FAO TRADE POLICY BRIEFS
on issues related to the WTO negotiations on agriculture

No. 4. EXPORT COMPETITION – appropriate disciplines for eliminating subsidies[1]

SUMMARY

- *During the phase out of export subsidies, product-specific caps or reduction commitments would enhance the transparency and predictability of the process.*
- *Disciplines on export credits with repayment periods of less than 180 days could focus on limiting the deviations of credit terms related to the transaction from those prevailing at commercial rates.*
- *Credits extended to Net Food Importing Developing Countries (NFIDCs) or Least Developed Countries (LDCs), or those used to support transactions of relatively small size, could be made exempt from such disciplines*
- *State Trading Enterprises (STEs) often play a critical role in the international marketing of agricultural products. Monopoly status has been crucial to their effectiveness, but there is inconclusive evidence that they distort trade.*
- *Various forms of food aid have different impacts on trade and varying disciplines are needed for different types of food aid delivery.*

The August 2004 World Trade Organization (WTO) Framework Agreement on agriculture calls for the establishment of "detailed modalities ensuring the parallel elimination of all forms of export subsidies and disciplines on all export measures with equivalent effect by a credible end date". Elimination includes: a) scheduled export subsidies, b) export credits, guarantees, and insurance programmes with repayment periods exceeding 180 days; c) trade distorting activities of State Trading Enterprises (STEs); and d) food aid not conforming to disciplines yet to be agreed. Other aspects to be further disciplined include: a) the terms and conditions of export credits, guarantees and insurance programmes with repayment periods under 180 days; b) other less trade distorting activities of STEs; and c) food aid transactions which may displace commercial imports.

The export competition pillar recognizes that government interventions through export credits, STEs or food aid to dispose of surplus production, could have effects similar to export subsidies in distorting international markets and trade flows. But because the concept of "equivalent effect" is complex and difficult to define, an important first step towards discipline mechanisms is to group policies and actions which produce similar effects and to eliminate or control them together.

1 Export competition: types and effects

EXPORT SUBSIDIES

Only 9 of the 21 WTO members entitled to use export subsidies currently do so and the European Union (EU) accounted for 90 percent of the value of export subsidies notified to WTO in 1995–2000 (see Table 1). In general, export subsidy use has declined greatly over the past decade from about US$7.5 billion in 1995 to less than US$3 billion in 2000. This reflects not only the reduction commitments under the Agreement on Agriculture (AoA), but also unilateral domestic policy reforms, as for example in the EU, which have reduced the need to use export subsidies.

Studies analysing the potential consequences of export subsidy elimination for world market prices have suggested that the longer-term effects may be limited for most commodities, but be more significant where the subsidy comprises a large proportion of the export value, notably in dairy products, sugar and beef.

Short-term domestic price disruptions in markets for import substitutes are generally more visible and potentially more damaging than longer-term effects. Export subsidies can displace not only third-country exports but also

[1] An associated Technical Note provides greater detail on the technical issues raised in this Trade Policy Brief: http://www.fao.org/trade/

domestic production in the importing countries. There is a need for further analysis of the effects of subsidy elimination on bilateral trade flows. This would be more informative than a regional or global market analysis, where models tend to predict small absolute decreases in exports, with in turn negligible effects on world prices.

EXPORT CREDITS

Government-supported export credits allow foreign buyers of exported goods to defer payment under more favourable terms (e.g. over a longer time) than would be available from financial institutions. The value of export credits increased from US$5.5 billion in 1995 to US$7.9 billion in 1998. The repayment period for 45 percent of these credits exceeded one year; and of these, the United States gave 95 percent. A wider range of commodities benefit from export credits than from direct export subsidies but the proportion of exports in any one product group that benefits is rarely over 15 percent.

The effect of export credits depends on both the level of budgetary expenditure on the credits and the terms of credit repayment (e.g. rate of subsidized interest, repayment period, fees, etc.). The subsidy equivalents (Table 2) indicate how much less importers are paying, on average, for transactions with export credits than they would be paying without them. Export credits from the United States are higher in per unit subsidy equivalent than those of other countries, mainly as a result of longer repayment terms.

A key question is to determine the sensitivity of export patterns to export credits. A frequent justification for export credits is that the recipient country suffers from liquidity constraints. In practice, however, export credits apply mostly to middle-income countries and other OECD economies. The Net Food Importing Developing Countries (NFIDCs) and the Least Developed Countries (LDCs) appear to have received only minimal access to export credits.

Table 1: Export subsidies 1995–2000 (million US$)

	1995	1996	1997	1998	1999	2000
European Union (25)	6 587	7 157	4 928	6 072	5 968	2 598
Switzerland	455	392	295	293	269	188
United States of America	26	121	112	147	80	15
Norway	84	78	100	77	126	44
Turkey	30	17	39	29	28	27
Other	122	107	65	38	22	22
Total	7 304	7 872	5 539	6 656	6 492	2 894

Source: Jales, M (2004) The Impact of Export Competition Policies. Presentation at the FAO Informal Expert Consultation on Export Competition. 25-26 November 2004, FAO, Rome.

Table 2: Pattern of export credit use, estimates for 1995-1998 (million $US)

	Total expenditure	Proportion of global total (%)	Credits with repayment period less than one year as proportion of total (%)	Subsidy equivalent (1998) (%)
Australia	6 803	24	100	0.3
Canada	3 613	13	97	1.2
European Union	4 379	16	93	0.0–3.8 [a]
United States of America	12 806	46	6	6.6
Other countries	195	1	71	-
Total	27 796			3.6

[a] *The subsidy equivalent is calculated for individual EU states since, unlike export subsidies, the use and terms of export credits is a decision for member states. The values include intra-EU export credits. The range presented covers the calculated subsidy equivalents for reporting EU countries.*

Source: adapted from OECD (2000) An analysis of officially supported export credits in agriculture. COM/AGR/TD/WP(2000)91. OECD, Paris.

STATE TRADING ENTERPRISES

State trading enterprises (STEs) with monopoly status have been criticized for abusing their status in influencing market conditions and trade flows, and for lack of transparency in market operations. On the other hand, in the case of many developing countries, STEs are often a useful solution to imperfect commodity markets, given the inability of many small producers in developing countries to access world markets directly. Pooling prices and underwriting losses can help reduce risks for both farmers and traders. In addition, the large scale of STEs allows them to compete with major transnational trading companies (who may also abuse their privileged market position). Many STEs, particularly in developing countries, play an important role in supporting domestic production and trade infrastructures, where market failure is common and private sector activity risks are high.

Only a small number of developed and developing country STEs are considered to be significant in the marketplace by virtue of the size of their global trading activities in the product and/or the sensitivity of the traded product. There is little evidence to date that STEs cause significant market distortion. Impact will depend on the combination of exclusive rights held by an STE both to procure and sell the product domestically and to sell it in the export market. STEs and private firms differ with respect to underlying purpose and mandate with STEs frequently holding a wide social mandate, whereas private firms seek mainly to maximize profits for owners and investors.

EMERGENCY AND NON-EMERGENCY FOOD AID

Food aid may displace commercial imports. An important indicator of the level of displacement is the concept of "consumption additionality". Food aid does not displace commercial imports if it leads to "additional" consumption. The degree of additionality depends on the characteristics of the recipients and the recipient country, as well as the programme design and implementation. Emergency food aid, about 60–70 percent of all food aid, can be considered "fully additional" since the recipients are, by definition, in distress and without economic or physical access to additional food needed. Non-emergency food aid can be divided into: (a) targeted food aid, given to specific recipients; and (b) food aid which is monetized by selling it on local markets. Targeted food aid has higher additionality than monetized food aid, which includes some project food aid and all programme food aid.

2 Developing appropriate rules

Determining equivalence of effect between different export measures requires a benchmark of the effect of export subsidies against which to compare other forms of export competition. However, it is difficult to quantify the effect of export subsidies and at present there are no detailed data to determine the relative effects of all other forms. It may thus be more appropriate to develop rules to reduce distorting effects in each area of export competition rather than establishing equivalency as a basis for those rules. Furthermore, to ensure workable disciplines and compliance, there is a need for a more timely system of notifications. The following is notable under each area.

EXPORT SUBSIDIES

Although there is agreement on the elimination of scheduled export subsidies, the timeframe is not agreed. Decisions will be needed on the elimination period and, if it is long, whether a significant initial downpayment (i.e. an agreed percentage reduction in the level of allowable use of export subsidies in the first year of the implementation period) is warranted. It will also be very important to restrict the ability of countries to maintain high export subsidies for products where domestic reform is protracted, while achieving overall commitments by greatly reducing export subsidies for products where domestic policy reform has effectively made them redundant.

EXPORT CREDITS

Disciplines on export credits have been discussed mainly in terms of constraining credits to repayments of less than 180 days. But on its own this will not be a sufficient discipline if the objective is to eliminate the perceived negative effect of such credits. Re-instrumentation of credit terms makes it possible to reduce the repayment period while making other terms, such as interest rates and fees, more favourable. Negotiations will be over the extent to which these terms are allowed to deviate from terms that are available commercially. For example, one possibility may be to restrict the extent to which the interest rate associated with the transaction falls below the prevailing rate, to less than 50 basis points. Similarly the allowable margin between the agreed shipment price and the prevailing world market price could be restricted.

However, placing over-stringent disciplines on export credits may impede legitimate uses, for example their use to assist in overcoming liquidity constraints faced by many LDCs and NFIDCs. Separating expenditures on credits into two categories on the basis of the status of the recipient country may provide one possible solution to avoiding the over-disciplining of export credits used for such purposes. Expenditures on credits to countries other than those indicated above would be subject to the disciplines, whereas for credits extended to LDCs and NFIDCs, where consumption additionally is more likely, but where the use of export credits is currently limited, no constraints would be placed on the repayment terms. Transactions of relatively small size, as defined by the FAO Consultative Subcommittee on Surplus Disposal, could also be exempt from such disciplines.

STATE TRADING ENTERPRISES

Any discipline mechanism must recognize the roles of STEs in promoting trade in uncompetitive global markets and correcting domestic market failures and imperfections. An important concern about these mechanisms is the proposed elimination of monopoly export rights to allow private enterprises to “coexist” with STEs, to purchase export commodities from domestic producers and to engage in their export. However, there are few cases of successful coexistence of these two types of enterprise and STEs are seldom able to maintain a viable market share in a deregulated environment. A private monopoly may replace the STE, with a less than optimal outcome. Restrictions on STEs will therefore not necessarily remove trade distortions resulting from monopoly power. It is also evident that current WTO rulings, for example those relating to the Canadian Wheat Board, can help to ensure that the position of STEs is not abused to the detriment of third-country exporters. Further disciplines on STE activities must therefore be carefully crafted.

FOOD AID

Discipline in this area must be considered in light of the humanitarian and development benefits of food aid. Procurement and distribution practices (e.g. triangular arrangements or in-country purchases) have changed greatly in the past decade and the debate on disciplining food aid should take these developments into consideration. Using consumption additionality as an indicator, it may be possible to rank different forms of food aid according to their trade-distorting potential. Such a ranking could be used to focus elimination or disciplining only on those forms which result in particularly large commercial displacement and offer no significant additionality.

Using this additionality indicator, emergency food aid would be considered least trade distorting; especially in the event of the country not being able to cover all its food imports on commercial terms. Disciplines could also be designed to eliminate conditions tied to the provision of food aid.

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