International
Food & Agricultural Trade
Policy Council

# Building on the July Framework Agreement: Options for Agriculture

## EXECUTIVE SUMMARY

June 2005

International
Food & Agricultural Trade
Policy Council

1616 P Street NW, Suite 100 Washington, DC 20036 / USA / TEL 1 202 328 5056 / FAX 1 202 328 5133 / www.agritrade.org
10 rue Berckmans / B-1060 Brussels / Belgium / TEL 32 2 534 9036 / FAX 32 2 534 9882

# Preface

In January 2005, with funding from the William and Flora Hewlett Foundation and the German Marshall Fund, the International Food & Agricultural Trade Policy Council commissioned three papers from members of the International Agricultural Trade Research Consortium. These papers were intended provide negotiators and other interested stakeholders with an independent analysis of options for elaborating the July Framework Agreement, as it moves from a “First Approximation” in the summer of 2005, towards the development of concrete negotiating modalities at the Hong Kong Ministerial in December 2005.

In addition, the IPC convened three task forces, comprised of IPC members as well as other agricultural trade experts, to provide substantive input and a wider range of views into these three commissioned papers. The authors presented their analysis to the IPC task at a meeting held in Washington, DC in March 2005 at the offices of the German Marshall Fund, as well as through an online forum throughout the spring of 2005. These commissioned papers were then presented and discussed at the IPC’s plenary meeting in May 2005.

This is the Executive Summary of these papers, which are being published separately in an Issue Brief by the International Policy Council. The Issue Brief and this summary draw heavily on the original commissioned papers, but have been condensed and supplemented by the views and opinions of task force and IPC members. As such, the papers and the executive summary reflect substantial input of both groups, but they have not been approved or agreed by members of the task forces or by members of the IPC. For those interested in the original commissioned papers, they will be published on the website of the International Agricultural Trade Research Consortium (IATRC), www.iatrcweb.org, in July 2005. The International Policy Council’s issue brief is being published, and is also available on the International Policy Council’s website, www.agritrade.org.

The IPC would like to thank the authors of the commissioned papers (David Blandford, Penn State University; Tim Josling, Stanford University; Mario Jales and Andre Nassar, Institute for International Trade Negotiations (ICONE); and Linda Young, Montana State University) for writing and extensively revising these papers. The IPC would also like to thank Amee Patel, a summer intern from Davidson College, who has done yeoman’s work in editing and preparing these papers for publication under an extremely tight deadline. In addition the IPC would like to thank Kari Heerman, former IPC Communications Director, Christin Cogley, Program Manager and Steve Shin, Intern, for their logistical support of the project. Finally, of course, the IPC extends its thanks to the Hewlett Foundation and the German Marshall Fund for their support of this project.

# Task Force Members

Piet Bukman (DS, XC, MA)
David Blandford (DS)
Jean-Christophe Bureau (DS, MA)
Drew Burke (DS, MA)
Luis de la Calle (DS, MA)
Brian Chamberlin (DS, XC, MA)
Cal Dooley (DS, MA)
Mike Gifford (DS, XC, MA)
Paul Green (XS)
Jim Grueff (DS, XC, MA)
Dale Hathaway (DS, MA)
Jikun Huang (DS, XC, MA)
Mario Jales (MA)
Pamela Kirby Johnson (DS, XC)
Robbin S. Johnson (DS, XC, MA)
Tim Josling (DS, XC, MA)
David King (DS)
Dean R. Kleckner (DS, XC)
Willem-Jan Laan (DS, MA)
Guy Legras (DS, XC)
Alan Matthews (DS, XC, MA)
Rolf Moehler (DS, XC, MA)
Raul Q. Montemayor (DS, MA)
Andre Nasser (MA)
Donald M. Nelson (DS, MA)
Charles J. O’Mara (DS, XC, MA)
David Orden (DS, MA)
Michel Petit (DS, XC)
Per Pinstrup-Andersen (DS, MA)
Eugenia Serova (DS, MA)
John G. Reed (DS, XC, MA)
Marcelo Regunaga (DS, XC, MA)
Susan Sechler (DS, XC, MA)
Jiro Shiwaku (DS, MA)
Klaus D. Shumacher (DS, XC)
Smita Singh (DS, XC, MA)
James Starkey (DS, MA)
Robert L. Thompson (DS, XC, MA)
Simon Tucker (XC, MA)
Ann Tutwiler (DS, XC, MA)
Ajay Vashee (DS, XC, MA)
Dick Wells (DS, MA)
Linda M. Young (DS, XC)
Jorge H. Zorreguieta (DS, XC, MA)

## INTRODUCTION

In the months of June and July, WTO agricultural negotiators will be working toward a “first approximation” of the detailed modalities to be agreed in Hong Kong in December 2005. The “first approximation” will be based on the July Framework Agreement, reached in 2004. On many levels, the July Framework offers innovations and improvements in earlier Doha negotiating texts and in the Uruguay Round Agreement on Agriculture (URAA). The URAA brought agriculture under world trade disciplines for the first time. A number of countries reformed their agricultural policies to comply with these disciplines, and few countries have breached these disciplines on any significant scale. The new dispute resolution process has allowed countries to challenge policies they believed were not in compliance with Uruguay Round disciplines. And the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS) set parameters for health and safety regulations under the WTO as well. However, cuts in tariffs and in the overall level of trade distorting support were not as robust as many had hoped.

It is important that the Doha Development Round go beyond the Uruguay Round to make meaningful reductions in trade-distorting domestic support, expansions in market access and an elimination of subsidized export competition. An analysis of the July Framework Agreement commissioned by the International Policy Council exposes several areas where such progress is possible, if countries have sufficient ambition. Analysis also points to areas where progress on paper may not translate into progress in reality. Negotiators must pay careful attention to these issues if the “first approximation” is to be an acceptable blueprint for the development of modalities.

**“It is important that the Doha Development Round go beyond the Uruguay Round to make meaningful reductions in trade-distorting domestic support, expansions in market access and an elimination of subsidized export competition.”**

## DOMESTIC SUPPORT

The July Framework Agreement widens the support that will be disciplined in the Doha Round to include all forms of trade-distorting support: the Amber Box, the five percent Blue Box level and five percent levels (ten for developing countries) of product and non-product specific *de minimis* support. This overall reduction in trade-distorting support is a very positive innovation and has the potential to exert greater discipline on actual support than did the URAA.

However, by widening the support to be disciplined, the July Framework Agreement also substantially increases the base of support from which reductions will be made. For example, countries which do not currently have (or do not fully utilize) Blue Box, product-specific or non-product specific *de minimis* subsidies could theoretically count the five percent allowances for each of these measures (a total of 15 percent of the value of production) in their Overall Trade Distorting Support ceiling. Countries having higher levels of Blue Box spending would have even higher permitted levels of Overall Trade Distorting Support. If countries can count these allowances toward their overall level of trade-distorting support, then total level of trade-distorting support permitted individual countries under the July Framework Agreement will be much higher than their permitted levels of trade-distorting support in the Uruguay Round. In the case of the United States, this new support base could be 250 percent higher than its current Amber Box support. In the case of the European Union, this new support base could be 160 percent higher. The July Framework does foreshadow some of these concerns, but the possibilities for strategic behavior are strong.

If countries are allowed to increase the permitted levels of trade-distorting support in this manner, the reductions in the permitted level of Overall Trade Distorting Support must be on the order of 60 percent for the largest subsidizers to result in even minimal reductions in actual levels of trade-distorting support. With the exception of a few smaller countries with extremely high levels of support, cuts of this magnitude will bring the share of Overall Trade Distorting Support to the overall value of production below 25 percent. Limits on the individual components (the five percent limit on the Blue Box, and the reduced limits on product and non-product specific *de minimis*) may be more binding in some cases than the overall reduction in trade-distorting support. One of the important insights from the analysis is that higher-income developing countries could take advantage of the various allowances under the new definition of Overall Trade Distorting Support (including the higher *de minimis* levels) to provide substantial trade-distorting subsidies to their agricultural sectors over time.

There is substantial variation in various countries’ reliance on different methods of support. This means that the choice of reduction formulas for the overall level of trade-distorting support and the reduction formulas for each component of trade-distorting support can be critically important.

***Amber Box Subsidies*.** The interplay between the level of cut in Overall Trade Distorting Support and the level of cut in Amber Box subsidies is complex. If the total percentage cut in Amber Box is the same as the percentage cut in the Overall Level of Trade Distorting Support, countries will need to further reduce Amber, Blue and/or *de minimis* spending to comply with the proposed cut in Overall Trade Distorting Support. If the total percentage cut in Amber Box subsidies were larger than the percentage cut in Overall Trade Distorting Support, the adjustment required for other components (the Blue Box and *de minimis*) would be reduced. If the total cut in Amber Box subsidies were lower than the Overall Trade Distorting Support cut, the Overall Trade Distorting Support reduction would be binding, forcing a country to reduce its Blue Box and *de minimis* spending below the caps, to meet the commitment on Overall Trade Distorting Support. If Amber Box subsidies are seen as more trade distorting than either Blue Box or *de minimis* subsidies, then the percentage cuts in Amber Box spending should be at least as large as cuts in Overall Trade Distorting Support, or larger. Negotiators need to find a balance between allowing countries the necessary flexibility to design policy measures to fit their domestic political and economic situations, while at the same time encouraging countries to shift support on the continuum toward less trade-distorting subsidies.

***Blue Box Subsidies.*** The July Framework Agreement revised the definition of the Blue Box and, in another important innovation, introduced caps on Blue Box subsidies at five percent (or higher for some countries) of total production value. However, unlike the other components of trade-distorting support, the July Framework does not require any reductions below the five percent cap. If cuts are made from the permitted overall level of trade-distorting support, this could provide countries that have not used the Blue Box with additional "padding" and open up a new category of support. While in some cases, such Blue Box support will be less trade distorting than Amber Box support, this is not necessarily guaranteed, as there is no requirement or measurement to determine that production controls actually offset the output enhancing effect of Blue Box payments. While there is no mandate to reduce Blue Box expenditures in the July Framework below the five percent cap, a deep reduction in the overall level of trade-distorting support could require some countries to make cuts in the Blue Box. If the reduction in Overall Trade Distorting Support were modest, there would be little pressure to make further cuts in the Blue Box. Countries which rely heavily on the Blue Box (the European Union and Norway, for example) will have make deep cuts in their Blue Box spending by the end of the implementation period to comply with the five percent cap.

> **" If cuts are made from the permitted overall level of trade distorting support, this could provide countries that have not used the Blue Box with additional 'padding' and open up a new category of support. "**

***Commodity-by-Commodity Caps.*** Another important innovation in the July Framework Agreement is the proposal to cap Amber Box subsidies by commodity (such commodity disciplines were discussed in the Uruguay Round but were eliminated by the Blair House Agreement). While a positive innovation, there are challenges in disciplining a measure based on the value of production, which changes due to circumstances beyond the control of policy makers. Product-specific caps could most easily be based on the percentage of support provided a given commodity relative to the value of its production in a base period. This approach would provide more flexibility for countries to meet their commitments when the value of production varies year to year. If countries agree to reduce commodity-specific support, as is suggested in the Framework, the reduction formula for each product would need to be of similar in magnitude to the reduction percentages for Overall Trade Distorting Support to ensure that trade-distorting support was reduced proportionately across the range of supported commodities. While the cap on commodity-by-commodity support is a positive development because it limits the ability of countries to shift trade-distorting support among commodities, it does not prevent it particularly because there are no commodity specific caps on the Blue Box. Ironically the use of such caps could eventually put pressure on policy makers to provide the full amount of support "permitted" under the cap.

***De Minimis*.** In another positive step, the July Framework Agreement calls for a reduction in product and non-product specific *de minimis* levels, but did not specify a reduction amount. The importance of these two categories of *de minimis* support varies, but for most countries, a reduction in non-product specific *de minimis* is likely to be more significant. While July Framework Agreement would impose greater constraint than under the URAA, including two separate allowances for each category means that *de minimis* becomes a significant proportion of the base period Overall Trade Distorting Support: twice the value of the Blue Box. Countries that do not use their *de minimis* exemptions will benefit from their inclusion in the Overall Trade Distorting Support, since this may dilute the reduction required in other components for any given reduction in the Overall Trade Distorting Support. Conversely, a meaningful reduction percentage for the Overall Trade Distorting Support could force additional reductions in actual *de minimis* support, regardless of a countries nominal entitlement. To the extent that *de minimis* subsidies are deemed to be less trade-distorting than Amber Box subsidies, this would be a positive outcome.

***Green Box Subsidies.*** The URAA exempted certain types of payments from reduction if they "have no, or at most minimal trade-distorting effects or effects on production." As a result, these payments have become significant for many developed countries. The July Framework Agreement calls for a review and clarification of these payments. The current thinking in the WTO classifies payments directly linked to current prices or production as trade distorting. This implies that updating the base area for payments (as was done in the 2002 Farm Bill) would not be allowed. The ruling in the Cotton Case also implies that countries cannot forbid the production of certain crops on base acres for direct payments.

A more general and difficult issue with the Green Box, as currently defined, is that some categories of Green Box payments may, of necessity, have an impact on production. For example, environmental or social payments are often designed to help support a particular production process or level of output in order to generate positive externalities or public goods. There is little doubt that the correction of market failures associated with agriculture (where they exists) will affect land use and production. While the WTO should remain neutral on the rationale a country provides for its payments to farmers, if such payments become a new mechanism for supporting agriculture under an environment of freer trade, the WTO needs to ensure that these payments are indeed minimally distorting. It would be worthwhile to create a formal WTO review process under the auspices of the standing Committee on Agriculture for proposals for any new programs or policies to ensure their conformity with the minimally distorting requirement. The burden of proof would rest on the country proposing to create a new program to demonstrate that it is minimally distorting. Such a process would provide a degree of certainty to countries that new Green Box policies would not be challenged under subsequent dispute panels.

## EXPORT COMPETITION

In perhaps the greatest step forward, the July Framework Agreement makes clear that all forms of subsidized export competition will be eliminated. Export subsidies for non-agricultural products have been banned since the early days of the GATT because they are the most directly trade distorting. So, even though economic analysis indicates the gains from eliminating subsidized export competition may be modest compared to other pillars, it is important not to underestimate the impact that elimination of subsidized export competition will have on the political dynamics of the negotiations, on certain product sectors, and indeed on the domestic programs that necessitate export subsidies. The elimination of export subsidies will be a very real and tangible impact of the Doha Development Agenda. The elimination of subsidized export competition is particularly important for countries (many developing) that cannot compete with the treasuries of the United States and the European Union. It is also a *sine qua non* for countries protecting their markets from subsidized imports. Without an elimination of export subsidies, they will be reluctant to countenance lower tariff barriers.

> **"It is important not to underestimate the impact that elimination of subsidized export competition will have on the political dynamics of the negotiations, on certain product sectors, and indeed on the domestic programs that necessitate export subsidies."**

### Direct Export Subsidies

***Timeframe and Product Treatment.*** While the goal is clear, implementing it is difficult because defining parallel disciplines on export credits, state trading enterprises, food aid and export subsidies is quite complex. Establishing the timeframe for export subsidy reductions is the least complicated. Because export subsidies have long been banned by the GATT/WTO on non-agricultural goods, an argument could be made for a relatively rapid phase-out of these measures. Since many countries link the existence of export subsidies and the need to retain barriers against subsidized imports, a rapid phase-out of export subsidies could bring forth a more solid result on market access. At a minimum, there is a strong case for a down payment in export subsidy cuts, along the lines of the down payment on domestic supports contained in the July Framework Agreement. And, while there have been various proposals on fast-tracking some commodities, given the complexities of establishing parallel disciplines across all forms of subsidized export competition, it seems most practical to establish one deadline for all commodities and encourage countries to phase out export subsidies more rapidly on products where this is feasible.

***Additional Disciplines.*** Continuing value and volume commitments, as in the URAA, is vital; the dual commitments constrain export subsidies in times of both high and low prices. The modalities should also clarify that unused commitments from one year cannot be carried forward to subsequent years. This discipline will become more important as subsidies are further reduced. Countries that have had the right to use export subsidies for a product during the URAA, but have not used export subsidies, should also forego that right.

**Export Credits**

The July Framework Agreement calls for an end to export credits granted beyond 180 days, and for negotiations on export credit terms. Rather than creating disciplines for each credit term, the most straightforward way to discipline these programs would be to reduce and eliminate government expenditures on these programs. While expenditure data is not readily available, the data on the dollar value of transactions is. While reducing the dollar value of transactions covered is not a perfect solution, this might provide an adequate basis to phase-out export credit programs over a transition period.

To the extent export credit programs alleviate illiquidity and facilitate transactions that would not have otherwise occurred, they could be beneficial in certain circumstances. Proposed disciplines would not significantly reduce this potential benefit of export credit programs since the poorest developing country members did not historically receive export credits. An export credit program designed to eliminate liquidity constraints faced by the poorest developing countries could assist the WTO in meetings its stated food security goals, and could substitute for low interest loans, which are now provided under the auspices of food aid. A multilateral institution could operate such a program. Alternatively, national governments could continue current programs with less rigid budgetary restrictions for designated recipients, such as Net Food Importing, Food Insecure or Least Developed Countries.

**State Trading Entities**

The July Framework Agreement also calls for the elimination of trade-distorting practices of state trading entities, including export subsidies and government financing of state trading entities. The proposals in the July Framework Agreement to eliminate export subsidies, to eliminate government financing and to eliminate underwriting of losses by state trading entities will eliminate many of their trade-distorting practices.

**“Elimination of government financing, duty-free access for importers, increased transparency and reporting requirements will go a long way towards eliminating their trade-distorting practices.”**

Most controversial is whether the exercise of monopoly power by state trading entities should be eliminated. Many of the original rationales for state trading entities no longer exist. State trading entities were created to help farmers manage their risk, to offset private market power, and to market their crops. In the intervening years, other institutions and innovations have emerged in many countries to address some of these concerns. In a number of countries, futures markets are well developed, as are crop and price/yield insurance markets. Farmers have many alternative marketing channels, so much of the justification behind state trading entities is fading. Elimination of government financing, duty-free access for importers, increased transparency and reporting requirements will go a long way towards eliminating their trade-distorting practices. If it is agreed that the monopoly status of state trading entities is inherently trade- distorting and should be revoked, the approach used in China’s WTO accession, to gradually mandate coexistence with the private sector, seems to be a reasonable way to facilitate the adjustment to a new marketing system.

**Food Aid**

The July Framework Agreement focuses on food aid disciplines to prevent displacement of commercial food imports. In addition to displacing commercial imports, food aid can also depress local production in developing countries. The extent of this displacement is not clear. Food aid constitutes a small share of the commercial market for grains, implying that there will not be much of an impact from reform of food aid programs in grains. However, while food aid may not have a major impact in global markets overall, it does have relevant impacts on specific commodities and countries. The negotiators must find the balance between reducing the impact of non-emergency food aid on commercial markets – both at the global and at the domestic level – and providing food aid to those in need.

***Grants.*** The July Framework calls for negotiators to discuss providing food aid solely through grants, not loans. While loans are more stable sources of development assistance than grants, the economic rational for providing loans for food aid are not strong. Restricting food aid to grants is also in line with the Food Aid Convention (FAC), which states that all food aid for Least Developed Countries should be given on a grant basis. And it conforms to the NFIDC Decision, which directed the WTO to ensure that an increasing percentage of basic foodstuffs be provided in grant form and/or on concessional terms.

***Discipline market development programs.*** Many WTO members, including some developing countries, believe that market development objectives are inappropriate for food aid programs. Language disallowing market development objectives for food aid programs should be included in the modalities. Monies expended for market development programs should be counted against a country's export subsidy commitments.

***Limit surplus disposal.*** The relationship between food aid and domestic agricultural policies of some donors, where stocks growing out of domestic price support are "disposed" of as food aid, has been extensively criticized. Food aid should be given purely in response to need without being linked to domestic agricultural policies, even though food aid from stocks can be used to meet legitimate humanitarian needs. Food aid donations from stocks tend to be erratic, and to be higher in times of low prices, when food aid is less needed and is more disruptive to local markets. However, in times of emergencies, food aid from surplus stocks can be essential. Mandating that food aid from stocks be channeled through the World Food Programme (WFP) for short and long term emergencies would reduce the impact of erratic national donations to individual countries, while ensuring the beneficial use of stocks.

***Limit programme food aid.*** Programme food aid is extremely variable, making it an unreliable resource. Programme food aid donations tend to be large relative to project food aid donations and are generally monetized, resulting in more disruption to commercial imports and to local markets. In addition programme food aid is sometimes ineffective due to misuse by recipient country governments. Governments frequently fund programme food aid by stocks arising out of domestic support policies. Programme food aid is seen as most disruptive to international markets. Finally, donating cash is far more efficient than transporting food around the world, and would ensure that assistance would reach needy countries more quickly. It is desirable to limit the size of programme donations to individual countries and over time to limit its possible market impact. It would also be useful to prohibit programme food aid from being sold on local markets because it is disruptive because of the sheer size and variability of the donations.

## MARKET ACCESS

The expansion of market access will be the main indication of the level of ambition of the agricultural talks. Though it is possible that the negotiations could still survive with modest ambitions in market access, the likelihood is that the political support for such an agreement would quickly fade. Improved market access in agriculture is vital, because agricultural tariffs remain five times higher than tariffs in industrial goods, and account for the bulk of the distortions in agricultural trade. Many recent analyses demonstrate that the vast majority of the gains from trade liberalization come from reducing tariffs and other market access barriers. Most of the gains to developed countries come from reducing their own tariff barriers, not from gaining access to developing country markets, and most of the gains to developing countries come from reducing their own barriers, largely because of the growing importance of South-South trade. The importance of market access for developing countries makes a strong result on the market access pillar central to the achieve of the Doha Development Agenda.

> **"... the vast majority of the gains from trade liberalization come from reducing tariffs and other market access barriers ...most of the gains to developing countries come from reducing their own barriers."**

Of the three pillars of the agricultural negotiations, market access is also the least developed in the Framework Agreement. Many gaps have yet to be filled in the market access talks. Most important perhaps is that the level of ambition on the formulas for tariff reductions will be intricately related to the designation of Sensitive and Special Products. It will be difficult for countries to know what they can need on tariff cuts if they don't know the flexibility other countries will have Sensitive and Special Products.

***Tiered Formula.*** The agreement to reduce higher tariffs by a greater percentage than lower tariffs by placing tariffs into bands or tiers is a positive step in the July Framework Agreement. As with domestic support, many countries maintain actual tariffs far below the level allowed in the URAA. This means that fairly large reductions in tariffs would be required before any improvements in real market access could occur. In some cases, the "tariff overhang" is over 100 percent, meaning that a large reduction in the bound tariff would be required to have any impact on actual tariffs.

The choice of tariff reduction within the bands is broadly between an across-the-board cut or a Swiss Formula cut. The advantage of an across-the-board cut lies on its straightforwardness while the Swiss Formula brings down high tariffs at a much greater rate. But as the tiered approach performs the same function, it is doubtful whether a series of Swiss Formula cuts specific to each band makes much sense. Hence, a series of percentage cuts increasing with the height of the initial tariff may achieve the same objective. The formula should be a simple linear cut in all tariff lines, not the average cut/minimum cut formulation used in the Uruguay Round, because the July Framework incorporated a number of flexibilities for sensitive products, so the average and minimum cut format is not necessary. A practical option would mimic the marginal income tax system, whereby the highest tariffs might be subject to a lower percentage reduction on the part of the tariff up to the first tier, a higher level reduction on the part of the tariff between the first and second tiers, and then the highest level reduction on the tariff remaining above the third tier.

Establishing the bands raises a practical issue. Countries tariff profiles differ enormously, both between developed and developing countries, and within each group of countries. While tariff distribution in developed countries follows a curved path, in the developing countries it is either a straight line or a set of consecutive straight lines in a "staircase" format. Appropriate thresholds for each band are sensitive since they can have disproportionate effects on different countries given the diverse nature of tariff structures. For example, Kenya has bound all its tariffs at 100 percent. Therefore whether to the threshold at 100 percent versus 101 percent makes an enormous difference. The more bands selected, the "smoother" the harmonization of tariffs, but too many bands will add little to the final result. Creating four bands is probably adequate to address the varied tariff profiles of both developed and developing countries.

***Tariff Cap*.** The July Framework Agreement calls for countries to discuss a cap on tariffs. A tariff cap remains the best way to deal with extremely high (or peak) tariffs. It is clear that to affect a substantial number of peak tariffs, the cap would need to be set at 100 percent (particularly when a number of these products will be classified as "Sensitive" or "Special" Products.) If it were impossible to set a tariff cap low enough to capture most tariff peaks, it would be desirable to create an extra tier subject to steeper reductions—for example, a Swiss Formula for these high tariffs, rather than settle for an ineffective cap. Another possibility therefore may be to delay the implementation of a cap until the end of the implementation period, thus allowing Members to anticipate the cap at their own pace. A tariff cap of 100 percent, for instance, could be introduced in the tenth year of the agreement, allowing countries a long time period over which to reduce peak tariffs.

***Sensitive Products.*** The July Framework Agreement leaves open the selection and number of Sensitive Products (for all WTO members). Ideally, a deal on tariff-cutting formulas should be reached before the number of allowed Sensitive Products is established. The level of ambition on tariff reduction would then determine the flexibility needed on Sensitive Products. The selection of Sensitive Products will be a matter for individual countries. But, the number of Sensitive Products should be limited to an established low percent of total production or trade. This would ensure that the category could not be used for widespread protection. Even exempting two percent of tariff lines from formula cuts would substantially reduce the expected gains from market access improvements. And, unfortunately, the very products which developed countries will likely designate as Sensitive (sugar, dairy, rice and a few others) are precisely the commodities of interest to developing country exporters.

**"The selection of Sensitive Products will be a matter for individual countries. But, the number of Sensitive Products should be limited to an established low percent of total production or trade."**

Tariff Rate Quotas (TRQs) should be established on Sensitive Products that do not already have them, in line with the July Framework's call for improved access on all products. Countries should reduce above-quota tariffs on Sensitive Products as well as increasing TRQs. These tariff cuts could, for instance, be at some percentage of the rate appropriate to similar tariffs on non-sensitive goods. To minimize the number of Sensitive Products, and to encourage "substantial improvements in market access for all products, as called for in the July Framework, the modalities should establish a relationship between the level of tariff cut agreed for Sensitive Products and the increase in tariff rate quotas required. For example, if a country implements only half of the required formula reduction on a Sensitive Product, then it should increase its TRQ by 50 percent over the implementation period. If it implements only twenty-five percent of the required formula tariff cut, then it should increase its tariff rate quota by 75 percent over the implementation period.

***Tariff Rate Quotas.*** The July Framework Agreement implies that only Sensitive Products be subject to Tariff Rate Quota expansion. While TRQs are not the preferred tool for improving market access, eliminating quotas on products with high tariffs that are not designated as Sensitive reverses improvements in market access, and abandons an important innovation from the URAA. In order to compensate for eliminating TRQs on product subject to prohibitive tariffs, meaningful reductions in peak tariffs and/or an effective tariff cap must be agreed. If significant progress cannot be made in reducing peak tariffs, serious consideration should be given to retaining the TRQs from the URAA and to continue increasing them by a share of domestic consumption, even though this would be beyond the terms of the July Framework Agreement. In addition, the WTO should develop guidelines to ensure that TRQ administration is more transparent, efficient and predictable.

***Within-Quota Tariffs*.** The issue of cutting or eliminating within-quota tariffs is introduced in the Framework as a way to "give the flexibility required to reach a final balanced result." Since the level of within-quota tariffs largely impacts the distribution of rents between governments and traders, there may not seem to be much advantage by eliminating in quota tariffs. But, as quotas increase over time, the benefits of duty-free access will also increase. Moreover, as internal prices fall due to policy reforms in some markets, the level of protection offered by within-quota tariffs increases, making it important to include within-quota tariff reductions in formula cuts.

***Tariff Escalation*.** The progressive tariff reductions in the tiered approach do not guarantee that the trade distortions caused by tariff escalation will be addressed. But the issue is important for a number of countries, including developing countries, and must be dealt with explicitly because a tiered formula alone would not be enough to address the escalation problem in many sectors. The Harbinson draft modalities paper proposed that tariffs on processed goods be reduced by some multiple of the reduction for raw materials. There is merit in making such a formula simple and avoiding commodity-by-commodity negotiations.

***Special Products*.** Developing countries can specify a number of Special Products, based on criteria of food security, livelihood security and rural development needs. Tariff reductions for Special Products might only need to be one-half that for other agricultural products. As with Sensitive Products, individual countries will determine which products to designate as Special Products based on their internal situation. As with Sensitive Products, the number of products should be limited to a certain percentage of trade or production, although this percentage could be higher than for Sensitive Products. Concrete criteria, such as the contribution of the product to caloric intake, the share of the product grown by farmers earning less than $2 per day, and the contribution of the product to the national income or employment should be established.

***Erosion of Preferential Access***. The erosion of preferences is a natural and generally desirable consequence of trade liberalization, at all levels: multilateral, regional and bilateral. There is increasing evidence that preferences have locked countries into certain commodities for which they might not have a comparative advantage, have shielded producers from competition so they cannot compete on world markets and are inefficient ways to transfer incomes to farmers in developing countries. Thus, it behooves most developing countries to begin to transition away from trade dependent on preferences and toward a more sustainable and competitive sectors.

However, reducing preferences in a way that causes direct harm (even if only in the short term) to low income developing countries would be politically difficult in the Doha Development Round. Given the very real political and economic ramifications, it is important preference granting countries and multilateral lending institutions provide financial resources to assist countries in diversifying their production and that developed countries offer additional market access for all products from the current preferred exporters.

***Market Access and Least Developed Countries***. The July Framework calls on developed countries and those developing countries in a position to do so, to provide duty- and quota-free access to LDCs, but placed no requirements on LDCs to open their markets. These provisions reflect a widespread view that LDCs are in no position to open their markets. In fact, LDCs may well have much to gain by open markets, so it is important to provide LDCs with the same possibility of reducing tariffs as other countries have. This may be done on a case-by-case basis, as not all LDCs will be in the same position to make such commitments.

## ISSUES OF INTEREST BUT NOT AGREED

***Differential Export Taxes.*** Export taxes are used primarily by developing countries as a source of fiscal revenue, to reduce relative domestic prices for food, and to reduce exports in times of domestic shortfalls. It should be clear that just as export subsidies distort markets by reducing world market prices, export taxes distort markets by reducing domestic prices, and differential export taxes distort trade by subsidizing domestic processing industries. Moreover, export taxes (differential or not) penalize producers, who in many developing countries already suffer from adverse terms of trade and urban policy bias. As other policies that distort export and domestic markets will be addressed in the Doha Round, differential export taxes should also be disciplined alongside them.

***Sectoral Initiatives.*** Sectoral initiatives are possible within the Framework, and could still be suggested by one or more members at any time. A sectoral initiative might take the form of a more-than-average tariff cut (perhaps to zero) coupled with an agreement to end export subsidies (ahead of the timetable suggested above) and trade-distorting domestic support (over and above the schedules suggested above). Such sectoral agreements that go beyond the modalities in particular sectors could eventually encourage other sectors to follow suit.

***Geographic Indications.*** Geographic Indications are another "issue of interest" in the July Framework Agreement. The EU originally raised the issue of GIs as one element of market access. A discussion on Geographic Indications should be launched under the auspices of the TRIPS Council, regarding whether and how the system being considered for wine and spirits might be extended to GI's for food products.

## CONCLUSION

The First Approximation of the modalities are means to an end, and the end is the offer that countries table in the final stage of the negotiations. While governments need flexibility to deal with sensitive agricultural products and policies in all three pillars, this flexibility should be granted within the modalities. Negotiators have a short four to six months to deliver the first approximation and the modalities text that will form the basis for a final Doha Round Agreement. Negotiators lost valuable time with important but technical issues The good will and political commitment required to resolve those issues needs to be continued in the coming months. It is vitally important that the momentum established last year that lead to the 2004 July Framework Agreement is regained so that the negotiations can continue to make real progress in 2005.

# IPC Members

International
Food & Agricultural Trade
Policy Council

IPC members represent the geographic diversity of the
chain from producer to consumer. IPC members are influential and experienced leaders in agricultural trade policy who are committed to finding solutions to global food and agricultural trade challenges.

**Robert L. Thompson (Chairman), United States**
**Piet Bukman (Vice Chairman), The Netherlands**

Allen Andreas, United States
Bernard Auxenfans, France
Malcolm Bailey, New Zealand
Andrew Burke, United States
Brian Chamberlin, New Zealand
Csàba Csàki, Hungary
Pedro de Camargo Neto, Brazil
Luis de la Calle, Mexico
H.S. Dillon, Indonesia
Cal Dooley, United States
Franz Fischler, Austria
Mike Gifford, Canada
Ahmed Goueli, Egypt
Dale Hathaway, United States
Jikun Huang, China
Heinz Imhof, Switzerland
Rob Johnson, United States
Hans Jöhr, Switzerland
Tim Josling, United Kingdom

Guy Legras, France
Rolf Moehler, Belgium
Raul Montemayor, Philippines
Donald M. Nelson, United States
Joe O'Mara, United States
Néstor Osorio,Colombia
Michel Petit, France
Per Pinstrup-Andersen, Denmark
Lord Henry Plumb, United Kingdom
Marcelo Regunaga, Argentina
Eugenia Serova, Russia
Hiroshi Shiraiwa, Japan
Jiro Shiwaku, Japan
Jim Starkey, United States
Jerry Steiner, United States
Ajay Vashee, Zambia
Anthony Wylie, Chile
Jorge Zorreguieta, Argentina

# *“Promoting an Efficient World Food System”*

The International Food & Agricultural Trade Policy Council (IPC) is dedicated to developing and advocating policies that support an efficient and open global food and agricultural system—a system that promotes the production and distribution of food supplies adequate to meet the needs of the world’s growing population, while supporting sound environmental standards.

An independent group of leaders in food and agriculture from developed, developing and least developed countries, the IPC’s members are chosen to ensure the Council’s credible and impartial approach. Members are influential leaders with extensive experience in farming, agribusiness, government and academia.

The IPC develops policy recommendations addressing the critical issues facing the world’s agricultural system. It conveys these recommendations directly to policy-makers and decision-makers around the world through policy papers, seminars, conferences and personal contacts. The IPC’s influence and credibility are derived from its membership, all of whom serve on the Council as individuals, and not on behalf of their institutions. With its broad and diverse membership, the IPC is a microcosm of the interests at stake in global agricultural policy debates.