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Commit to Farm Subsidy Reform to Revive the WTO's Doha Round

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This week, the Doha Round of multilateral trade negotiations collapsed into a race by World Trade Organization (WTO) members to lay the blame for the failure of the talks on each other rather than admit that all are at fault for failing to bring the world the benefits of freer trade. Once the dust has settled and WTO members focus on the global cost of failure, policymakers may be ready to engage in meaningful liberalization, not just free-trade rhetoric. In this setting, President Bush has a unique opportunity to establish principled leadership on trade. The Administration should commit to reducing and reforming America's farm support programs, giving the Doha Round a chance to conclude successfully.

Doha Crumbles

Doha's negotiating agenda includes some of the member countries' most politically sensitive and difficult trade issues. To reach an agreement, the U.S. and the European Union needed to make meaningful offers to cut agricultural protection and developing countries, including India and Brazil, needed to offer significant reductions in barriers to trade in manufactures and services. Ultimately, no country has stepped forward with an offer sufficient to bring the round to a successful conclusion.

The U.S. proposal circulated in 2005 remains the strongest plan for opening markets across all sectors. However, it went too far in agriculture for Europeans and too far in services and manufacturing for many other countries. For these countries to even consider the U.S. plan, they need to see the U.S. accept serious, politically difficult cuts, namely in domestic support programs for agriculture.

Much like the EU, the U.S. is constrained on what agriculture concessions it can offer. While U.S. agricultural subsidies differ in both size and scope from the EU Common Agriculture Policy, they are equally protected by well-funded, solidly entrenched protectionist interests. Real and significant cuts in U.S. domestic programs, as called for by other WTO members, would be extremely difficult to push through Congress, especially without extensive commitments by other countries in services and manufacturing market access. As such, any compromise proposal, falling roughly between the relatively strong U.S. and relatively weak EU positions, would be too meager by U.S. standards.

As a consequence of members passing responsibility for putting forward a bold compromise proposal, negotiations bogged down on agriculture and finally collapsed. No one country is to blame. All share the responsibility of losing sight of the fundamental reason why trade liberalization is so

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beneficial. And all share the responsibility for failing to cooperate and promote global prosperity. Moreover, all countries will pay an economic price if negotiations cannot be resuscitated.

The Cost of Protecting Agriculture

Subsidies supporting agriculture producers are significant and widespread. WTO members report subsidies totaling more than $221 billion per year, on average,[1] a little more than 18 percent of the value added to the world economy by agricultural production.[2] Based on World Bank and WTO data, the EU and the U.S. each paid out a little more than a third of total subsidies in 2001. A Cato Institute study reports that U.S. farmers received $46.5 billion from the American government in 2004, or 18 percent of total U.S. farm income.[3]

Contrary to perceptions that support goes only to small, low-income farmers, large, high-income farms are increasingly the beneficiaries of U.S. support programs. A recent U.S. Department of Agriculture report found that both the number and market dominance of large farms (those with sales of at least $500,000) grew significantly between 1989 and 2003. At the same time, the number of small farms (those with sales between $10,000 and $250,000) fell from 40 percent of all farms in 1989 to 26 percent in 2003.[4] With structural changes and economies of scale driving a competitive shift in farm size and earnings, commodity payments from support programs now flow increasingly to farms with little need for them. Large farms received 32 percent of all commodity payments in 2003, up from 13 percent in 1989.[5]

For consumers, global barriers to trade in agricultural products artificially prop up domestic prices for food and other agricultural products. This raises the cost of living for families. According to a 2004 OECD study, U.S. farm programs resulted in higher food prices and caused the transfer of more than $16 billion from American households to domestic farmers over and above what the farmers received from direct government assistance.[6]

Barriers to agricultural trade also depress world prices of agricultural products, impacting farmers in developing countries. William Cline of the Institute for International Economics has estimated that by removing trade barriers, developed countries could convey economic benefits to developing countries that are worth about twice the amount of annual aid transfers.[7]

Holding the Global Economy Hostage to Agriculture Supports

The service sector accounts for roughly 79 percent of the U.S. economy and 30 percent of the value of American exports.[8] Service industries account for eight out of every ten jobs in the U.S. and provide more jobs than the rest of the economy combined. Over the past 20 years, service industries have contributed about 40 million new jobs across America.[9]

A University of Michigan study has estimated that removing barriers to trade in services alone

1. Congressional Budget Office, "Policies That Distort World Agricultural Trade: Prevalence and Magnitude," August 2005.
2. Based on calculations using data from World Bank, World Development Indicators database, at *http://devdata.worldbank.org/data-query/* (July 24, 2006).
3. Daniel Griswold, Stephen Slivinski, and Christopher Preble, "Ripe for Reform: Six Good Reasons to Reduce U.S. Farm Subsidies and Trade Barriers," Cato Institute, Center for Trade Policy Studies *Trade Policy Analysis* No. 30, September 14, 2005.
4. U.S. Department of Agriculture, "Growing Farm Size and the Distribution of Farm Payments", *Economic Brief* No. 6, March 2006.
5. *Ibid.*
6. Organisation for Economic Co-operation and Development, "Agricultural Policies in OECD Countries: Monitoring and Evaluation 2005," June 2005.
7. William R. Cline, "Effective Economic Growth for People: The Role of the United States," Center for Global Development, December 2004.
8. U.S. Department of Commerce, Bureau of Economic Analysis, "International Economic Accounts," at *www.bea.gov/bea/di1.htm* (July 24, 2006).

would result in a $1.4 trillion gain in global income.[10] With its strengths in services, the U.S. would benefit significantly.

Developing countries with nascent or government-supported services sectors are reluctant to open their markets and expose domestic firms to the rigor of global competition. Other issues, including regulations, immigration policy, and transparency, cloud the subject of liberalizing services trade for both developed and developing countries. These issues have been barely addressed in the Doha negotiations since they stalled on agriculture liberalization.

A number of studies identify what countries, both rich and poor, would gain by freeing trade. A University of Michigan study concluded that reducing agriculture, manufacturing, and services trade barriers by just one-third would add $164 billion, or about $1,477 per American household, annually to U.S. economic activity. Completely eliminating trade barriers would boost U.S. annual income by $497 billion.[11] The World Bank estimates that the continued reduction of tariffs on manufactured goods, elimination of subsidies and non-tariff barriers, and a modest 10 percent to 15 percent reduction in global agricultural tariffs would allow developing countries to gain nearly $350 billion in additional income by 2015. And developed countries would stand to gain roughly $170 billion.[12] The impasse over agricultural subsidies, however, now blocks these benefits.

Save the Doha Round: Cut U.S. Farm Programs

Trade is not a zero-sum game. Gaining market access for exports is important; however, opening access to a wider variety of cheaper imports is critical to unlock the long-term potential of free trade.

The Bush Administration has offered to dismantle domestic protection for agriculture unilaterally but done little to make that reform a reality. U.S. initiative in cutting farm programs has the potential to revive multilateral trade negotiations, and American taxpayers would earn a break from the burden of higher food prices and these expensive federal programs. Even if global trade talks continue to falter, American consumers and business would win. The Administration and Congress should work aggressively to reform the U.S. farm program now.

Ultimately, leading nations must step up to the plate and take responsibility for promoting the benefits of free trade to all. Successful conclusion of the Doha Round will increase economic opportunity, expand economic freedom, and promote prosperity for all involved. Domestic protectionism should not be allowed to stymie that goal any longer.

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9. Office of the U.S. Trade Representative, "Free Trade in Services: Opening Dynamic New Markets, Supporting Good Jobs," Fact Sheet, May 2005.

10. Drusilla K. Brown, Alan V. Deardorff, and Robert M. Stern, "Computational Analysis of Multilateral Trade Liberalization in the Uruguay Round and Doha Development Round," University of Michigan, Research Seminar in International Economics, *Discussion Paper* No. 489, December 2002.

11. Drusilla K. Brown, Alan V. Deardorff, and Robert M. Stern, "Multilateral, Regional, and Bilateral Trade-Policy Options for the United States and Japan," University of Michigan, Research Seminar in International Economics, *Discussion Paper* No. 490, December 2002, and "Computational Analysis of Multilateral Trade Liberalization in the Uruguay Round and Doha Development Round," University of Michigan, Research Seminar in International Economics, *Discussion Paper* No. 489, December 2002.

12. World Bank, *Global Economic Prospects 2004: Realizing the Development Promise of the Doha Agenda*, at http://econ.worldbank.org (July 24, 2006).