [4-6%]x4/3 of tariff lines
Min deviation of 1/3 of applicable rate of reduction	[3-5%] of consumption	[3-5%] + [0.5-1%] of consumption	2/3x[3-5%] of consumption	2/3x[3-5%] + [0.5-1%] of consumption
Deviation of 1/2 of applicable rate of reduction	[3.5-5.5%] of consumption	[3.5-5.5%]+ [0.5-1%] of consumption	2/3x[3.5-5.5%] of consumption	2/3x[3.5-5.5%] + [0.5-1%] of consumption
Max deviation of 2/3 of applicable rate of reduction	[4-6%] of consumption	[4-6%]+ [0.5-1%] of consumption	2/3x[4-6%] of consumption	2/3x[4-6%] + [0.5-1%] of consumption
Timing of Implementation	1 <sup>st</sup> day: +1%. Then Each year: +1% Until new volume reached	same	same	same

The Draft text remains unclear as to whether Developed Members should continue to have access to the Special Safeguard (SSG) provision in the existing Article 5. This consists of two safeguards: a volume-triggered safeguard and a price-triggered safeguard. The text reflects the absence of any agreement as to whether the SSG should be terminated or whether it should be continued in a modified form. One of the alternatives suggested in the draft text is that:

- (1) the volume-triggered safeguard be adjusted so that in any case where a Member wanted to apply an extra tariff, the Member would have to show that there had been a 25% increase in imports over the preceding three years; and
- (2) the price-triggered safeguard be adjusted by halving the size of the safeguard tariff allowed in response to particular price falls as set out below in Table 3.

**Table 3 Proposed change to Special Safeguard Provision SSG – price triggered SSG**

Existing trigger level	Existing Permissible SSG	Proposed permissible SSG
Import price is 10% below trigger price	Zero	<b>Zero</b>
Price between 10% and 40% below trigger price	30% of amount by which the difference > 10% of the trigger price	<b>15% of amount by which the difference &gt; 10% of the trigger price</b>
Price between 40% and 60% below trigger price	As above plus 50% of amount by which the difference > 40% of the TP	<b>As above plus 25% of amount by which the difference &gt; 40% of the TP</b>
Price between 60% and 75% below trigger price	As above plus 70% of amount by which the difference > 60% of the TP	<b>As above plus 35% of amount by which the difference &gt; 60% of the TP</b>
Price > 75% below trigger price	As above plus 90% of amount by which difference > 75% of TP	<b>As above plus 45% of amount by which the difference &gt; 75% of the TP</b>

A new paragraph in the Feb 8 draft indicates that the SSG would continue with no change for Developing Members. This draft provision does not contain any time limit or sunset clause.

Next, the draft text provides for an additional ‘Special Products’ exception from the tariff cuts for Developing Members only. We have noted above that the provision for the exception for Sensitive Products would allow Developing Member countries to apply lower tariff cuts to approximately [5.3 – 8%] of tariff lines provided that they increased the volume of TQs by approximately [2-3.7%] of consumption. Developing Member countries have sought to be able to resort to an exception for Special Products to enable Developing Members to designate other products that would not be subject to the ordinary tariff cuts, in addition to the exception for Sensitive Products. The Draft text stipulates that Developing Member countries should be allowed to designate 8% of tariff lines as Special Products in their complete discretion. Then they can also self-designate additional products as Special upon the guidance of a list of criteria for the designation of Special Products, up to a maximum designation of [12][20]% of tariff lines as Special Products. The bracketed text in the draft indicates that there is disagreement about the tariff cuts that should be applied to Special Products. The text suggests:

- (1) that for the first 6% of tariff lines designated as Special, the tariff cut should be [8][15]%;
- (2) that for the next 6% of tariff lines designated as special, the tariff cut should be [12][15]%; and
- (3) “[A further] [8 per cent of] [no] tariff lines shall be eligible for no cut.]

The 3<sup>rd</sup> point is an exact quote of the last sentence of para 123 of the draft text with all of the square brackets included. It demonstrates the diversity of views. If you take out some of the bracketed text, it reads, “No tariff lines shall be eligible for no cut” but if you take out other bracketed text, it reads: “A further 8 per cent of tariff lines shall be eligible for no cut.” (!)

Developing Members have also sought to have access to a new Special Safeguard Mechanism. Just as in the Uruguay Round the EU and others sought to have a safeguard measure to enable them to increase tariffs to offset price falls, the Developing Members in the Doha Round have made a similar proposal that they be able to resort to a new Special Safeguard Measure to enable them to increase protection to insulate their farmers from falls in world prices. As was the case in the Uruguay Round, in this Round, other Members have been reluctant to allow such a mechanism to provide pervading insulation from world markets. The draft text contains a lot of bracketed text setting out different views on such matters as how much it can be invoked, the triggers, the extent of the Special Safeguard Mechanism (SSM) measures, and the duration of the SSM

measures. Upon all of these matters, there remains considerable uncertainty as to what might eventually be agreed upon. Two of the key provisions are:

- (1) that the SSM shall not be invoked for more than [3] [8] [products] in any given 12 month period;
- (2) that the SSM shall remain in force for the duration of the Doha Round implementation period [after which it shall expire].

The draft text provides for both a volume triggered SSM and a Price triggered SSM. These are summarized in Table 4 but the amount of bracketing indicates the degree of disagreement.

**Table 4 Special Safeguard Mechanism for Developing Members**

SSM	For a Trigger of:	The SSM is:	Up to a maximum ceiling of:
Volume Triggered SSM	If: Imports > [105][130]% of 3yr Avg	[Higher][lower] of [50][20]% of bound rate Or [40][20]% points	<i>[-incomprehensible text in para 128(a)]</i>
“	If: Imports > [110][135]% of 3yr Avg	[Higher][lower] of [75][25]% of bound rate Or [50][25]% points	[0.5% of] the difference between the current bound tariff and the pre-Doha Round bound tariff
“	If: Imports > [130][155]% of 3yr Avg	[Higher][lower] of [100][30]% of bound rate Or [60][30]% points	The difference between the current bound tariff and the pre-Doha Round tariff
Price Triggered SSM	If price < [70%] of 3 yr Avg Import Price BUT No recourse [as far as practicable] where the volume of imports in the current year is declining	[50% of] the difference between the Import Price and the Trigger Price	[0.5% of] the difference between the pre Doha bound tariff and the current bound tariff

The February 8 draft adds more precise provisions on three matters that were only dealt with in very general terms in the July 17 draft text:

- (1) provisions on Tropical Products;
- (2) provisions on tariff escalation;
- (3) provisions on erosion of preferences.

The Tropical Products provisions of the Feb 8 Draft Text stipulates that certain listed Tropical Products would be subject to a much higher tariff rate cut (including an 85% cut for products having an existing tariff rate higher than 25%) and would be ineligible to be claimed as sensitive products. However, these higher cuts would only be required from Developed Members not Developing Members, and the provisions would not prevent Developed Members from designating Tropical Products as Sensitive Products. Indicative of some disagreement is the fact that the Annex G list of Tropical products in the draft text actually contains two lists: one list includes both rice and sugar and the other includes rice but not sugar. (The text suggests that the minimum 54% tariff cut for Developing Members would be calculated by using the ordinary rates of reductions on Tropical Products not the accelerated rates, meaning that the higher rates of reductions on tariffs on Tropical Products could not lead to any compensating lower rates of reductions on other products.)

The tariff escalation provisions require higher rates of tariff cuts, if the rate on a processed product is more than 5% higher than the rate on a raw or unprocessed product. This requirement for higher cuts does not apply to products designated as Sensitive, and the requirement to implement a higher cut is mandatory for Developing Members but not for Developed Members.

The Draft Text now offers detail on the erosion of preferences. Under the Cotonou Agreement, and before it the Lomé Convention, the member states of the European Union grant preferences to former colonial possessions. These countries are the main supporters of the special provisions on erosion of preferences. The text proposes an extension of the implementation period for tariff cuts to those products covered by preferences, for example, bananas and sugar. The text indicates that there is disagreement as to the length of the extension of implementation period referring both to two years and to 10 years.

I have summarized the draft text provisions on market access and the extent of the Special and Differential Treatment for Developing Members in Table 5.

**Table 5 Market Access and Special and Differential Treatment for Developed Members**

	Developed Member	Developing member
Rate of Tariff Cut	Approx 50% to 70% But if necessary increased so as to make the average at least a <b><u>minimum of 54%</u></b> (including rates of reductions on Sensitive Products)	Approx 33% to 47% But if necessary decreased so as to make the average no more than a <b><u>maximum of 36%</u></b> (may or may not include rates of cuts on Sensitive Products)
Implementation Period	5 years	8 years
Except % of tariff lines designated as Sensitive	4% - 6% Sensitive lines	5.3% - 8% Sensitive Lines
With 2/3 of ordinary cut plus	Expand TQ volume by 3-5% of consumption	Expand TQ volume by 2-3.3% of traded consumption
With 1/2 of ordinary cuts plus	Expand TQ volume by 3.5-5.5% of consumption	Expand TQ volume by 2.3-3.6% of traded consumption
With 1/3 of ordinary cuts plus	Expand TQ volume by 4- 6% of consumption	Expand TQ volume by 2.6 – 4% of traded consumption
Except % of lines designated as Special	Zero Special lines	Between 8% and 20% designated as Special
With tariff reductions on Special Products of;	.....	1 <sup>st</sup> 6% lines: [8][15]% cut 2 <sup>nd</sup> 6% lines: [12][25]% cut Rest of lines: not close to agreement on size of cut
Volume Triggered Safeguard	SSG – if 125% of benchmark (prev 3 years)	Existing SSG + SSM – if [110][130]% of benchmark (prev 3-5 years)
Price Triggered Safeguard	SSG – half existing % of gap b/w price and benchmark	SSM – 50% of gap b/w price and benchmark of [70]% of 3 yr Avg imp price

**Provisions on Export Subsidies:**

I said I would concentrate on Market Access and to a lesser extent on domestic support. I do wish to point out one element which is the time period for bringing the prohibition of export subsidies into force. The July Draft stated that export subsidies for Developed Members would be abolished by 2013. The Feb 8 draft text has now added to this the provision that export subsidies for Developing Members be abolished by 2016.

**Provisions on Domestic Support:**

To move now to the third aspect of the negotiation, Domestic Support, let me first review the way the existing rules work for domestic subsidies. The usual rule is that in contrast to export subsidies, domestic subsidies are not prohibited. However, if a domestic subsidy causes adverse effects on another Member, then the Subsidies and Countervailing Measures Agreement (SCM Agreement) provides for possible remedies: that is, even though domestic subsidies are not prohibited, it is possible to retaliate against a domestic subsidy if it causes adverse effects. The Agreement on Agriculture goes a little bit further than that; it creates a concept called the Aggregate Measure of Support (AMS), and it provides an absolute prohibition on paying domestic subsidies above the level of the Aggregate Measure of Support recorded in an individual member's schedule. That prohibition was softened by provisions which excluded certain categories of subsidies from the AMS:

- (1) if the subsidies were linked to production but only compensated for price falls below reference prices set at 1986-1988 levels;
- (2) if the subsidies were linked to production but constituted less than 5% of the value of production (called *de minimis* subsidies);
- (3) if the subsidies were paid on only a limited volume of production even if they were paid by reference to a price gap or price deficiency (called Blue box subsidies);
- (4) if the subsidies were not linked to current production at all, nor to current prices (called Green Box subsidies).

In addition to creating the prohibition on subsidies in excess of the AMS commitments, the AoA also provided that Members would for a period of time be immune from having their domestic subsidies challenged under the serious prejudice rules as long as those domestic subsidies were confined within the limits of their bound AMS commitments.

What should be happening in these negotiations is that we should be continuing to encourage a shift from less efficient to more efficient subsidies, moving them away



from their link to production. However, we do need to bear in mind the point, made above, that the economic welfare gains that can be realized from reducing the domestic subsidies are very small compared to the economic welfare gains that can be realized from reducing import barriers. Therefore, whatever is to be done about domestic subsidies must be done in a way that does not make it harder to reduce import barriers and therefore, harder to achieve the large welfare gains from doing so. I argue that the best way to do this is to allow the general rules on adverse effects to operate in relation to domestic subsidies, and to adjust the AMS rules to reduce those domestic subsidies which have big effects on the prices received by farmers for production.

On the first point, the operation of the ordinary rules allowing retaliation against subsidies which cause adverse effects, arguably the position is that with the expiry of the peace clause in Article 13 of the Agreement on Agriculture, those ordinary rules do now apply and they will continue to apply unless the members agree to some kind of extension of the peace clause. There might be opposing arguments that the adverse effects rules might not be used as a basis for authorizing retaliation against subsidies which are kept within the levels allowed under the AMS rules. The only way to be clear on this is to rewrite the peace clause. At the moment, however, the Feb 8 Draft text is silent on this issue. I submit that it would be better to insert a new peace clause that made it clear that domestic subsidies on agricultural products within the AMS levels would receive:

- (1) no immunity from adverse effects claims in respect of effects in other markets;
- (2) no immunity from Countervailing duty actions; but
- (3) an immunity only from adverse effect actions in the form of non-violation nullification or impairment claims in respect of the effect of domestic subsidies in displacing imports into the home market.

I suggest that the Members should insert a new peace clause which restricts adverse effects claims in that very limited way but clarifies that no other immunities would exist.

On the second point, the adjustment of AMS rules to reduce those subsidies which have big effects on the prices received by farmers, it is necessary to achieve some welfare gains from this process but not to try to tighten up on domestic subsidies so much that it makes it harder to achieve agreement on reductions to import barriers. Therefore, the objective should be to reduce some AMS limits but to leave room for parties to convert subsidies into forms which provide less incentives for production and if necessary also

to leave room for payment of some production linked subsidies within limits. The way to do this would be to break each Member's existing AMS cap down into product specific caps and then to require reduction of those product specific caps which provide the largest support as a percentage of the value of production. Breaking the AMS caps into product specific caps expressed in terms of budget outlays (or equivalents) would still leave the problem that the existence of a breach could usually not be determined until after the end of the relevant period when the relevant data becomes available. However, requiring the product specific caps to be expressed in terms of per unit payments would enable challenges to be made as soon as laws are published. In the event of imports causing injury to domestic industry, Members could remain free to increase those product specific per unit AMS bindings through Article XXVIII renegotiations and to keep payments within those bindings immune from non-violation complaints. The special safeguards under the Agreement on Agriculture could be adapted so that Developed Members would be unable to apply import tariffs as safeguards unless they had also applied safeguard subsidies and then could only apply import tariffs to the extent that the safeguard subsidies had not already provided additional insulation from the world market. In general, this would have the effect of reducing the highest per unit production linked subsidies and would provide an incentive for transforming production linked subsidies into subsidies with limited links or no links at all to production. In any case, combined with the removal of the immunities from the adverse effects rules, other parties would still be able to seek authorization to impose retaliatory import tariffs on those Members which continued to pay subsidies that had adverse effects in the markets of other members or in third country markets (regardless of whether payments were inside or outside of the AMS caps).

If you ask the question how does the approach taken in the draft Falconer text compare with my recommendation, you will see that the Falconer draft text proposes much more stringent reductions of domestic subsidies than I have suggested will be necessary or useful. The draft text provides for:

- (1) a tiered formula for reductions in Total AMS;
- (2) the imposition of product specific caps at levels existing in a base period but not for specific reductions in those product specific caps which provide the highest degree of support;
- (3) reductions in the *de minimis* category;
- (4) a redefinition of the Blue Box category and the imposition of a cap on total

- Blue Box and of a cap on Blue Box payments on specific products;
- (5) a tiered formula for reductions in a new measure called the Overall Trade Distorting Support (OTDS) to be applied to the extent that the other reductions and caps do not achieve the required reduction in OTDS;
  - (6) an amendment of the definition of the exempt Green Box category; and finally
  - (7) even more substantial reductions of AMS in relation to cotton.

A significant feature of the tiered formula is that the highest reductions apply to the member with highest aggregate domestic subsidies not to the subsidies which provide the highest degree of support to the particular product. So a small country with production subsidies that are a high proportion of the world market prices has to apply a lower reduction than a big country with production subsidies that are a low proportion of the world market prices. The following two tables show the rates of reduction required in Total AMS and in Overall Trade-Distorting Support. The cuts to OTDS are required as an additional layer of obligation: if after applying the reductions on AMS, Blue Box and *de minimis*, the measure of OTDS has not reduced by the specified percentage, then a further reduction would be required. Among the changes in the February 8 version of the text is the insertion of the implementation periods.

**Table 6 Rates of Reduction in Total AMS**

The Member's Final Bound Total AMS in US\$ billion	Reduction rate for Developed Member	Reduction rate for Developed Member with AMS>40% of production	Reduction rate for Developing Member (including some Recently Acceded (RAMS))	Reduction rate for SLI-RAMS or NFICS
>40US\$ billion	[70%] 25% in yr1 Then 5 equal instalments			
15<FBT AMS<40US\$ billion	[60%] 6 steps over 5 yrs	[60%]+[70-60%] 6 steps over 5 yrs		
FBT AMS < 15 US\$billion	[45%] 6 steps over 5 years	[45%]+[60-45%] 6 steps over 5 years	2/3 x [45%] 9 steps over 8 years	

**Table 7 Overall Trade-Distorting Support (OTDS)**

The Members Base Overall Trade Distorting Support in US\$ billion	Reduction rate for Developed Member <b>33% in yr1 Then 5 annual steps</b>	Reduction rate for Developed Member with OTDS>40% of production	Reduction rate for Developing Member with AMS commitments <b>20% in yr 1 Then 8 annual steps</b>	Reduction rate for Developing members without any AMS commitments	Reduction rate for SLI-RAMS or NFIDCs
>US\$60 bn	[75][80]%			Zero	Zero
US\$10 bn < OTDS < 60 US\$ bn	[66][73]%	[66][73] + 0.5 (difference between [75][80])		Zero	Zero
OTDS < US\$10 bn	[50][60]%		2 /3 x [50][60]%	Zero	Zero

Note: SLI-RAMS are small low income recently acceded member  
NFIDCs are net food importing developing countries

As you can see, the proposed rules are much more complicated than the changes that I would recommend. It is also apparent that although the text would require caps on product specific AMS at levels in a base year, and would require cuts in total AMS and total OTDS, the proposed rules would allow substantial freedom for Members who are currently paying subsidies that are very high as a proportion of world prices on particular products to continue to do so – since reductions are not mandated on product specific AMS. They will create ridiculously complicated rules. Operation of the rules will depend on timely notifications of AMS, product specific AMS, *de minimis*, and blue box. It will be impossible to adjudicate on complaints until some time after the end of the relevant period when data becomes available.

There has been a lot of media attention focused on the question of whether the U.S. will

be prepared to accept reductions in domestic support of the magnitude contemplated by the draft text or as demanded by some other WTO Members. The key to understanding this is that a number of the U.S. programs for domestic subsidies are based on a calculation of the price gap between an internal target and the world market price. In recent years, the world prices have been relatively high so the amount of the payments by the U.S. have been kept relatively low because of those high prices. However, for the U.S. to commit itself to the reductions of domestic support in the contemplated by the draft text, it would have to fundamentally change the way that those support programs calculate the size of payments. It would not be possible for the U.S. to leave those programs in place which compensate for price falls in the way they do now. They would either have to change the programs so that they are not connected to price falls at all or put caps on the extent to which they compensate for price movements.

### **What would be the Outcome from Implementing this Draft Text?**

Under the Draft Text, certain countries would be able to retain high tariffs on certain products. For most Developed Member countries, the allowance of [4-6]% of lines as “Sensitive Products” will be enough to cover most products that have high protection. Developed Members will be able to reduce their highest tariffs by a rate as low as about 22% although with a TQ increase of 4-6% of domestic consumption. Developing Members will be able to apply reductions as low as 8-15% on 6% of Special tariff lines, as low as 12 – 20% on a further 6% of special tariff lines, and then for a further 5 – 8% of Sensitive Products be able apply a rate as low as about 8% though with TQ volumes of 2.5 -4% of traded consumption. This would leave the U.S. with high tariffs on sugar, dairy products, and peanuts and some others; the EU with high tariffs on at least sugar dairy and meat; Japan with high tariffs on at least wheat, rice and dairy; Korea with high tariffs on at least dairy, meat and rice; and Canada probably with high tariffs on at least dairy and poultry. A lot of Developing Member countries would be able to retain high tariffs across 15%-28% of products. Those Developing Members would also be able to increase their tariffs again possibly in response to very small price falls or very small increase in the volume of imports. On that basis the Doha Development round will have failed to achieve reductions of the highest levels of protection and will have failed to achieve the largest of the available economic welfare gains.

In relation to domestic subsidies, the draft text would apply new disciplines and reductions in a way that would mean that the country that applies the highest dollar

value of subsidies reduces them the most. This is perverse, because it has the effect that if a big country pays a subsidy that is a small proportion of the value of production, that could be subject to a big cut. But if a small country pays a subsidy that is a high proportion of the value of production, that could be subject to a small cut. That makes no sense at all. Those Members who currently have high per unit production linked subsidies will hardly need to change those if they can achieve the average reductions by reducing other subsidies.

Therefore, even with the changes contemplated under this draft text, agriculture will still be substantially more protected than other industries. In Developed Members, there will still be highly protected products upon which protection would not be reduced very much. There will also be high per unit production linked subsidies. In developing countries relatively high protection would remain across a range of agricultural products. Is this liberalization really achieving the promise of the Doha Round? It will achieve some of these economic welfare gains, but many others have been lost. We are looking at a situation where we would not achieve much in the way of reductions on the highly protected products in the Developed Member markets, and the developing countries have been almost entirely let off the hook. The same world Bank study as referred to above indicates that for developing countries to reap the economic gains from the Doha Round, it is not enough for them to get market access into developed countries: they need to get market access into other developing countries as well, and they need to realize the gains from lower prices by reducing their own import barriers: so I emphasize they need to cut their own barriers. The net result of implementing this proposed agreement would be that the GATT/WTO would have continued to fail to achieve a similar degree of liberalization in agriculture as it has achieved in other sectors. The system would still fail to deliver benefits to countries having a comparative advantage in agriculture. It would still fail to deliver the benefits of the multilateral system to Developing Members.

This Round could have been done in a much more simple way: there could have been an across-the-board tariff cut for every Member country and every product, cutting the highest tariffs by the most. The domestic subsidies could have been dealt with adequately by subjecting them to the ordinary rules on subsidies and also reducing the higher price specific production linked subsidies measured on a per unit basis. That approach would have captured more economic welfare gains in this round. For future rounds, it would have left the import regime closer to a tariff only regime so as to

facilitate further tariff cuts and the per unit binding of product specific AMS would have facilitated negotiation of further reductions of any product specific production linked subsidies that were continuing to be a problem. To summarize what was needed:

- (1) apply tariff reductions (even if smaller than the percentages in the draft text) on a harmonizing basis across all products for all countries – with no product exclusions (that would have achieved significant reductions in protection in the EU, G10 and U.S.);
- (2) focus Special and Differential treatment on the length of the implementation period instead of the size of the tariff cuts allowing concessions on the tariff cuts only to considerably underdeveloped Members (identified on the basis of criteria not related to objectives of policies but related to the capacity to achieve objectives with non-trade policy instruments);
- (3) allow a special Safeguard – but for Developed Members move to a situation in which they could choose to apply production linked subsidies as a safeguard but not be able to apply safeguard import protection except through the Agreement on Safeguards; while for Developing Members allow tariff surcharges to partially offset price falls occurring at the same time as increases in the volume of imports;
- (4) apply the SCM Agreement to export subsidies on agricultural products
- (5) adjust the AMS by setting caps on product specific AMS;
- (6) apply reductions to the higher per unit product specific AMS caps;
- (7) apply the SCM Agreement to all subsidies;
- (8) only give immunity for non-violation nullification or impairment for domestic subsidies conforming to product specific AMS caps.

However, the negotiation has proceeded along quite different lines. In a sense, the course of the negotiations has been fairly predictable. The Developed Members sought to exclude sensitive products. The Developing Members instead of rejecting the idea of sensitive products completely, sought to utilize it themselves on a larger scale, adding demands for exclusion of Special Products and for a Developing Member only variable levy-like safeguard clause. Then the Developing Members also insisted in very severe reductions in total AMS and also sought to reduce the scope for members to shift subsidies from one more trade distorting category into another less trade distorting category. Predictably the reaction of the Developed Members faced with the loss of the ability to substitute subsidy protection for border protection was to be even stronger on insisting on exclusion of sensitive products and the retention of a safeguard mechanism,



and to press for AMS reductions not to be product specific. In summary, the progression of the negotiation has been characterised by two parallel developments both of which have contributed to the deterioration in what would be the result. First there has been a trend to more and more exceptions from the proposed tariff reductions and second there has been a trend to more and more restrictions on domestic subsidies. I would argue that it would have been better to allow more room on subsidies so as to be able to retain the integrity of the rules on import barriers.

Please consider my argument in the context of the statements I made at the beginning about the essential elements of the multilateral trading system:

- (1) that it should aim for tariff reductions with a dispersion reducing effect;
- (2) that the rules should guide members toward achieving wealth transfer objectives using lower cost policy instruments instead of higher cost policy instruments which means away from using import barriers (especially away from any policy instruments with quantitative element) toward using subsidies (especially toward subsidies that are not linked to production instead of those that are so linked);
- (3) that it works because of reciprocity and it is necessary to limit deviations from reciprocity; and
- (4) we should aim to maintain a rule of non-discrimination.

Then I would like you to consider that the reason for the negotiation drifting so far away from where, I argue, it should be is that the Members and their negotiators have failed to maintain and support these essential elements of the system.

Does it matter? Well, it will matter if the system fails to open world markets and it develops into a situation in which, in the future, it is not possible to reach agreement on further reciprocal exchanges of liberalization. If that is the case, then the multilateral system will break down and we will be left with a system involving hundreds of discriminatory bilateral trade agreements which leave significant gaps of protection unliberalized. If all WTO Members would come to WTO negotiations with a view to strengthening the principles of reciprocity, ranking of instruments, reducing dispersion and non-discrimination, then the multilateral system could create a world in which price signals flow around the world and everyone must constantly adjust to changes occurring all over the world. On the other hand, if WTO Members come to WTO negotiations to negotiate exceptions for themselves and leave it to others to protect the principles of the system, then the outcome will be the multilateral system will cease to function and may

even break down completely. That would lead to different countries or different parts of the world insulating themselves from changes occurring in other places until sudden and painful adjustments are unavoidable and would leave a situation in which smaller countries would need to negotiate trading access one on one with bigger and more powerful countries.

### **Question and Answer Session**

**Q: Should the provisions on special and differential treatment be slightly limited to perhaps not give so much special and differential treatment?**

**A:** This is the fundamental issue that has changed the shape of the Doha Round compared to any other round. This is the first round of negotiations to feature the G20 and the G33. Developing Members have, for the first time, engaged law firms in London, Geneva, or New York to write them briefs on how to come to the negotiation and what they should negotiate. You could be forgiven for thinking that these developing countries have actually out-negotiated the rich countries.

In addition, this is the first round of negotiations in which we have had dozens of non-governmental organizations complaining about globalization and that the world trading system does not serving the needs of developing countries. All parties come to the negotiations feeling that it is not permissible to say anything about encouraging developing countries to adopt better economic policies.

We have to be careful that we do not continue to give special and differential treatment to countries that have reached a stage of development where they are capable of contributing fully to the multilateral trading system. One has to go a long way below the OECD members on a list of countries before getting to ones that do not have enough spending or taxing infrastructure for the ordinary theory of trade liberalization to be applicable to them.

So it is true to some extent that Special and Differential Treatment, in this round, is a little bit out of control. Developed countries could push some of the developing countries a little bit more. There will likely be a continued push toward restricted access to Special Products, in particular.

**Q: What about the Peace Clause?**

**A:** The Peace Clause seems to have been negotiated on the basis that, when it ran out, dispute settlement would take place under the Subsidies Agreement. After the banana, sugar, and cotton cases, there have been more technical interpretations of Article 21 of the Agreement on Agriculture, to the view that if there is some kind of provision relating to this subsidy in the Agreement, then the subsidies agreement does not apply. But these interpretations are flawed: the correct view is that the Peace Clause has expired, so now everything is subject to the subsidies agreement.

If no Peace Clause goes in to the Doha Round agreement, then it will mean that a country will be in violation if it exceeds the AMS binding, but regardless of whether this is exceeded, it will also be possible for another country to bring a complaint under Articles 5 and 6 of the Subsidies Agreement, and to argue on the basis of serious prejudice. My suggestion would be that it would be useful to allow a very limited continuation of the peace clause so that there would be a limited immunity from non-violation nullification and impairment complaints for domestic subsidies that conform to the AMS caps.

**Q: What do you think of the U.S. perspective on domestic support cuts?**

**A:** The way the U.S. has been negotiating the Aggregate Measure of Support rules demonstrates that it is worried about having wriggle-room to focus support on particular products. The way that the U.S. has asked for a special base period to calculate its Aggregate Measure of Support is perhaps a reflection of this.

This is one of the areas where the whole negotiation has gone wrong. The G10 made a mistake in insisting that reductions in an Aggregate Measure of Support should not relate to the proportion of production rather than the total absolute dollar value of production. There is no logic in forcing the U.S. (a bigger country, but generally with an aggregate measure of support as a smaller proportion of production) to make a really big cut, and a smaller country like Norway, with a high Aggregate Measure of Support as a proportion of value, to make a smaller cut because the total dollar value is smaller. The proposals in the draft text do not do what could be done in terms of making reductions on a product-specific Aggregate Measure of Support. It would have been more

important to get bindings on a product-specific Aggregate Measure of Support, and then apply a harmonization formula so that those products for which there was a high subsidy would be subject to cuts.

**Q: Can we advance negotiations without a big U.S. decision on domestic support?**

**A:** U.S. moves on these subsidies will be determined by what they get in exchange. It may be that the deal offered to the U.S. is not good enough to encourage the House of Representatives and the Senate to approve the package. We do have to consider that the proposed changes to the rules on domestic support would require the U.S. to substantially dismantle the system of guaranteeing particular prices by making payments that compensate for price falls. To get that approved by the legislature in the U.S. will require that they get something in return. It seems the big developing countries may not be offering to grant enough market access for their offer to be attractive to the U.S.

**Q: Regarding tariff rate quotas in the context of free trade agreements and the application of a possible deal on the Doha Round, what happens if there is a discrepancy between quotas on any given product?**

**A:** Both obligations would have to be honored. If an importing country has promised to allow a low tariff rate quota in a bilateral agreement, then to comply with that bilateral agreement it will have to let in whatever volume it has promised to let in at that low rate. But if, at the same time in the multilateral agreement, the country has promised to let in a certain volume at a certain low rate, then it will have to comply with that as well. There may be some interesting questions about allocation, that is, whether Article XXIV justifies a country allocating the bilateral tariff rate quota in whatever manner has been agreed in the bilateral free trade agreement. The multilaterally agreed TQ would have to comply with the limited disciplines that are in the existing GATT and Draft Text about allocating that tariff rate quota to the different sources of exports.