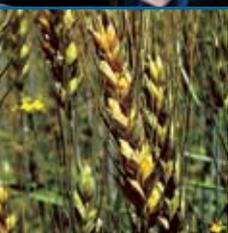


2006

The State of Agricultural Commodity Markets



Part 1

Developing countries, agricultural trade and the Doha Round



Addressing development concerns in multilateral agricultural trade negotiations

Agricultural trade expansion has the potential to make significant contributions to reducing poverty and food insecurity. Evidence from case studies suggests that, in many countries, increased volumes of agricultural exports, by lifting the incomes of farmers, have contributed to poverty alleviation and enhanced food security in regions where export-oriented agriculture is a primary activity (FAO, 2003; 2006a).

However, agricultural trade expansion has been constrained by a number of factors, not least of which have been the various trade barriers and trade-distorting subsidies, mainly but not exclusively imposed by the developed countries. On average, developing countries face higher tariffs than do developed countries. At the same time, the prospects

for “South–South” trade between developing countries, which is a rapidly growing component of world trade, are limited by the import tariffs imposed on each others’ products by the developing countries themselves. Overall, therefore, multilateral trade negotiations aimed at reducing such barriers are to be welcomed as a potential stimulus for expanded world trade.

Although there has been significant progress in reducing similar levels of distortion in other economic sectors, multilateral negotiations have found agricultural products to be a stumbling block in successive trade rounds, and it was not until the Uruguay Round that the first serious steps were taken to bring agricultural products within international trade rules and reduce trade barriers.

Agriculture in international trade negotiations

Agriculture has had a difficult history in the sequence of rounds of multilateral trade negotiations, only being brought under the General Agreement on Tariffs and Trade (GATT) disciplines on trade when the Uruguay Round was concluded in 1994. Until that point, agriculture was subject to a number of exceptions from the GATT rules. GATT members, notably those who had the financial resources to do so, used these exceptions to grant export subsidies and impose quantitative import restrictions as adjuncts to their domestic agricultural support policies.

The distortions created by these measures led to the “disarray” in world food markets, which later multilateral trade negotiations, beginning with the Uruguay Round, sought to address. The Punta del Este Declaration, which launched the round in 1986, set an agenda aimed at reducing import barriers and limiting subsidies that directly or indirectly affected

agricultural trade. The inclusion of the latter category brought a variety of domestic support measures into the picture. The reluctance of some countries to make concessions across the board delayed the eventual Agreement on Agriculture in the concluded Uruguay Round, but even this agreement still permitted the use of significant levels of domestic and export subsidies.

The Uruguay Round Agreement on Agriculture also contained a commitment to re-initiate negotiations towards further reductions in agricultural protection and trade-distorting support. As a result, agriculture has been maintained as a central component of the Doha Round of negotiations launched in 2001. Although originally timetabled to conclude at the end of 2005, the round, which was suspended for a time in mid-2006, is now in its fifth year, with agriculture again the key stumbling block.



The stalling of the current Doha Round in mid-2006 was in large part attributed to difficulties in reaching agreement on the scope for further reductions in support of the agriculture sector.

Developing countries (in common with developed countries) have a genuine interest in seeing that the distortions that constrain their agricultural export expansion are reduced. Developing country trade in agricultural products is underperforming, and this is limiting the scope for developing countries to harness the potential benefits of increased export earnings in supporting their economic development. Although multilateral negotiations have proved to be difficult, they remain the most promising opportunity for moving towards a less constrained trading environment.

In pursuing this process, however, countries need to reflect on how best to formulate trade rules that, in addition to promoting the overall objective of removing obstacles to trade expansion, also provide sufficient flexibility to developing countries to implement agricultural trade policy reforms in a way that mitigates potential threats to their food security and economic development, and which also allows the use of trade policies that are compatible with measures to support their agricultural and broader development efforts (for further discussion of these issues, see FAO, 2006b).

The stalling of the Doha Round provided an opportunity to consider whether the approach taken in the agricultural negotiations to date is most appropriate for achieving the development objectives of the round. This approach has focused squarely on seeking reductions in distortions to agricultural trade arising from domestic support payments, export subsidies and import tariffs – the so-called “three pillars” of domestic support, export competition and market access. Such measures may be appropriate to curb excessive support to, and protection of,

agriculture, which have resulted in excess production in a number of developed countries; however, for many developing countries, the problem, rather than being one of excess production, is one of insufficient support aimed at raising agricultural productivity levels and domestic food production. Although developing countries as agricultural exporters may benefit from higher international prices and enhanced market opportunities, there are legitimate concerns that this should not be at the expense of the capacity to assist agriculture sectors in other developing countries in fulfilling their role in economic development and improved food security. In reflecting on the difficulties facing the current round of multilateral trade negotiations, it is necessary to recognize and acknowledge the different situations and requirements of different countries.

Conflicting models

In pursuing agricultural negotiations, some countries have proposed that reductions in their own high levels of trade-distorting support and policies be contingent upon other countries reciprocating (albeit by a proportionately smaller amount) by reducing their import tariffs. Their case has been strengthened by model-based results suggesting that freer agricultural trade, resulting not just from reduced support and protection of developed country agriculture but more especially from greater openness of developing country agricultural markets, will result in significant gains to the latter.

More recently, however, this view of the benefits of trade reform has been seriously questioned as far as the benefits from the WTO negotiations are concerned. Not only have global trade-model results been exposed as lacking for a number of technical reasons (see FAO, 2005a) – the most recent studies, which attempt to overcome such limitations, reveal much smaller gains, and in some cases losses, to developing

countries – but it is increasingly recognized that for the negotiations to contribute positively to development, a more nuanced and realistic view of developing country agriculture is required.

Developing countries are highly heterogeneous in their agricultural trade concerns. As agricultural exporters, they export a range of products. Some export primarily tropical products, where the barriers to access to developing country markets tend to be relatively low and further tariff reductions may result in limited additional access. Those dependent on exports of tropical products where tariffs are already low will see little impact on the demand for their exports from currently proposed tariff reductions. Typically, these countries also face supply-side constraints, which hinder adjustment to the new market opportunities that trade reform might yield for processed and value-added products (which tend to be more heavily protected). For other developing countries, exports are primarily of temperate products, such as sugar or cotton, which can face significant barriers. This area is where the gains from reduced barriers are expected to be greatest.

Furthermore, producers from different countries often face different barriers in accessing the same export market. Least-developed countries (LDCs) and a number of other developing countries currently enjoy preferential access to developed country markets in terms of lower import tariffs than the “most-favoured nation” (MFN) tariffs paid by other countries in the same market. Again, while those in the latter category may gain from trade liberalization in these products, those in the former may suffer as a result of preference erosion.

There are a number of countries, particularly but not exclusively the small island developing states (SIDS), that are highly dependent on exports of certain products under preferential arrangements, notably bananas and sugar. These can account for a significant share of their total export



The erosion of preferences

For some developing countries, a key issue is the erosion of trade preferences as liberalization lowers tariffs in general. Through trade preferences, developing country exports of certain products gain access to developed country markets at tariff rates lower than the most-favoured nation rates that are charged to other exporters.

The difference in the tariff rates normally accrues to exporters, and can amount to significant additional export earnings. Trade preferences include the Cotonou Agreement between the European Community (EC) and the African, Caribbean and Pacific (ACP) group of states, and the United States African Growth and Opportunity Act (AGOA).

In some cases – exports from least-developed countries under the European Union’s “everything but arms” (EBA) initiative, for example – the preferential tariff is reduced to zero. Preferences are important for some of the poorest and most vulnerable developing countries, especially small island developing states. However, the benefits of such preferences are eroded as MFN tariffs are reduced as a result of multilateral trade liberalization, thereby reducing export earnings from traditional exports, especially bananas and sugar. Preferences for these products have also been under attack from complaints in the WTO against the policies that imply them.

earnings, incomes and employment, so preference erosion has potentially severe economic consequences. For them, the benefits of multilateral tariff cuts would not compensate for the loss of preferences.

Food imports

Developing countries are significant agricultural importers. Many developing countries are also food importers, and increasingly so. They currently benefit from the higher supplies and lower prices of temperate agricultural products on world markets, which are the result of the subsidies for production and trade in the developed countries. As this support is reduced, prices are expected to increase, leading to higher food import bills for those developing countries dependent on food imports. Many countries have a high dependence on food imports because they are resource constrained (for example, some countries in the Near East and North Africa). These countries often have relatively low barriers to imports of food products, and may be concerned that expected increases in food prices on the world market will hurt their consumers as these increases are passed through to domestic markets.

Other countries may have high food import dependence for quite different reasons. For many, their agriculture sectors, despite relatively abundant natural resources, are underdeveloped and unable to satisfy domestic demand for food. Many such countries, especially those at earlier stages of agricultural development, consider it necessary to maintain tariffs and other forms of border protection, which raise domestic agricultural prices and provide incentives for agricultural development (see FAO, 2006b). Often these countries have in place (or would like to have in place) policies that provide some level of protection to their producers while investments are made in improved productivity and technologies. Administrative and financial limitations generally preclude significant use of other policies to support agricultural producers in these countries. Developed countries and more advanced developing countries have also justified the use of border protection. However, alternative policies, such as direct income payments to farmers, tend to be more readily available in these countries, and it is debatable whether border protection is the most appropriate intervention to achieve such goals in these contexts.

Threats to domestic food production

Multilateral trade reform implies that developing countries will be obliged to reduce their import tariffs. The exact impact of such reductions will depend upon how much higher “bound” tariff rates – those maximum permitted tariffs subject to negotiation in the WTO – are than current rates actually applied. Besides the obvious reduction in tariff revenues (which can be a significant proportion of government revenues), lower tariffs will imply intensified competition from imported foods for the domestic agriculture sector. Reduced tariffs also increase vulnerability of domestic production to competition arising from “import surges”. A number of instances have been reported in which a developing country’s agricultural production has apparently been negatively affected by such sudden, short-run increases in food imports.

The threat to domestic food production from increased imports depends on how competitive domestic production is. Some developing countries may not be competitive, owing to supply-side and infrastructural constraints, and may have limited possibilities for diversification into other products. These countries may therefore be concerned that liberalization, if undertaken before these constraints are removed, could jeopardize their broader development goals and also their food security. Evidence on the impact of trade reform on food security has been gathered from studies of individual countries, although this is often inconclusive. Some studies suggest that liberalization has been associated with reduced poverty and enhanced food security, whereas others have indicated just the opposite. A recent FAO study (FAO, 2006a) concluded that, for countries at earlier stages of development, trade reform can be damaging to food security in the short to medium term if introduced before a package of policy measures to raise productivity and maintain employment has been put in place.

Who benefits?

Developing countries continue to be disappointed with the results of the Uruguay Round, and concern remains that the Doha Round should make due allowance for their special circumstances and needs. The concerns of the poorer developing countries are well summarized by the Arusha Declaration on African commodities. The key concern articulated there is that if the agriculture sector of African countries is not competitive, tariff reductions that increase exposure to competition from imports may adversely affect agricultural growth, food security, incomes and employment. Against these real risks, the benefits of liberalization are seen as less tangible. For many developing countries, the Uruguay Round had little beneficial impact and, according to various model-based studies, most of the gains from any further liberalization are likely to accrue to the developed countries and the larger, wealthier developing countries.

In participating in the current round, developing countries are therefore seeking recognition of the fact that the development of their agriculture sectors requires different approaches in different situations, and that the negotiations need to reflect this concern by providing greater levels of flexibility in the implementation of trade reforms.

Stages of development

Agricultural development strategies need to recognize that agriculture’s role in economic growth and poverty reduction changes as countries develop. At earlier stages of development, the agriculture sector can account for a large proportion of gross domestic product (GDP) and an even larger proportion of employment. In these circumstances, increasing agricultural productivity is essential – first for capital investment in agriculture itself, and then to allow labour and capital to be released to other sectors of the economy. As development proceeds, the agriculture sector becomes less important in its share of GDP, although it may continue to be important as a major employer.

Given that increasing agricultural productivity is most critical in the earlier stages of development, governments might justifiably wish to give a clear priority to agriculture in their spending, and to stimulate actively and facilitate agricultural development. Countries that have achieved periods of sustained agricultural productivity growth have tended to lift the constraints to continued growth step by step, beginning with the most binding, while at the same time intervening to create a conducive economic environment – rather than adopting a liberal policy stance, including with respect to trade policy, from the start.

Arusha Declaration and Plan of Action on African Commodities

Paragraph 14 of the Arusha Declaration and Plan of Action on African Commodities adopted by the African Union Conference of Ministers of Trade on Commodities (Arusha, United Republic of Tanzania, 21–23 November 2005), states:

While the current “Doha Development Round” provides an opportunity to reduce distortions in international agricultural markets through further strengthening of disciplines on trade distorting support and protection, appropriate account needs to be taken of the development and food

security needs of our people through special and differential treatment under trade rules. Our countries need flexibility and policy space under WTO multilateral trade rules to choose the most effective strategy appropriate to our situation. Their effective and expeditious reduction in subsidies by developed countries in cotton, sugar and all other commodities of interest to developing countries would be a welcome development, while taking into account the interest of preference receiving countries.

Source: UNECA, 2005.



Most countries agree on the importance of reaching an agreement that will lead to a less distorted agricultural trading environment and provide a way out of the current difficulties. This issue of *The State of Agricultural Commodity Markets* examines further the principal elements of flexibility that may be needed to alleviate the concerns of developing countries regarding the role of trade in improving the competitiveness of their agriculture sectors.

The need for special and differential treatment

The extension of “special and differential treatment” (SDT) to developing countries is a means through which multilateral trade negotiations address the need to retain policy flexibility in relation to

development goals and potential negative impacts of trade liberalization on some developing countries’ agricultural production, trade and food security. There is broad agreement that the rules of the international trading system should recognize the food security and development needs and the priorities of developing countries.

Special and differential treatment would provide flexibility in the implementation of trade rules as well as in the formulation of domestic policies more conducive to promoting development objectives. Properly formulated, such treatment regimes could help to mitigate the potential adverse effects of increased import competition and import surges, and would ease adjustment to a new market situation. There has been much discussion in the Doha Round concerning the most appropriate means to achieve this.

Special and differential treatment

Special and differential treatment (SDT) has long been a defining feature of the multilateral trading system. SDT describes preferential provisions that apply only to developing countries (DCs) and the subcategory of least-developed countries (LDCs), and not members designated as developed countries. Three forms of SDT are identified in WTO agreements. First are measures that allow different commitments by the different categories of members. For instance, under the Uruguay Round Agreement on Agriculture, developed countries had to reduce their bound tariffs by 36 percent over six years while developing countries were required to reduce their bound tariffs by 24 percent over ten years. In the Doha Round, LDCs will be exempt from further reductions in their bound tariffs, and the provisions related to both “special products” and the “special safeguard mechanism” will be available only to developing countries. Second, there are trade preference provisions, the most recognized of which is the generalized system of preferences (GSP) whereby products from developing countries are permitted to be imported at lower tariff levels by developed countries. Third, a large number of declarations call

on developed countries to support DCs and LDCs in implementing the new trade regulations and mitigating negative impacts of trade liberalization. These are known as “best endeavour” clauses; they are controversial because DCs and LDCs feel that they have generally been ignored by developed countries because they are not legally binding.

The debate over SDT continues, with DCs and LDCs remaining dissatisfied with developed country responses to assist them in increasing their capacity to trade and to implement trade regulations. The Doha Declaration (WTO, 2001) recognized these concerns and includes specific provisions for negotiations to improve SDT measures. Paragraph 44 calls for a review of all SDT provisions “with a view to strengthening them and making them more precise, effective and operational” (WTO, 2001). The major challenge facing negotiators is operationalizing SDT in light of the recognition of significantly different requirements among member developing countries, in an institutional environment where there is great unwillingness to create new categories of members. Yet, such differentiation is the very essence of SDT (for further detail see FAO, 2005b).

From the 2001 Doha Declaration onwards, it has been stressed that special and differential treatment for developing countries should be mainstreamed in the negotiations to provide for operationally effective recognition of their development needs, including food security and rural development. Although special and differential treatment is an integral aspect of all three “pillars” of market access, domestic support and export competition, special and differential treatment under the market access pillar was highlighted in the July 2004 Framework Agreement.

In July 2004, it was agreed that developing countries will be able to designate certain products that are crucial to their food security and longer-run economic and social development as “special products”, for which agreed tariff reductions would not be applied fully. In the Framework Agreement, WTO members accepted the importance of different treatment for such products and agreed that based on three criteria (food security, livelihood security and rural development needs), developing country members should have the flexibility to designate an appropriate number of special products. Although it is clear that the broad criteria for designating products as “special” will relate to food security, livelihood security and rural development, the precise operational definition and criteria for determining special products are problematic. These special products would be subject to limited tariff reduction commitments; in this way, they would be protected from intensified import competition (along the lines of an “infant industry” type of argument).

It should be noted parenthetically that there is also agreement that all countries should be allowed to designate certain products as “sensitive products”. Unlike for special products, there are no specific criteria for designating products as “sensitive”, and the choice will be subjective and according to a country’s special interests. As with special products, some limit on the number of products to be so designated will be necessary.

However, though special product exemptions may have a limited impact on world market prices in view of the smaller share of developing countries in world trade in the products likely to be concerned, designating even a few products as sensitive could reduce significantly the benefits of global trade reform. This is particularly so in the case of dairy products (as is illustrated elsewhere in this report).

The Framework Agreement also proposed that a special safeguard mechanism (SSM) should be available to all developing countries to counter depressed import prices and import surges. Rather than exempting certain products from tariff reductions, as in the case of special products, this new mechanism would raise tariffs temporarily to deter imports and hence avoid depressed prices and possible damage to domestic production. (Further detail on the key components

of the SSM is provided in FAO, 2005c.) Current safeguard measures in place are generally either not available to all developing countries or are regarded as too complex to be effective.

Special products provisions and the SSM are designed to address different concerns. The flexibility provided by the former may be appropriately used for products falling into the category of those that are not currently competitive, but critical to the achievement of economic and social objectives. By contrast, the SSM may be more appropriate in providing a level of protection to products that are competitive, but which, as a result of limited recourse to risk management instruments in countries with underdeveloped markets, can be subject to short-term disruptions resulting from depressed international prices or from surges in imports.

The July 2004 Framework Agreement

One important date set by the Doha WTO Fourth Ministerial Conference in 2001 was to reach an agreement on formulas and other “modalities” for countries’ commitments by 31 March 2003 as a first step towards the conclusion of the Doha Round by 1 January 2005. As it turned out, the March 2003 deadline on the modalities was missed and the WTO members then turned their attention to reaching an outline or “framework” of the modalities. This was eventually agreed on 1 August 2004, after the deadlock at the Fifth Ministerial Conference in Cancún, Mexico.

The agreement, popularly known as the July Framework or “package” (WTO, 2004), was based on the emergence of converging positions among the WTO members. The text included “frameworks” in key areas, such as agriculture and industrial market access, and was seen as providing a basis for focusing negotiations on fuller “modalities”, which would include completed formulas for tariff reductions.

The Framework’s annex on agriculture runs to seven pages and includes outlines for formulas for reducing import barriers, export subsidies and domestic support,

as the basis for concrete and complete formulas in the “modalities”.

The Framework Agreement also incorporated decisions that were reached under certain pillars, such as abolishing all forms of agricultural export subsidies by a set date, as well as substantially reducing trade-distorting domestic support to agriculture. The text also made clear the language for the so-called “parallelism” – that is, ensuring that the elimination of direct export subsidies is matched by the elimination of subsidy components of export credit, food aid and the exports of state trading enterprises. It also made progress on cotton with the provision of a “down-payment” of a 20 percent reduction in trade-distorting domestic support in the first year.

Progress was also made in addressing a complaint by many developing countries that there were serious imbalances between the amount of detail on provisions for developed and developing countries, including “sensitive products” (which had been described in some detail in the drafts being considered at that time) and developing countries’ provisions for “special products” (which had not been described in such detail).

However, on top of the flexibility and protection provided by special products and the SSM, many developing countries will also require assistance to help overcome supply-side constraints in production, marketing and trade. Measures such as special product status and the SSM are not a solution to the underlying longer-run problems of lack of competitiveness and supply-side constraints that developing countries may face. If poorer countries are to withstand intensified import competition and to benefit from trading opportunities that may arise from liberalization, this must entail creating an environment to allow the reallocation of resources to activities where they can be

used more productively, as well as overcoming marketing problems through better infrastructure (such as roads, markets and port facilities) and diversification. These supply-side constraints still need to be addressed, and international assistance will be needed. In this context, it is encouraging to note the aid-for-trade initiative, which aims to address supply-side constraints. The designation of special products and the availability of a special safeguard mechanism therefore provide an element of protection within which incentives for the modernization of the agriculture sector can be maintained to sustain rural incomes, employment and food security, in line with broader development goals.





Special products for development

Developing countries recognize the potential benefits of more liberalized agricultural trade and are committed to this objective in the current round of multilateral trade negotiations. However, many of them seek flexibility in applying agreed tariff reductions so as not to prejudice their longer-run economic and social development. Their concern is that if the agriculture sector in developing countries is weak, there is a danger that tariff reductions will expose them to competition that they are unable to handle, and may actually harm agricultural growth, incomes and even food security. Indeed, many developing countries have seen little benefit from the Uruguay Round, and modelling of further liberalization has suggested that future benefits will flow not towards LDCs, but to developed countries and the wealthier developing countries. WTO members have accepted that trade liberalization involves risks for some developing countries, and have agreed on the need for special and differential treatment that would limit those countries' commitment to tariff

reductions so as to safeguard their development needs and priorities. Measures for achieving this have been key elements in the negotiations. Special products are the most important of these measures.

Special products are products identified by a developing country – “self-designated” – as being particularly important to its overall development because of their significant role in enhancing food security, livelihood security and rural development generally. These products will be exempted from the full extent of any tariff reductions agreed to in the Doha Round of trade negotiations. In 2005, the WTO Sixth Ministerial Conference in Hong Kong Special Administrative Region of China declared that:

Developing country Members will have the flexibility to self-designate an appropriate number of tariff lines as Special Products, guided by indicators based on the criteria of food security, livelihood security and rural development.

(WTO, 2005).

Criteria for special products

Food security: According to FAO, “Food security exists when all people, at all times, have physical and economic access to sufficient, safe and nutritious food to meet their dietary needs and food preferences for an active and healthy life” (FAO, 2004a).

Livelihood security: The adequate and sustainable access to income and other resources to enable households to meet basic needs. Livelihood security includes adequate access to food, potable water, health facilities, educational opportunities, housing and time for community participation and social integration.

Rural development: This process affects the well-being of rural populations, and includes the provision of basic needs and services – access to food, health services, water supply and basic infrastructure such as roads – and the development of human capital through education. It also refers to activities that reduce the vulnerability of the agriculture sector to adverse natural and socio-economic factors and other risks, and strengthen self-reliance.

Source: Calpe and Prakash, 2005.



The position of the LDCs in the discussion of special product provisions has been the subject of some debate during the most recent round of negotiations. It has been argued that because LDCs will not be required to reduce their bound tariff levels in implementing any agreement reached, and therefore would not require special products exemptions, it is not clear that they should support the extension of this provision given that the use of special product provisions by other developing countries could restrict the LDCs' own export opportunities.

The contribution of special products can be seen from two

different perspectives. From the strict development perspective, special products are meant to provide flexibility ("policy space") to a developing country to promote development goals and mitigate the negative impacts of full tariff reductions.

From the perspective of realizing a successful outcome of the multilateral negotiations, the contribution of special products is to provide flexibility (reduced tariff cuts) for some products in order to achieve more comprehensive liberalization on all products and conclude the Doha Round.

How can special products be identified?

Clearly, it is not possible for developing countries to self-designate an unlimited number of special products, so specific criteria for defining them are needed. Simply designating these products without clearly linking the choice to food security, livelihood security and rural development might help achieve an agreement in the WTO, but would not necessarily contribute to the achievement of development goals. A comprehensive and systematic approach to selection is required, beginning from explicit national development goals and based on practical and operational indicators for each of the three criteria.

FAO has developed a set of indicators that best meet each criterion – though given that the issues of food security, livelihood security and rural development overlap, these indicators could also be relevant to more than one criterion (Ford *et al.*, 2005).

As an example the table shows some representative values of these indicators for three different types of developing country.

Food security indicators

- Contribution of product to nutrition (share of product in calorie consumption)
- Import dependency (ratio of product imported over product consumed)
- Self-sufficiency ratio (ratio of product consumed over product volume produced)
- Stability in access of product (variability of domestic production)

Livelihood security indicators

- Incidence of displacement by imports (import growth rate; and correlation between production and import of product)
- Agricultural land product share (share of product in area harvested)

Rural development indicators

- Importance of product in national and rural economy (share of

Selected special products from case study analysis

| Country type | Product | Share in total calorie consumption (percentage) | Volume imported/ volume consumed (percentage) | Share in total area harvested (percentage) | Share in total production volume (percentage) | Production volume growth rate (percentage) |
|---------------------------------------|--------------------|-------------------------------------------------|-----------------------------------------------|--------------------------------------------|-----------------------------------------------|--------------------------------------------|
| Net food exporting developing country | Rice, milled paddy | 39.68 | 0.00 | 56.54 | 19.63 | -0.70 |
| | Refined sugar | 12.45 | 0.00 | 5.12 | 1.54 | -1.99 |
| | Coconuts | 2.68 | 0.09 | 1.87 | 0.69 | 0.43 |
| | Maize | 2.14 | 3.39 | 7.01 | 2.18 | -1.91 |
| | Chicken meat | 1.69 | 0.01 | 0.00 | 0.58 | 6.56 |
| | Bananas | 1.45 | 0.00 | 0.77 | 0.87 | 0.94 |
| | Cassava | 1.45 | 0.00 | 6.03 | 8.56 | -4.00 |
| | Wheat | 0.03 | 99.00 | 0.01 | 0.00 | 0.00 |
| Net food importing developing country | Wheat | 33.12 | 44.00 | 17.80 | 4.10 | -1.34 |
| | Maize | 4.83 | 41.45 | 14.91 | 4.17 | 1.41 |
| | Refined sugar | 4.00 | 35.40 | 0.00 | 0.40 | -2.20 |
| | Dates | 1.70 | 0.03 | 0.55 | 0.64 | 5.10 |
| | Sorghum | 1.30 | 0.01 | 2.78 | 0.57 | -6.35 |
| | Tomatoes | 1.23 | 0.10 | 3.24 | 4.08 | -0.89 |
| | Oil of soybeans | 1.03 | 79.71 | 0.00 | 0.03 | 19.81 |
| | Rice, milled paddy | 0.25 | 0.78 | 10.70 | 3.55 | -2.30 |
| Small economy developing country | Raw sugar | 18.00 | 0.00 | 8.52 | 48.30 | -1.50 |
| | Rice, milled paddy | 9.84 | 10.89 | 2.98 | 0.26 | 5.96 |
| | Maize | 5.96 | 2.46 | 7.88 | 1.54 | 2.70 |
| | Chicken meat | 4.05 | 1.94 | n.a. | 0.41 | 23.12 |
| | Beans, dry | 3.64 | 5.56 | 4.07 | 0.20 | -15.42 |
| | Plantains | 1.82 | 0.00 | 0.56 | 0.86 | -13.69 |
| | Oranges | 1.15 | 0.00 | 7.20 | 8.30 | -14.00 |
| | Beef and veal | 1.09 | 0.91 | n.a. | 0.06 | 27.60 |
| Potatoes | 0.93 | 73.09 | 0.05 | 0.04 | -28.55 | |

Note: n.a. = not available.

Source: Ford *et al.*, 2005.

product in total agricultural production; and production growth rate for the product)

This list of indicators is not exhaustive, and countries could be given the flexibility to choose from among a menu of indicators those that are most relevant for them. Analysis shows that a reduced set of indicators can adequately represent a larger set of indicators, and hence classification can be made on the basis of only a handful of criteria.

In practice, calculation of the various indicators for each criterion would provide an initial list of products that might be designated as “special”. The current and prospective trade policies for each of the products on this initial list would then need to be assessed to determine whether differential trade policy treatment is required. For example, if tariffs are already low, then the case for designating the product as a special one to limit further reductions may be stronger. If special treatment is regarded as desirable, then the specific form that that differential treatment might take becomes a subject for negotiation with trading partners.

In practice, however, these steps are not always so straightforward, not least because of limitations of the available data for calculating the different indicators. Furthermore, because food systems, livelihood systems and rural development are dynamic, the list of possible special products might vary through time.

How should special products be treated?

Once identified, special products would be accorded more moderate treatment in the application of trade rules agreed in the WTO. The strongest proponents of the concept of special products have suggested that special products should not be subject to any tariff reduction, any new tariff rate quota commitments or tariff capping (that is, setting a maximum tariff that can be imposed on the product), and that all special

products should have recourse to the special safeguard mechanism (discussed later in this report) that would raise tariffs temporarily to deter sudden increases in imports. It has been further suggested that qualified products should be given flexibility in all other pillars under the WTO negotiations (i.e. not just in relation to tariffs under the market access pillar), which would also allow developing countries flexibility in the use of domestic support policies such as subsidies and export enhancing support.

Using the special product provision – the case of rice

It is likely that rice would be designated as a special product by some developing countries. It might also be designated as a sensitive product by some developed countries. Rice provides an interesting example of the issues involved in designating special products. Given the significance of rice in international trade, its designation as special or sensitive – and therefore at least partial exclusion from the reform process – would have implications for international rice markets and for the overall effects of multilateral trade liberalization. Although agreement to designate special products may reassure developing countries that their rural development and food security concerns will be safeguarded (and hence may overcome a potential obstacle to a successful outcome for trade negotiations), it does have a potential cost in terms of the lost benefits to other exporting countries of a more comprehensive liberalization. These costs have been explored in FAO model-based analyses of the potential effects on world market prices, production and trade of designating rice as special or sensitive (Calpe and Prakash, 2005; FAO 2005d).

The graph shows the effects of three different rates of tariff reduction compared to a baseline describing the current situation. The three different scenarios are: completely free trade with tariffs for all products



Effects of designating rice as a special or sensitive product



Note: Prices are weighted averages.

Source: Calpe and Prakash, 2005.

including rice reduced to zero; free trade with zero tariffs for all products including rice, except developing countries designating rice as a special product (reducing rice tariffs by only 33 percent), and developed countries designating rice as a sensitive product (reducing rice tariffs by 50 percent) and LDC tariffs not reduced at all; and free trade, but with no rice tariff reductions where rice is designated as a special or sensitive product.

As would be expected, the impacts on rice prices, production and trade vary directly according to the degree of market opening. Under free trade, with no LDC, special or sensitive product exceptions, trade expands substantially, driven by a marked fall in import prices. However, the designation of rice as a special or sensitive product diminishes the size of these effects, with virtually all impacts vanishing when no market opening at all is required for such products.

Rice was a major source of contention in the previous Uruguay Round of multilateral trade negotiations, as several countries objected to the opening of their rice market because of its possible negative consequences on food security, livelihood of farmers and the environment. A way out of the ensuing stalemate was found with the incorporation into the final Agreement

on Agriculture of the Special Treatment Clause, which allowed countries to maintain non-tariff barriers on products, subject to certain conditions. The clause was mostly used to exempt rice from the general easing of market access by Japan, the Republic of Korea, the Philippines and Taiwan Province of China; as a result, this is often referred to as the “Rice Clause”.

Although many countries have since reformed their rice policy regimes, rice is still considered by many to be a strategic product that cannot be treated as other agricultural commodities – reviving the notion that some form of “special treatment” for rice is needed in the current round of multilateral trade negotiations if more ambitious market opening objectives are to be achieved for agriculture in general.

In practice, in the event that the Doha Round is concluded, only a few countries might actively use the special or sensitive product exceptions for rice, because many of the most important rice players are classified as LDCs and are therefore exempted from tariff cut obligations. Moreover, several developed and developing countries producing rice already apply tariff rates well below the maximum “bound” levels notified to the WTO, a signal that they may not fiercely oppose cuts

to their bound rates. So even the full agreed reductions in tariffs, which are on bound values, may not have an impact on the tariffs actually charged. Indeed, because of large differences between bound and applied tariffs (the so-called “tariff overhang”) in major importing countries, little effect may be observed under the current round of trade policy reform unless the reduction in bound rates is deep enough to eliminate the gap between bound and applied tariff rates.

On the other hand, even minor players in the rice economy may be tempted to designate rice as special or sensitive, along with wheat, maize and other grains, to limit concessions on market access for the whole cereal sector. This was the case in the Uruguay Round Agreement on Agriculture, where rice was made eligible for the special safeguard even by countries where it did not appear to be a strategic crop. As far as special and sensitive products are concerned, the risk of abusing these exceptions is expected to be reduced through the imposition of limits to their number or through the stringency of the criteria that the products will have to meet.

Contrasting the effects of special and sensitive products – the case of dairy products

As with rice, dairy product trade remains highly constrained by market access barriers, and it has proved difficult to effect trade reform in this sector. The tariffication exercise of the Uruguay Round resulted in dairy products having among the highest tariffs of the agriculture sector. As a result, trade negotiations that result in significant across-the-board decreases in trade barriers would significantly affect domestic dairy and trade policies. In this context, recent clauses defining special products and sensitive products that provide exemptions from general disciplines may affect the potential for dairy reform. The key question is how much.

With dairy products declared to be special products, developing countries may exempt dairy products



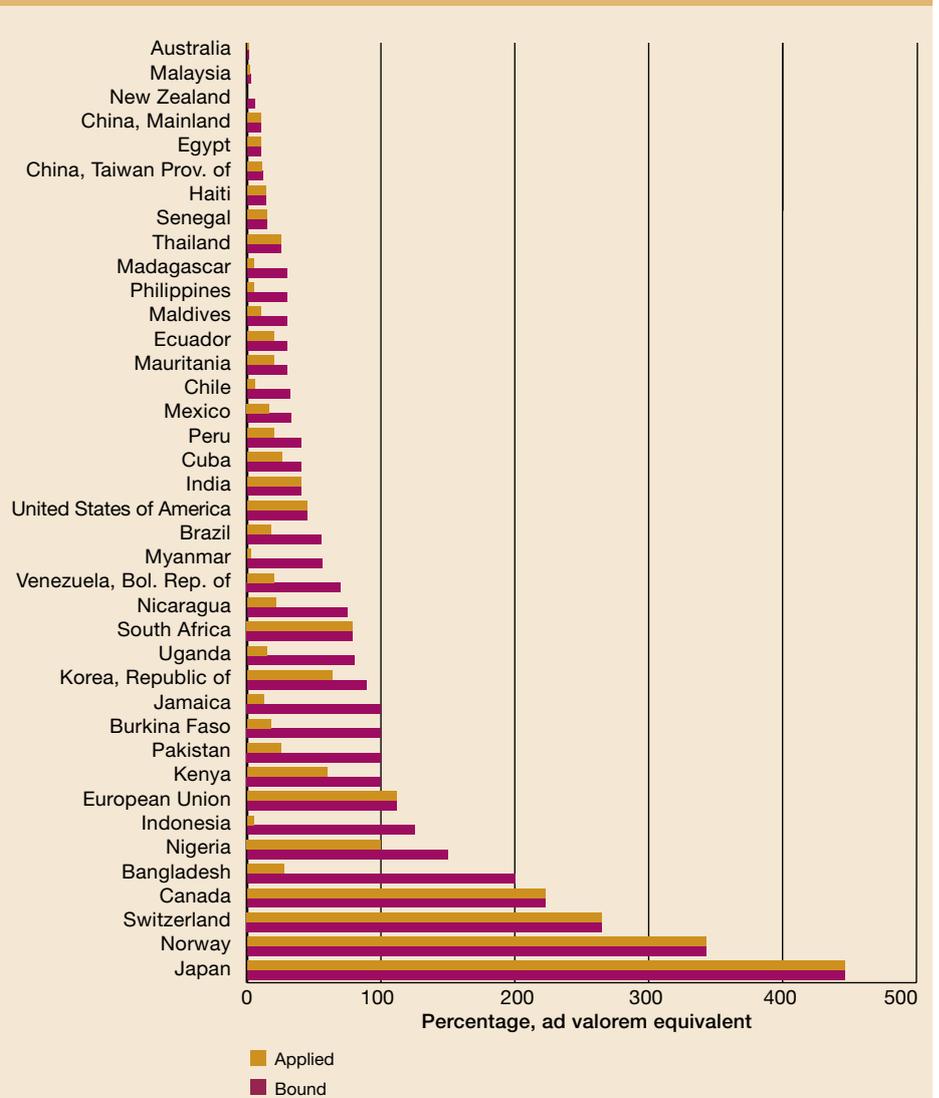
from tariff reduction insofar as the dairy sector may be considered of fundamental importance to “food security, livelihood security and rural development needs”. Declared as sensitive products, countries may deviate from general tariff formula reductions by offering “substantial improvement” in market access through tariff-rate quota expansion that takes into account a deviation from the tariff formula. The number of individual dairy products eligible is critical; in some developed countries, dairy products account for a significant share of agricultural tariff

lines, with the European Union (EU) at 8 percent and the United States of America at 14 percent.

FAO analysis (FAO, 2005e) suggests that, aside from the absolute size of bound dairy tariffs, the key factors affecting the implications of special and sensitive product designation are:

- The extent of tariff “overhang” – the difference between the tariff rates “bound” in the WTO and those actually applied. This is very significant in many developing countries, as the graph shows. In these cases, even a substantial

Tariff profile for butter: average over-quota tariffs for selected countries and regions



Note: Tariff data refer either to average out-of-quota, or average single MFN tariff where there is no quota, depending on the country.

Source: FAO/UNCTAD, 2006.

reduction in bound tariffs may not be enough to reduce actually applied tariffs and would have no effect on market access.

- The extent of tariff “water” – the excess of a tariff over what is strictly necessary to prevent imports from undermining existing domestic price support policies (a concern particularly in developed countries, where this is prevalent). In these cases, tariff reduction may not be sufficient to cause price or policy changes, and improvements in market access would be minimal.
- What trade-off or rule is negotiated to determine how much to expand import quotas to compensate for less-than-full tariff reductions where dairy products are designated as sensitive.

Without special or sensitive product exemption, a significant tariff cut would lead to higher world dairy product prices of as much as 8 to 12 percent, but these changes would be more than halved with special and sensitive product treatment. FAO analysis (Cluff and Vanzetti, 2005) indicates that even if all developing countries declared special product exemption for the dairy sector, there would be little impact on world markets compared with no exemption, largely because of the size of the tariff overhang and the limited role played by these countries in world markets. However, for sensitive product designation by developed countries, the impact of an ambitious tariff formula cut is reduced considerably, and increases to market access would be severely limited.

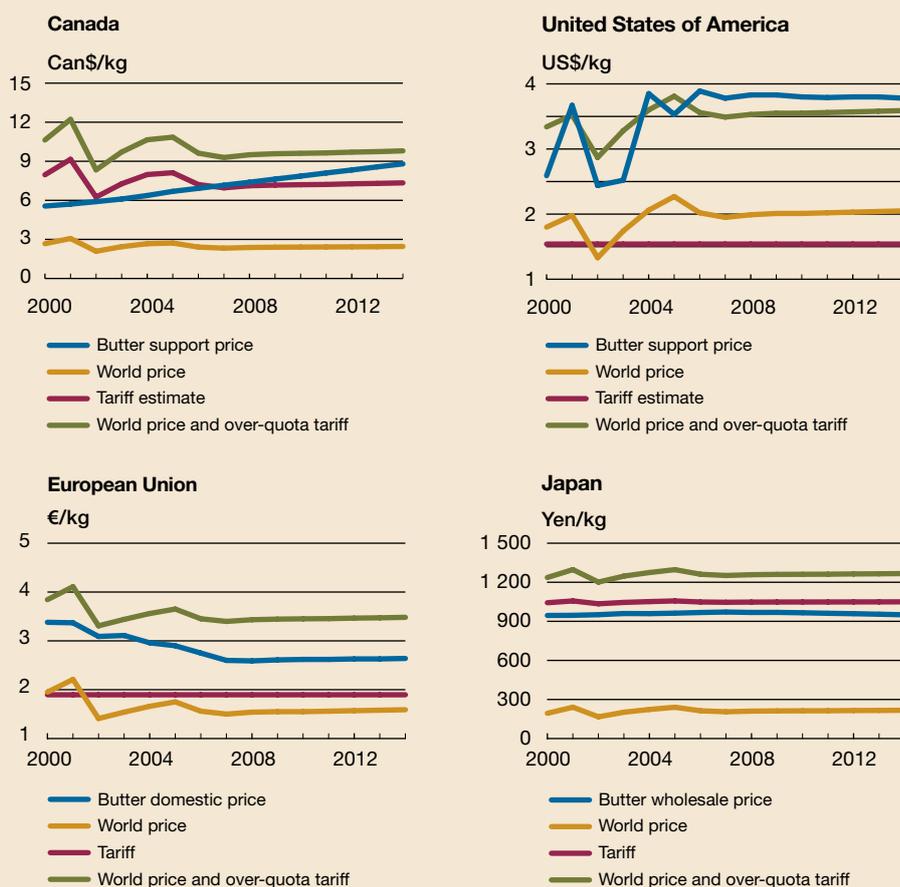
Dairy tariff statistics: average over-quota or single tariffs, 2002

| Product | Bound tariff (percentage) | | Applied tariff (percentage) | | Difference (percentage) |
|-----------------------|---------------------------|-----|-----------------------------|-----|-------------------------|
| | Mean | Max | Mean | Max | Mean |
| Butter | 57 | 573 | 28 | 447 | 29 |
| Cheese | 50 | 494 | 23 | 265 | 26 |
| Concentrated products | 54 | 496 | 24 | 303 | 29 |

Note: Tariff data refer to averages of out-of-quota tariffs or single MFN tariffs where there is no quota, for all countries.

Source: FAO/UNCTAD, 2006.

Tariff “water” for butter, selected countries and regions



Source: Calculations from OECD-FAO, 2005.

Import surges, market disruption and the special safeguard mechanism

Trade liberalization not only exposes the agriculture sectors of developing countries to intensified competition from imports, it also increases vulnerability to sudden, short-run inflows of imports – import surges – which can disrupt domestic food markets and production. Such vulnerability is of particular concern to developing countries that are endeavouring to develop their agricultural potential and to diversify production.

That import surges and depressed import prices pose threats to domestic market stability is no longer contested. There have been many reports of developing countries, particularly low-income food-deficit countries (LIFDCs), experiencing increasing numbers of import surges of various food products, notably since the mid-1990s when import barriers were lowered. FAO analysis of food import data for 102 developing countries between 1980 and 2003 confirms this picture, finding more than 7 000 import surges, with increasing frequency after 1994 (FAO, 2005f). Consequent negative effects on domestic production, industry and employment have also been claimed.

Import surges – a widespread phenomenon

FAO analysis shows that while the phenomenon of import surges is widespread, both geographically and by commodity, some product groups and regions have been more affected than others. Among food groups, the most affected were vegetable oils, meats and coarse grains. Using the definition of an “import surge” as an increase of 30 percent or more over average imports in the previous three years, the incidence of import surges

ranged from less than 10 percent for cereals (about one every ten years) to 21 percent for vegetable oils (or one every five years). Among individual commodities, those most frequently subject to import surges were pig and poultry meats, palm oil, sugar and eggs, all ranging around 20–23 percent in frequency. Although all countries have experienced import surges, some appear to have been affected more often than others: in Asia, Bangladesh and India; in Africa, Ghana, Kenya, Malawi, Nigeria and Zimbabwe; and in Latin America, Ecuador and Honduras. Some 50 countries (or nearly half of those covered by the analysis) experienced more than 70 import surges during the 23 years studied.

The factors contributing to import surges include country-specific factors such as weather variability, exchange rate movements, changes in trade policies, domestic market liberalization and foreign direct investment with links to food trade. But import surges can also result from transitory exogenous factors, either policy or market driven, which may lead to sharp declines in world commodity prices. Resulting import surges can, in turn, impose significant injury on domestic industries with implications for short-term profitability and long-term investment in the sector, in some cases having a negative impact on employment, rural poverty and food security. While short-term domestic production shortfalls resulting from the vagaries of climate can result in a surge in imports, these additional supplies are often necessary to maintain consumer access at acceptable prices. However, there are numerous cases of implementation of tariff reduction commitments by developing countries that are



associated with more frequent import surges that have damaged or threatened to damage or displace viable domestic production, and which have had a negative impact on employment, rural poverty and food security.

The need for protection – the special safeguard mechanism

The escalating frequency of press coverage related to import surges and their associated disruption of local markets in developing countries and injury to local producers highlights developing countries' lack of access to effective safeguard instruments. Given this experience, agreement was reached in the July 2004 Framework that a special safeguard mechanism (SSM) involving an additional tariff to defend against import surges will be established for the developing countries. This instrument is to be simple and effective.

Under existing agreements, many countries do not have access to an effective safeguard instrument and are reluctant to reduce their bound tariffs below levels that would impede them from varying applied tariffs for safeguard purposes. Whereas the development of appropriate trade remedy measures could potentially meet some of the concerns of developing countries with regard to import surges, the imposition of any trade restraint measure to counter damaging import surges needs to be anchored in an analysis of the impacts, and in particular the resultant disruption and injury to domestic agriculture. Arbitrary recourse to safeguard measures, in the absence of proven injury, could have a negative impact on economic growth and consumer well-being by limiting resources for other, relatively more viable domestic industries.

The basic idea of establishing an SSM for developing countries is a positive development because it allays fears of liberalization and provides a concrete instrument to respond to the problem of import surges. Although agreements

have been reached on some of the elements of the SSM, discussions continue on the other more problematic elements such as triggers and remedies (namely, the type and amount of additional trade restrictions imposed in the case of a surge). The challenge is to devise appropriate triggers and remedies so as to balance the defensive interests that a SSM is expected to safeguard while not undermining the offensive interests of exporters in terms of market access.

Designing a special safeguard mechanism

From the outset, negotiations over the SSM covered four key elements or "design" aspects of the instrument:¹ Which countries will have access? Which products will be covered? How will the mechanism be triggered? What will be the remedy? By the time of the WTO Ministerial Declaration in December 2005 (WTO, 2005), agreements had been reached on two elements: that all developing countries will have access to the SSM; and that there will be both price and volume triggers. Other elements remain undecided.

Product eligibility

The July 2004 Framework Agreement was quiet on whether the SSM would be limited to some products only, or would apply to all tariff lines. During the negotiations, a number of ideas arose, ranging from limited product eligibility based on certain criteria to no restriction whatsoever. The latter position was taken by the G33 group of more than 40 developing countries. Argentina, Paraguay, the United States of America and Uruguay, on the other hand, proposed some restrictions. These included restriction to only those products that have taken the full tariff cuts as per the standard tariff-cutting formula; those products for which new, reduced bound tariffs fall below recent applied rates; and those products that are produced domestically or are close substitutes for products produced domestically.

The triggers

It has been agreed that there will be both price and volume triggers. The subsequent negotiations have concerned the conditions under which a country would be allowed to trigger an SSM.

The price trigger

The price trigger of the Uruguay Round agricultural special safeguard (SSG) was based on a fixed reference price in a base period. An SSG is triggered when the current import price falls below the fixed reference price. The G33 proposed three-year moving averages of import prices as the reference price. Some others have proposed a combination of moving average and fixed references. In each case, an SSM would be triggered when current import price falls below the reference price. The key question is which of the alternative references is preferred given the simplicity and effectiveness objectives. Movements in current and moving average prices for sugar are illustrated in the graph on the following page.

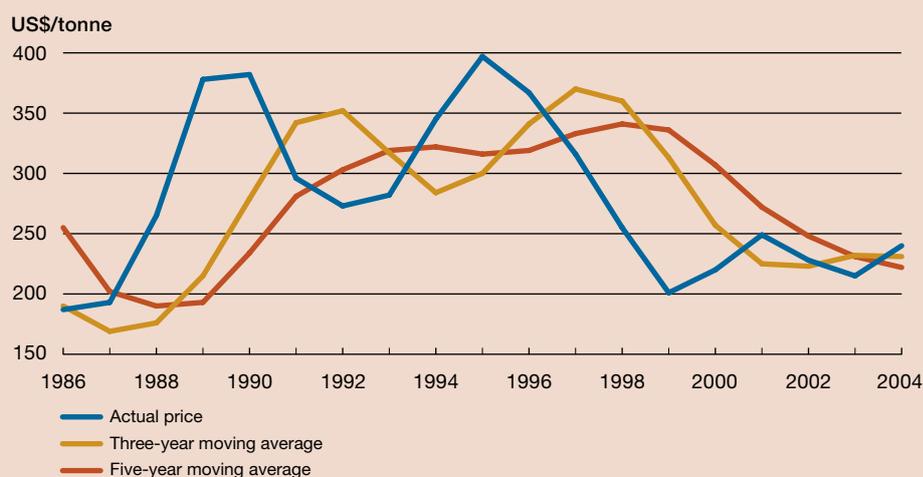
The main advantages of the fixed reference price option are simplicity and fewer data needs, whereas the main disadvantage is that the fixed price does not incorporate recent information on prices, unless updated periodically. As a result, when current prices deviate significantly from longer-term trends, safeguards may be triggered inappropriately. FAO analysis based on world market prices of ten food products confirms that this is the case.

This weakness is avoided, however, with references based on moving averages. The same analysis shows that the three-year moving average reference price does a good job (most of the time) in triggering a safeguard when prices are depressed. However, this reference price was found to have missed (i.e. failed to trigger during) those periods when depressed prices were persistent. A five-year moving average reference

¹ For further detail on the key components of the SSM, see FAO, 2005c.

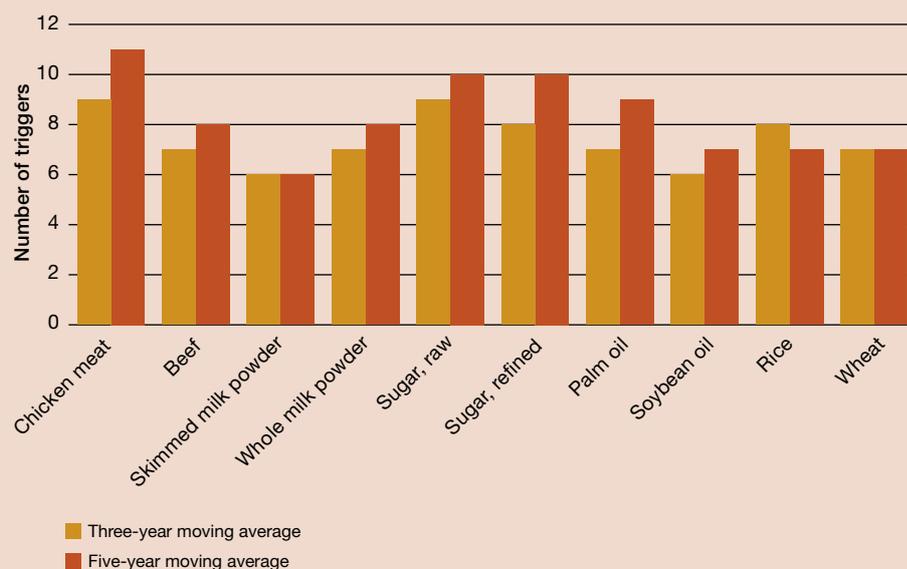


Three- and five-year moving average prices for white sugar



Source: Sharma, 2005.

Simulated total number of triggers for various commodities for three- and five-year moving average reference prices, 1986–2004



Source: Sharma, 2005.

price, on the other hand, triggers safeguards even in those cases, and may therefore be more effective.

The volume trigger

The formula for the Uruguay Round SSG volume trigger was based primarily on the import levels for the previous three years, with adjustments made for the degree of import penetration and change in consumption in the previous period. The G33 proposal for an SSM is

similar, but is based only on the import levels for the previous three years. A safeguard is triggered when the current import volume exceeds the trigger level.

An analysis of various trigger mechanisms for a sample of ten cases in 1990–2004 shows that the moving average import reference (both three-year and five-year) triggers safeguards about 60 percent of the time. Opinions differ on whether this level of safety is about right or whether it is too high.

Remedies for import surges

The word “remedy” refers to the corrective measure taken following a trigger. In the case of the SSM, as in the SSG, this concerns the additional tariff to be levied. The issue is, how much additional tariff should be imposed?

Under the existing SSG rules, in the case of a price trigger, the additional duty varies with the depth of the price depression below the fixed trigger level. The SSG response was designed to offset only a part of the price depression. For example, allowed extra tariffs are 4 percent for a price depression of 20 percent, 28 percent for a depression of 50 percent and 70 percent for a depression of 80 percent. The additional tariff escalates for price depressions of more than 80 percent. As regards the SSG volume trigger, the additional duty is fixed at a maximum of one-third of the level of the duty in effect in the year in which the action is taken.

The G33 text released in early 2006 proposed remedies for both triggers. For the price trigger, the maximum additional duty would fully offset the gap between the reference and current import price. In contrast, the other two proposals made in the WTO are for offsetting the gap only partially. This is certainly the case with the joint proposal from Argentina, Paraguay and Uruguay, in which a schedule was presented of additional duties that vary with the extent of the price depression (as in the SSG), but offsetting the price gap only partially. The remedy in the United States’ proposal does not relate additional duties to the gaps, but is determined by a formula based on current and Uruguay Round bound tariffs. There is indeed no easy way to determine an optimum level of the remedy that would be most effective for all countries and products, but the main issue seems to be whether the degree of offset should be full or partial.

In the case of the remedy for volume surges, the G33 proposed a schedule of additional duties that

Total number of triggers for three- and five-year moving average reference import levels, 1990–2004

| Importer | Product | Number of triggers | |
|--------------------------|----------------|--------------------|-----------|
| | | MA-3 | MA-5 |
| Cameroon | Chicken meat | 8 | 8 |
| Ghana | Chicken meat | 11 | 11 |
| Jamaica | Chicken meat | 6 | 7 |
| Senegal | Milk powder | 6 | 5 |
| Sri Lanka | Milk powder | 8 | 10 |
| Cameroon | Rice | 12 | 13 |
| Honduras | Rice | 12 | 13 |
| Nicaragua | Rice | 8 | 7 |
| Cameroon | Sugar, refined | 12 | 11 |
| Tanzania, United Rep. of | Sugar, refined | 9 | 8 |
| Total | | 92 | 93 |
| Percent triggered | | 61 | 62 |

Note: MA-3 and MA-5 are three- and five-year moving average reference import levels, respectively.

Source: FAO.

vary with the extent of the surge itself, such that the additional duty is higher when imports are high. In contrast, additional duty in the joint proposal from Argentina, Paraguay and Uruguay is fixed at 20 percent of the current bound tariff, while the remedy in the United States’ proposal is the same as for the price trigger, as noted above. Trade theory suggests an approach to determining an appropriate level of additional duties for a given level of import surge, but this may not be practical in a negotiating context as the formula depends on parameters such as the import elasticity of demand for the product, which may not be known with any accuracy.

Tariff preferences and their erosion

The need to address the issue of preference erosion was underscored by the Framework Agreement. Many developing countries enjoy trade or tariff preferences through which their exports of certain products gain access to developed country markets at lower tariff rates than are charged to other exporters (“most favoured nation” or MFN rates). In some cases – exports from LDCs under the EU’s “everything but arms” (EBA) initiative, for example – the tariff is reduced to zero. Preferences can be either reciprocal or non-reciprocal. Reciprocal preferences occur when two countries offer each other trade concessions not offered to other countries. Non-reciprocal trade preferences are trade arrangements where a country unilaterally offers concessions to one or more other countries. Non-reciprocal trade preferences are important for many of the poorest and most vulnerable developing countries. About 80 LDCs and small island developing states (SIDS) benefit from non-reciprocal preferences, although they account collectively for less than 2 percent of world agricultural exports.

The preference is a lower tariff rate to be paid compared to that paid on imports from other countries. The difference between the two rates is the preference margin. Developing countries receiving tariff preferences enjoy higher export volumes and values from their trade with the preference-giving country. In principle, this should contribute to their growth and development. The preference-giving country loses tariff revenue equal to this preference margin on each unit of imports from the countries holding the preference. As imports from the preferential exporters can be sold in the domestic

markets of the preference-giving countries at the same prices as imports from any other source, the exports of preference-receiving countries obtain a price higher than the world price – again, by the amount of the preference margin. There is therefore a potential transfer to the exporting country from the budget of the preference-giving country, in the sense that the preference margin is tariff income foregone by the importing country. However, this transfer income does not necessarily go to producers and exporters in those developing countries holding the preference; the transfer can be shared through the value chain between importers, traders and consumers in the importing country and exporters, traders and producers in the exporting country. Exactly how it is shared will depend upon a variety of factors, including the relative market power of these different players in the value chain, the extent to which the product differs between different exporters and the particular market situation.

In agriculture, such schemes are of particular importance to a few countries and in the case of a limited number of products². For preference holders, trade preferences are seen as providing access to developed country markets, as well as increasing export volumes and prices for products that they might not otherwise be able to trade competitively. They are of special value to SIDS because their small domestic markets, which limit their ability to exploit economies of scale and diversification

² For further discussion of the issues pertaining to agricultural preferences in the context of the WTO negotiations, see FAO, 2005g.



opportunities, and their limited resource base make it difficult for them to achieve and maintain competitiveness. Preferences can therefore increase their populations' welfare by sustaining employment, incomes and economic growth. At the same time, limited product coverage, administrative constraints on preference utilization (such as complicated rules of origin), the high costs of compliance with technical, sanitary and phytosanitary regulations and domestic supply-side problems in some countries have limited the ability of many beneficiaries to take full advantage of trade preferences. Moreover, where they have been effective, the incentives provided to the producers of preference-receiving products may have reduced the incentives to invest in other competitive sectors. The usefulness of preferences to the recipient countries in contributing to their long-term growth and development has therefore been questioned.

Preferences also discriminate between preference holders and other developing countries, potentially constraining the development prospects of the latter. In practice, the relative share of preferential trade in global agricultural exports has been declining over the past decade, suggesting that preferences have not significantly curtailed the market opportunities of third countries. Within the WTO, an "enabling clause" is the legal basis that permits deviation from the principle of non-discrimination among WTO members for the granting of trade preferences to developing countries. The clause requires, however, that there be no discrimination among developing countries in the granting of trade preferences, except for special treatment in favour of the least developed among them (the LDCs). Individual developed countries sometimes grant specific preferences for limited groups of developing countries that include non-LDCs, such as those the EU extends to African, Caribbean and Pacific (ACP) countries under the Cotonou Agreement, which

provides duty-free access to EU markets for 77 ACP countries, and includes special protocols that give considerable preferences to certain ACP countries for bananas, sugar, rice and rum. This agreement has in the past been deemed not compatible with the enabling clause and it has required a waiver by WTO members of the existing rules for its continuation during a defined period. However, a recent WTO appellate ruling suggests that schemes that discriminate in favour of some non-LDC developing countries may be consistent with the enabling clause, provided they meet conditions related to that clause and extend the same preferences to all developing countries of the same status.

Commodities traded under preferences share some of the characteristics and concerns of special and sensitive products. However, preferences raise certain particular complications given that although developing countries may benefit from preferences, they are offered by developed countries. Furthermore, they may be an adjunct to the support and protection that the developed countries give to their own agriculture sectors, as in the case of sugar in the EU. Policies in support of these products in preference-granting

countries have been among the most restrictive and have been challenged in the WTO. Challenges involving preferential trading schemes in the WTO have been upheld, notably relating to the EU's trade in bananas and sugar, which accounts for the bulk of preferential trade. Radical changes in the EU's Common Market Organization for sugar – which will mean a significant reduction in the EU sugar support price – have recently been agreed by the EU agricultural ministers. Apart from EU sugar producers, the reform will affect developing countries and LDCs that depend on the preferential treatment and the consequent higher prices that they enjoy for sugar exports to the EU, and which are linked to the EU sugar support price. In the case of bananas, preferences for certain ACP imports into the EU have been affected by the substitution of the previous EU tariff rate quota banana import system by a tariff-only system in 2006, again in response to a series of WTO rulings. These two cases are discussed in more detail in the following sections.

All developing countries, including those holding preferences for certain products, should benefit from general MFN tariff reductions, which will improve their access to developed

Sugar and banana exports and preferences: values from selected countries, 2000–02

| | Exports as a percentage of agricultural exports | Exports as a percentage of total merchandise exports | Exports as a percentage of GDP | Value of preferences as a percentage of GDP |
|----------------|-------------------------------------------------|------------------------------------------------------|--------------------------------|---------------------------------------------|
| Sugar | | | | |
| Fiji | 55 | 20 | 6.3 | 3.5 |
| Guyana | 41 | 20 | 14.0 | 9.3 |
| Jamaica | 26 | 4 | 0.9 | 0.7 |
| Mauritius | 74 | 6 | 5.7 | 4.6 |
| Bananas | | | | |
| Dominica | 63 | 26.0 | 4.7 | 0.71 |
| Saint Lucia | 68 | 65.0 | 4.3 | 0.71 |
| Saint Vincent | 50 | 38.6 | 4.6 | 0.94 |

Source: FAO, 2004b.

country markets. As MFN tariffs are reduced, the preference margins and hence the relative benefits of trade preferences to the beneficiary countries will erode. Economic analyses of this trade-off suggest that, in aggregate, the gains from multilateral tariff cuts would more than compensate for the losses from erosion of preferences. However, there are a number of countries, particularly but not exclusively SIDS, that are highly dependent on exports of certain products under preferential arrangements, notably bananas and sugar. These can account for a significant share of their total export earnings, incomes and employment, so preference erosion has potentially severe economic consequences. For them, the benefits of multilateral tariff cuts would not compensate for the loss of preferences. There is concern among those seeking greater trade liberalization that the continued existence of preferences could result in less-than-hoped-for liberalization because preference-receiving countries will not press for ambitious cuts in MFN tariffs, and preference-granting countries could use the provision of preferences as an argument for the maintenance of support and protection to their own agriculture. At the same time, the erosion of preferences seems unavoidable as tariffs are cut generally in multilateral negotiations, new bilateral and regional trade agreements are signed and developed country policies involving preferential schemes are challenged in the WTO. The main questions relate to how much economic damage will be incurred as a result of the loss of preferences, and what can be done to mitigate this damage. Consensus on further reductions in MFN tariffs in the WTO will depend upon the answers to these questions.

There have been suggestions as to how to maintain and improve the operation of at least some preference schemes where these can be shown to have significant net benefits and the countries concerned actually need them because their exports would otherwise not be competitive. The

emphasis could be on maintaining “deep” preferences that provide significant market access concessions for a limited number of countries that need them, as opposed to “shallow” preferences for all developing countries. The difficulty here is to reach agreement on the criteria for how countries and products are to be identified, and what the preference concession should be. It has also been suggested that the benefits of preferences might be maintained, at least temporarily, by treating the commodities concerned in a similar way to special products. By limiting the extent of tariff reductions for these products or by delaying or extending the timetable for their implementation, the degree of preference erosion could be reduced. Where preference erosion occurs and a country suffers economic losses as a result, an argument might also be made for negotiation of compensation.

Fundamentally, to cope with significant erosion of trade preferences, the current beneficiary countries will need adjustment assistance to enhance the productivity and competitiveness of their preference-dependent agricultural commodity sectors, or to facilitate the diversification and exit from such sectors. Until many preference-receiving developing countries improve their supply capacity and competitiveness, they will stand to lose from further MFN tariff reductions or participation in reciprocal preferential arrangements with developed countries. Prospects for increased access from further liberalization for preference-receiving countries are likely to be limited, because beneficiary countries already enjoy low tariffs.

Erosion of trade preferences – bananas in the Caribbean

Bananas provide a good illustration of the kind of problems that preference erosion presents to small vulnerable economies.

Bananas are grown in all tropical regions and are the world’s most



exported fresh fruit in terms of volume and value, accounting for more than half of the cargoes of fresh fruits and vegetables shipped from ACP countries to Europe. Banana export revenues contribute substantially to the economies of many low-income food-deficit countries, including Cameroon, Côte d'Ivoire, Ecuador, Guatemala, Honduras and the Philippines. Bananas are also key crops of overseas territories of the European Union, such as the French Antilles, Madeira and the Canary Islands. Bananas have also been of vital importance to the economies of certain small island developing states in the Caribbean – notably Jamaica and the Windward Islands – where bananas have been the main agricultural export and have generated a substantial share of employment and incomes. However, without the benefit of the trade preferences granted to certain ACP states by the EC, which guaranteed a market share by quota at higher than world prices, Caribbean exports would not have been competitive. The geography, climate and farm structures mean that banana production costs are relatively high and the number of alternative export crops that might be grown is limited.

With the benefit of preferences, the Windward Islands and Jamaica have been heavily dependent on the EC market. The EC, with 25 member states and a population of 450 million consumers with high average income, is the largest market for export bananas, accounting for 44 percent of world imports. Only 16 percent of its domestic consumption is supplied by its (mainly overseas) territories, and the bulk is imported from Latin America, Africa and the Caribbean. The EC's banana trade policy and terms of access to EC markets therefore have a major impact on world markets and on the prospects of exporters in all these regions.

Until December 2005, the EC limited banana imports from different groups of suppliers through a complex system of tariff-rate quotas.

Main characteristics of the EU banana import systems, 2005 and 2006

| Origin | 2005 | | | 2006 | | |
|---------------------|----------------|------------------|------------------------------|----------------|------------------|------------------------------|
| | Quota (tonnes) | Tariff (€/tonne) | Above-quota tariff (€/tonne) | Quota (tonnes) | Tariff (€/tonne) | Above-quota tariff (€/tonne) |
| All third countries | 3 113 000 | 75 | 680 | none | 176 | – |
| ACP countries | 750 000 | 0 | 380 | 775 000 | 0 | 176 |

Source: FAO.

Certain ACP countries – mainly Cameroon, Côte d'Ivoire and Jamaica – and the Windward Islands were allocated a quota of 750 000 tonnes that could enter duty-free, while other, Latin American suppliers were allocated a quota of 3.1 million tonnes, but with a tariff of €75 per tonne. Imports above either of these quotas faced significantly higher “prohibitive” tariffs. With the overall quantity of imports limited by the quotas, EC banana prices were maintained much higher than those in other countries, such as the United States of America. These higher prices, together with the quota allocation, meant that the Caribbean producers could export to the EC in spite of their higher production costs.

A series of complaints against this system were brought in the WTO. Basically, the argument was that in granting trade preferences to ACP suppliers, the system discriminated against Latin American suppliers and limited their access to the EC market. In January 2006, the EC simplified its import system by replacing the tariff rate quotas with a tariff-only regime. The tariff was set at €176 per tonne. ACP imports enter duty free up to a limit of 775 000 tonnes, so a trade preference for ACP countries remains. The passage from the old to the current system, and especially the setting of the tariff level, raised considerable political and economic debate and controversy (see FAO, 2005h). Latin American suppliers argued for a lower tariff. Among the ACP suppliers, though the West African producers could be

competitive with the preference margin of €176 per tonne, the Caribbean producers argue that this is inadequate to compensate for their higher production costs.

The new import system has replaced the quota on third-country imports with a tariff of €176 per tonne with no quantitative restrictions. It has kept a duty-free quota for bananas imported from ACP countries. The new import system also has implications for the market shares of the various ACP countries, and in particular the balance between Caribbean and West African producers. Under the previous system, which prevailed from 1993 to 2005, the duty-free import quota reserved for these countries was distributed on the basis of the quantities imported in a specific reference period in the past (“historical references”). More than half of the quota was allocated to Caribbean suppliers, in particular the Windward Islands and Jamaica, and the remainder was distributed to African suppliers. However, over the period 1993–2005, exports from the Windward Islands and Jamaica decreased while those from Cameroon and Côte d'Ivoire rose markedly. This led to a situation in which, due to the system of historical references, the Windward Islands and Jamaica received more EU quota rights than the quantities they exported, while Cameroon and Côte d'Ivoire were in the opposite situation and had to buy quota rights from these two exporters. This situation has changed with the new import system,

as some 60 percent of the import quota is now allocated on a “first come, first served” basis. The banana industries of Cameroon and Côte d’Ivoire claim that the new system is fairer because it reflects better their competitiveness *vis-à-vis* other ACP suppliers. Conversely, the Windward Islands and Jamaica fear that it may severely reduce their exports, and they argue that their banana industries need the revenues obtained from the sales of unused quota rights to offset their higher costs of production.

Caribbean banana-exporting countries are also concerned about the future of the duty-free access for their bananas when the EC-ACP Cotonou Agreement expires at the end of 2007. The EC has expressed its intention to replace the agreement with economic partnership agreements (EPAs) to be negotiated separately with each ACP country. It is not clear whether the EC would continue to provide similar trade preferences under the EPAs and whether WTO members would grant the necessary waiver to the GATT rules. The EBA initiative, which will eventually allow unlimited duty-free imports of bananas into the EC from LDCs, is a further concern for Caribbean exporters because they are not LDCs.

The reduction in the degree of preference resulting from the changes in the EC’s banana import regime leaves the Caribbean industry vulnerable. Furthermore, if Caribbean producers cannot compete for licences for the duty-free quota against West African producers under the new first come, first served system, their preference margin would disappear altogether. The reduction in the degree of preference is the result of the need to comply with the WTO judgements against the previous EC banana import regime. It is not due to tariff reductions agreed in multilateral trade negotiations, although such negotiations might well lead to MFN tariff reductions. This latter possibility has led Caribbean producers to ask that the EC designate bananas as a sensitive product to limit future possible tariff

cuts and further shrinkage of the preference margin. The vulnerability of the Caribbean industry highlights the urgent need for improving its productivity and competitiveness, as well as to examine possibilities for diversification, if it is to withstand any further reduction in the preference margin. The EC has already provided assistance to this end under its Banana Support Programme and Special Framework Assistance.

Trade liberalization and preferential trade agreements – sugar

Preferential access to EU sugar markets is covered by the long-standing Sugar Protocol (SP) and the special preferential sugar (SPS) agreements. These grant duty-free access to sugar that originates from African, Caribbean and Pacific countries, subject to quotas. Since their inception in 1975, these agreements have aimed at sustaining employment and incomes in developing countries and LDCs, among which are many small island developing states that depend on sugar production and exports. In addition to these agreements, the EU’s EBA initiative, which came into effect in 2001, also discriminates in favour of the LDCs by granting duty-free access to imports of all products that originate in these countries, with the exception of arms and munitions. Imports of sugar under the EBA initiative are subject to tariff rate quotas, with duty-free in-quota imports and a gradually reducing tariff for out-of-quota imports until 2009. Much attention has been focused on the impact of trade liberalization on these agreements, and on the consequent reduction in the value of preferences for the beneficiary countries. More significantly, radical changes in the EU sugar policy will involve a 36 percent reduction in the current intervention price over four years beginning in 2008.

This will affect the price received by the ACP countries, eroding their preference margin and thus reducing



their export earnings. Given that many of these countries are dependent upon sugar production, with sugar exports accounting for a large share of total export earnings, these reforms will have negative repercussions on their economies.

Trade constraints in LDCs

For the LDCs, which will be granted full duty-free access to the EU sugar market from 2009 onwards, the EU Common Agricultural Policy reform in the sugar sector will lessen the preference margin. Nevertheless, these countries will benefit from the EBA initiative, for the difference between the world price and the EU price is likely to continue to be significant. An important issue for the LDCs is their ability to exploit the market access opportunities brought about by the EBA initiative, as trade costs may be an impediment to increasing sugar exports significantly. In general, these costs are determined by distance, infrastructure and communication technologies and include freight costs, information costs, contract enforcement costs, currency exchange costs, inventory and holding costs and regulatory costs. Given the poor infrastructure in many LDCs, as well as the demanding regulatory requirements for exporting under the EBA initiative, such costs may be prohibitive for LDCs. Rules that govern trade under the EBA may be relatively strict, thus resulting in underutilization of preferences. Such rules define specific requirements related to the transport of products that originate in LDCs, as well as the amount of value that has to be added to imports of LDCs from non-LDCs in order to be treated as LDC-originating products.

Estimating the impact of the policy changes

A recent FAO study focused on the impact of the EU sugar policy reform on preference margins and export revenues accruing to the ACP countries that are signatories of the SP and SPS agreements, and on the impact of the EBA initiative on LDCs, taking into consideration the

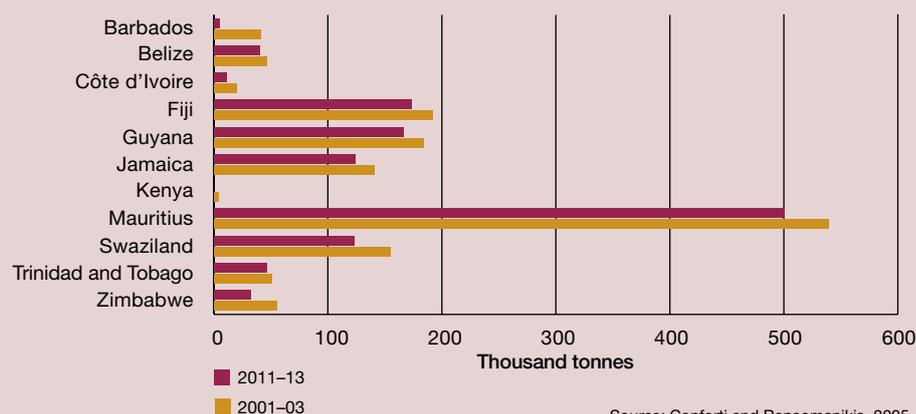
trade costs these countries are likely to face (Conforti and Rapsomanikis, 2005). The study identifies three country groups among those enjoying preferential access to the EU market: ACP developing countries, ACP least-developed countries that can export under both the SP and the EBA initiative and LDCs that are expected to export only under the EBA initiative.

Exports to the EU from ACP developing countries that currently enjoy preferential access under the SP and the SPS agreements are expected to contract, as a result of the abolition of the latter, as well as the reduction in the EU support price. The latter measure will have a significant impact on relatively high-

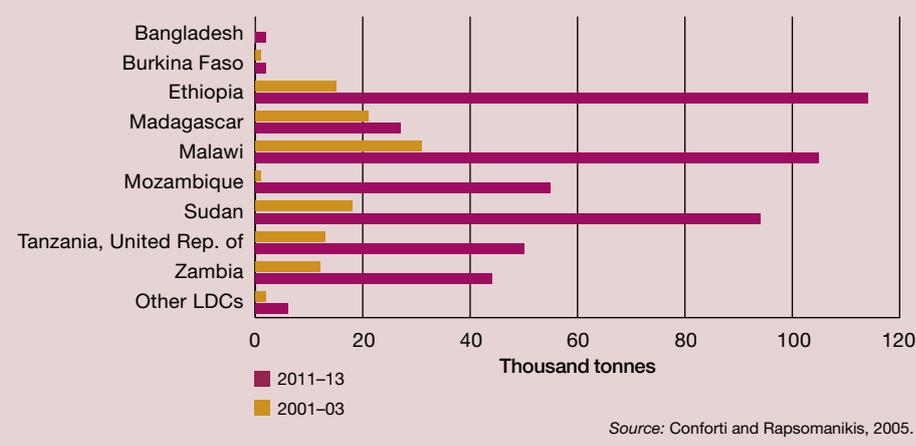
cost producers, such as Barbados, where exports to the EU are expected to fall significantly. The elimination of SPS agreements will negatively affect some ACP countries with lower production costs such as Côte d'Ivoire, Fiji, Guyana, Jamaica, Mauritius, Swaziland and Trinidad and Tobago.

For least-developed ACP countries that currently export to the EU under the SP and SPS agreements and have already established infrastructure that facilitates trade, the EBA initiative will imply a progressive increase in duty-free access to the EU market, which will become unlimited after 2009. For example, Malawi and the United Republic of Tanzania are expected to increase their exports to the EU

Sugar exports from ACP non-LDCs



Sugar exports from LDCs to the European Union



significantly. The LDCs that are not SP and SPS agreements signatories will enjoy significant benefits from the EBA initiative. Some of these LDCs are important sugar producers, such as Ethiopia, Mozambique and the Sudan, and are expected to increase their exports to the EU significantly. Sugar exports to the EU from other LDCs, such as Chad, Mali, Mauritania and Sierra Leone, are also expected to increase, but to a lesser extent. These countries are not significant sugar exporters, but have regularly been exporting small amounts of sugar to the EU in recent years.

On the whole, the EU policy reform is not expected to alter the LDCs' export trends to the EU, as long as the preference margin remains high. However, the recent increase in world sugar prices may affect export

trends as trade costs are important in shaping trade flows. The unlimited duty-free access to the EU market under the EBA initiative would, in theory, allow the LDCs to export their entire domestic production to the EU, while at the same time importing refined sugar at the world market price in order to cover their domestic food consumption needs. However, the analysis suggests that in the medium run, the rate of growth in LDCs' exports to the EU will be affected by their ability to overcome trade costs. In the long run, infrastructure improvements, better transport networks, information technology and services are likely to result in a decrease in transport costs, thus leading to further increases in sugar exports from the LDCs to the EU.





Conclusions: development priorities, the Doha Round and beyond

Trade agreements that include commitments to reduce levels of border protection and trade-distorting support to the agriculture sector often fail to reflect the heterogeneity of trading partners and their legitimate concerns for flexibility in implementing these agreements. Largely as a result of past experience in the negotiation and implementation of multilateral trade agreements, many countries are hesitant to commit to further trade liberalization given the significant risks that it can impose and the intangibility of potential benefits.

This hesitancy has been a key reason for the lack of progress in the Doha Round of agricultural trade negotiations. Although there is general agreement that, in aggregate and in the longer run, trade reforms should have a positive effect on development and growth, and hence on reducing poverty and food insecurity, in the short run liberalization may offer little benefit and can impose significant costs on developing countries, a group that includes the most vulnerable and poor. The interests and priorities of different developing countries are not the same, and there would undoubtedly be losers as well as gainers from any further liberalization that did not fully take account of the development concerns of these countries.

As this issue of *The State of Agricultural Commodity Markets* has argued, countries dependent on exports of tropical products may find little benefit in terms of improved access to developed country markets because import tariffs are typically already low. In general, tariff reductions alone will be insufficient to stimulate export growth in these products, although reductions in the extent of tariff escalation may remove an obstacle to efforts to

diversify and add value to exports. Developing countries holding trade preferences are another group for which liberalization may have adverse consequences as tariff reductions erode the benefits of preferences.

In addition, many of the poorest developing countries are also increasingly dependent on imports for a significant share of their food supplies. Because liberalization of global food markets is expected to lead to an increase in the prices of temperate food products on world markets, food import bills will increase correspondingly. Perhaps even more significant, the reduction by developing countries of import tariffs under a multilateral agreement exposes their domestic agriculture sectors to intensified international competition and a threat of disruptive import surges. In either case, domestic food production, which makes up the bulk of domestic food supplies, could be affected, with a consequent challenge to national food security.

In light of these concerns, it is not surprising that the Doha Round of negotiations has been preoccupied to some extent with measures to mitigate those effects under the broad heading of special and differential treatment, notably the designation of special products and a special safeguard mechanism. The Sixth Ministerial Declaration proposed that developing countries “will have the flexibility to self-designate an appropriate number of tariff lines as Special Products, guided by indicators based on the criteria of food security, livelihood security and rural development” (WTO, 2005). Developing countries themselves are not unified in support of special products, and negotiators in the Doha Round have struggled to reach acceptable operational solutions. Special products might be



counter to the interests of developing countries that are exporters of agricultural products, and in fact those countries have argued for setting limitations on the range of products that can be designated as “special” to avoid restricting market access for their products. Other countries have also called for limiting the number of products that can be designated as special to avoid protection of too many imported products. Various countries also have different views on special safeguard mechanisms, which would allow the imposition of higher tariffs to counter import surges. Some agricultural-exporting developing countries fear that these might limit their exports to other developing countries, and have argued that safeguards should be triggered only by increases in imports significantly above normal levels.

The potential erosion of preferences has also provoked suggestions as to how they might be maintained, at least for certain countries in relation to certain products – the idea of “deep preferences”. But the question immediately arises, which countries and which products?

What has become clear is that a multilateral agreement that includes commitments to further reductions in border protection is unlikely to be achieved unless such concerns are more adequately addressed than they have been to date. The stalling of the Doha Round in late July 2006 provided an opportunity for reflection as to how best to ensure that such concerns are addressed through flexibilities granted within the trade agreement, rather than provisions falling under the category of “best endeavour”. Although the threats of intensified import competition, import surges and preference erosion are real, all the measures proposed to mitigate them involve a relaxation of the concept of broad-based liberalization and preserve or re-introduce an element of protectionism, and this fact would require acceptance among all negotiating parties.

However, although critical to the resolution of the current round of negotiations, the designation of

special products and the safeguard mechanism, as well as measures to address concerns about the erosion of preferences, are measures that on their own cannot address long-term structural problems of agriculture in the developing countries. As tariffs are reduced multilaterally, the agriculture sectors of developing countries need to be in a position to benefit from new export opportunities and to withstand intensified international competition. Expanding exports will require overcoming several supply-side constraints, as well as success in meeting increasingly stringent standards of international trade. Developing countries will have to be competitive, and they will need assistance to develop such competitiveness.

International recognition of the need for developing countries to improve their productivity and competitiveness and the role of the international community in providing appropriate assistance is apparent in the current discussions of the “aid-for-trade” initiative. However, the need for aid for trade goes beyond the current context of coping with the implications of multilateral trade reform. The fundamental problems of supply-side and institutional constraints, which limit the ability of developing countries to adjust to a changing trade environment, need to be addressed. Various international organizations have come together through the “integrated framework” to provide support to LDCs in diagnosing their trade constraints and coordinating international assistance. However, this framework needs further strengthening and broadening to provide a wider range of assistance to a wider range of countries.

The potential range of assistance required is broad. Priorities need to be determined on an individual country basis according to a detailed analysis of the constraints that each faces. At the heart of any strategy aimed at improving competitiveness, there is a need to focus on productivity and technology issues at the farm level, with interventions according to the country’s stage of agricultural

development. However, beyond this, efficiency throughout the commodity value chain needs to be addressed. This includes investment to improve the functioning of markets – key to stimulating private sector investment in the area of agriculture – as well as state investment in market information systems, investment in rural infrastructure, roads and other transport networks, storage facilities, port facilities and communications. Investments will also be needed in technology, institutions and expertise to meet product standards – not only public sanitary and phytosanitary standards, but also increasingly stringent standards by the private sector, including traceability and social and environmental certification. The necessary background to all these measures is a favourable policy and institutional environment, supported by appropriate agricultural trade policy. Another policy area that will need to be addressed is how to replace revenues lost as a result of reduced import tariffs, which in many cases account for a significant portion of government revenues.

Finally, as a prerequisite for a positive and equitable outcome of multilateral trade negotiations, capacity in developing countries needs to be built and strengthened to ensure that those countries can analyse and identify options that are in their best interest, and at the same time play a full and effective role in the negotiation process.