

**Agricultural subsidies
and its impact on
developing
economies
economics essay**



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Agriculture subsidies are the payments by the government to producers of agricultural products for the purpose of stabilizing food prices, ensuring plentiful food production, guaranteeing farmers' basic incomes, and generally strengthening the agricultural segment of the national economy. Domestic crop yield can fluctuate considerably depending on the local weather. International crop supply and prices also fluctuate considerably depending on weather (eg, drought in Australia), politics (e. g. farm seizures in Zimbabwe), war, and other factors affecting crop yields in foreign countries. As a result of these fluctuations in production levels and prices, there could be very large variations in farm revenues and food available for purchase on the global market. Price support and income guarantees can help to maintain a strong domestic farm sector and domestic food supply, by smoothing farmers' income over time and better ensure that farmers are not required to maintain a hefty float every year to maintain income. Farm subsidies have the effect of transferring income from the general tax payers to farm owners. It is argued in some countries that without support from government, domestic farmers would not be able to compete with foreign imports. Removing subsidies would therefore drive domestic farmers out of business, leaving the country with a much smaller (or possibly nonexistent) agriculture industry. A country that is unable to domestically produce enough food to feed its people is at the mercy of the world market, and is more vulnerable to trade pressure and global food shortages and price shocks. Agriculture is one of the economic sectors where subsidies are the most important. As mentioned by Pearce: " The economic sectors with the largest share of global subsidies -agriculture fisheries, transport and energy, accounting for 81% of world subsidies – affect 66% of world trade. If <https://assignbuster.com/agricultural-subsidies-and-its-impact-on-developing-economies-economics-essay/>

manufacturing is added, 87% of world subsidies affect 97% of world trade.

[i]The importance of subsidies therefore has profound implications on production and trade in the agricultural sector. But at the same time the agriculture subsidies have many negative effects on the trade & environment, which this paper highlights.

This paper will also deal with the impact of agricultural subsidies in relation with the effects on the international trade & environment. The negative implications of the agricultural subsidies on the developing countries will be focused along with the role of WTO in curbing the negative externalities of the subsidies provided by the developed countries. This paper will further look in to the various international covenants like Agreement on Agriculture (AOA) & other ministerial rounds under the roof of WTO.

AGRICULTURAL SUBSIDIES & INTERNATIONAL TRADE

There is trouble ahead on the farm front, despite assurances made to poor countries by the World Trade Organization's Agreement on Agriculture (AOA) promising drastic reductions in agricultural subsidies being doled out in the Western countries. Earlier this year, President Bush signed into law a new farm bill worth \$180 billion that will raise U. S. agricultural subsidies up to 80 percent a year for the next 10 years. Behind the 2002 Farm Security and Rural Investment Act is a simple principle: U. S. producers will market crops at very low prices, and then have their incomes topped up by government transfers. For 2002-03, wheat and maize growers will get a 30 percent top-up, rising to almost 50 percent for rice and cotton farmers. The result will be that giant grain traders, such as the Cargill Corporation, will be able to buy

commodities from farmers at artificially low prices and farmers will get fat government checks to make up for their losses.

While the 2002 farm bill acts as a welfare program for agribusiness, with U. S. taxpayers footing the bill, it also robs the world's poor. Wielding the World Bank, the International Monetary Fund (IMF), and international trade agreements, the U. S. is opening up foreign markets for exports by forcing poor countries to remove government subsidies and lower import tariffs while the U. S. shields itself from foreign competition by increasing its subsidies and maintaining tariffs.

These measures have allowed the U. S. to dump its farm surplus on world markets. For example, the U. S. exports corn at prices 20 percent below the cost of actual production, and wheat at 46 percent below cost. The dramatic increase in U. S. agricultural subsidies will further jeopardize the livelihoods of those in developing countries. Poor regions, like Africa, depend on agriculture for about a quarter of their total output, most of it coming from low-income families.

Exporters in Africa will also suffer. According to the World Bank, West African cotton exporters already lose about \$250 million a year as a direct result of U. S. subsidies; this figure will rise sharply. In West African countries like Burkina Faso, Mali and Chad, where cotton accounts for more than one-third of export earnings, the losses already represent around three times the savings provided through debt relief. This is a classic example of trade policy undermining aid. In the cotton-growing basin of Sikasso, in southeast Mali, where 80 percent live in poverty, the consequences will be

devastating. Staple food producers in developing countries face particularly bleak prospects as IMF imposed import liberalization exposes them to intensified competition with subsidized imports. For instance, since Mexico's import barriers started tumbling under the North American Free Trade Agreement, U. S. maize imports have tripled. Mexican smallholders have been forced out of local markets, undermining rural economies and fuelling migration. The U. S. department of agriculture is now targeting countries such as Brazil and the Philippines.

Import liberalization in markets distorted by subsidies can have devastating implications for efforts to combat rural poverty and improve self-reliance. When the IMF bulldozed Haiti into liberalizing its rice markets in the mid-1990s, the country was flooded with cheap U. S. imports. Local production collapsed, along with tens of thousands of rural livelihoods. Self-sufficient a decade ago, Haiti today spends half of its export earnings importing U. S. rice.

The wider danger is that the U. S. farm bill will undermine local agriculture and foster dependence on imports. This will be particularly damaging in sub-Saharan Africa, where staple food production lags behind population growth and imports have risen 40 percent over the past decade.

Even the World Bank ex- president, James Wolfensohn, acknowledges “ these subsidies are crippling Africa's chance to export its way out of poverty.”^[ii]The developing world faces trade barriers costing them \$200 billion per annum twice as much as they receive in aid. Industrialized nations

currently spend about \$350 billion a year assisting their farmers, more than the economic output

Flipping the script, if developing countries were able to increase their share of world exports by just 5 percent, this would generate \$700 billion. The potential for this to translate into poverty reduction for hundreds of millions of people is enormous. Economic modeling by Oxfam indicates that if Africa, East Asia, South Asia and Latin America were each to increase their share of world trade by 1 percent, the resulting gains in income could lift 128 million people in poverty.

The double standards of the U. S. administration that professes allegiance to market economics and fiscal probity have unleashed a wave of indignation among countries whose development prospects largely depend on farm exports. Agriculture and food are fundamental to the well being of all people, both in terms of access to safe and nutritious food and as foundations of healthy communities, cultures, and environment. All of these have been undermined by dependence on the vagaries of the free market promoted by the World Bank, the International Monetary Fund, and the World Trade Organization. For millions in poor countries, the “ world market” of agricultural products simply does not exist. What exists is an international trade of grain, cereals, and meat surpluses dumped primarily by the E. U., the U. S., and other members of the Cairns Group. Behind the faces of trade negotiators are powerful transnational corporations such as Cargill and Monsanto, which are the real beneficiaries of domestic subsidies and international trade agreements. Fundamental change to this repressive trade regime is essential.

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AGRICULTURAL SUBSIDIES & ENVIRONMENT

With or without subsidies, agriculture as a major land use has a profound effect on the environment; environmental degradation by farmers has been going on for millennia, but many farmers have learnt to look after the natural resources that they use and have responded quickly to economic incentives to do so as they seek ways to sustain their livelihoods. Agricultural activities impact on the environment via soil quality (texture, erodibility, nutrient depletion, moisture balances, salinity and soil conservation, including flood protection and landscape), water systems, including surface and groundwater pollution and irrigation, air quality, including greenhouse gas emissions, biodiversity, wildlife habitats and ecosystems. Analysis of the environmental and economic impacts of agricultural subsidies is exceedingly complex, but many are unquestionably damaging, for example, the practice in forested tropical countries of providing cash incentives for clearing forest land for agriculture and livestock production. Similarly, subsidies to irrigation water, in the form of less than full-cost recovery pricing, encourage over-use of scarce water, and hence, water logging and soil salinization. In contrast, a subsidy to promote and encourage kerosene consumption may be environmentally beneficial if it reduces the demand for fuel wood and deforestation. Deciding which subsidies are, or are not, environmentally benign is extremely hazardous. Boldly stated, agricultural subsidies can encourage the production of environmentally harmful pollution, lead to the excessive use of natural resources and often impose high costs on consumers, taxpayers and government budgets. Their reduction/removal would increase economic efficiency, reduce government spending and, at

the same time, improve environmental quality. Farm incomes and profitability will eventually recover following an initial adjustment period. The exclusion of environmental externalities (e. g., pollution) from the profit and loss accounts of farmers and land users means that environmental damage caused by their economic activities is not paid for by those directly responsible for causing the externality. Private costs differ from social costs, and society and the environment must pick up the bill. This is often aggravated by government agricultural support or subsidy programs, which artificially raise the price of agricultural output and further encourage agricultural production and the associated, unpriced environmentally harmful by-products. Support removal, along with complementary policies to internalize social and environmental externalities, will lead to society getting the prices right and optimizing the economic system.

According to the World Trade Organization, “ higher subsidies, such as provided for in the 2002 U. S. Farm Bill, lead to an intensification of agricultural production in OECD countries which can generally be considered detrimental to the environment in terms of exposure to pesticides and fertilizers, habitat destruction and land degradation....”[iii]

Indeed, in order to produce more, farmers convert wetlands to agriculture, intensively use fertilizers and pesticides, and divert water from rivers and streams. For example:

Roughly half of U. S. wetlands lost from 1986 to 1997 – more than 300, 000 acres – were converted to agricultural use.

Fertilizer and pesticide runoff from farmlands contribute to destructive algal blooms and the 7, 000-square-mile dead zone that appears every summer in the Gulf of Mexico off the coasts of Louisiana and Texas.

Subsidized water diversion for irrigation in California has contributed to a 60 percent to 80 percent decline in fish populations in the Trinity River and record low numbers for many species in the San Francisco Bay-Delta ecosystem. Current agricultural production practices result in environmental externalities, i. e. environmental costs of production are not entirely included in the pricing as producers do not face the full costs of their production's environmental impacts. Subsidizing producers for the environmental costs of their production diminishes environmental damages, raises producers' awareness of their environmental impacts and generally favors environmental-friendly practices. However, it leaves environmental externalities as externalities. Therefore, with subsidies, prices will not reflect the environmental costs of production and consumers will not face the true cost of their consumption. Internalizing those costs through regulations and market-based instruments would encourage producers to adopt production practices which would diminish the environmental costs and increase overall economic efficiency.

Different Conservation Programs

With this growth environment conservation programs were also started which was discussed in US Farm Bill 2002 and these programs provide producers with financial and technical assistance regarding “ soil erosion, wetlands, wildlife habitat, and farmland protection.”[iv]Under the 2002 Farm

Bill, financial support is increased for almost all existing programs and two new programs are created; the Conservation Security Program and the Grassland Reserve Program.[v]. Even the CRP[vi] is a land retirement program which was created to diminish land erosion. Under this program, land is set aside for “ permanent conserving uses for 10 to 15 years And the Environmental Quality Incentives Program provides financial and technical assistance to producers to implement environmental practices. In the 2002 Farm Bill, EQIP’s purpose is redefined and its budget is significantly increased. The new budget of EQIP is US\$9 billion over 10 years. EQIP spending may receive more international attention as a result of the increased budget. The new budget is distributed 60 percent/40 percent between livestock and crop producers. Available assistance to livestock producers may be used to comply with the upcoming new animal waste regulations to be adopted pursuant to the Clean Water Act.[vii]

AGRICULTURAL SUBSIDIES & WTO

One of the priorities of the current round of WTO negotiations is to bring substantial reduction in trade distorting domestic support. A simulation using the subsidy reduction formulas mentioned in the draft ministerial text for the Hong Kong meet also indicates that due to the existence of significant overhang between actual and committed levels of subsidies in developed countries, the effective rate of reduction of subsidies will be much less than it appears at the first glance. It follows that unless deep reduction commitments are imposed on developed countries, it will not lead to a substantial cut in their trade distorting domestic supports. The negotiators should calibrate the subsidy reduction formulas so that the post-cut level of <https://assignbuster.com/agricultural-subsidies-and-its-impact-on-developing-economies-economics-essay/>

trade distorting support for developed countries should not exceed 5 percent of their total value of agricultural production. The resulting artificial maintenance of high levels of production led to the sale of agricultural surpluses on the world market at prices below their cost of production, a practice known as dumping. Dumping has continued – increased even – since the creation of the WTO.

Negotiations on agriculture began in early 2000. In November 2001, at the Doha Ministerial Conference, the Doha Declaration reconfirmed the long-term objective of the WTO Agriculture Agreement and set a series of deadlines for achieving it.

In 2002, President Bush signed the farm bill providing \$180 billion in support to American farmers over the next decade.[viii] Members missed the March 31, 2003, deadline for agreeing on modalities, targets and issues related to rules for achieving the objective.

On August 31, 2003, a joint US-EU proposal on agriculture was offered in an attempt to move negotiations forward.[ix] On September 14, 2003, the 5th WTO Ministerial Conference in Cancun ended without the . comprehensive draft commitments from member countries to reduce agricultural support and protection and other distortions.

On January 12, 2004, US Trade Representative Zoellick sent a letter to WTO members saying that he believed . an agreement to eliminate export subsidies by a certain date was necessary if trade talks were to progress. He proposed setting a new mid-2004 deadline for some basic accords and called on trade ministers to meet in Hong Kong before the end of 2004. January 1, <https://assignbuster.com/agricultural-subsidies-and-its-impact-on-developing-economies-economics-essay/>

2005, was the original deadline set by the Doha Declaration for the end of negotiations.

The Ministerial Declaration launching the Uruguay Round observed that there was an “ urgent need to bring more discipline and predictability to world agricultural trade by correcting and preventing restrictions and distortions including those related to structural surpluses so as to reduce the uncertainty, imbalance and instability in world agricultural markets.[x]The Uruguay Round AoA distinguishes between support programmes that directly stimulate production and trade, and those that are considered to have no direct effect. AoA does not impose restrictions on the latter category[xi]. Support measures that are exempt from reduction commitments are categorized as ‘ Blue Box’[xii]and ‘ Green Box’[xiii]subsidies. Production and trade-distorting subsidies are classified as ‘ Amber Box’[xiv]subsidies, and they are subject to reduction commitments. Amber Box subsidies are measured by Aggregate Measure of Support or AMS.

At the WTO, there is pressure from countries in the Global South for the United States and the European Union to change their agricultural policies. One of the groups of countries leading this fight, called the G-20 and led by Brazil, China, South Africa, and India, met in Mid-March of 2005 to release their vision for agricultural trade policy reform. One of their key demands is the reduction of any agricultural subsidies in the U. S. or the EU that give farmers in those countries an unfair advantage in international trade. For example, farm subsidies that encourage farmers to produce more of a certain commodity can lead to overproduction, which lowers the price of the commodity, which in turn gives the farmers in the Global North an unfair

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advantage. They are able to sell their goods at a lower price because they know they will receive subsidies from their government. Many countries in the Global South do not have the resources to subsidize their farmers in a similar fashion. Their main protection is using tariffs to keep out products from other countries, but the use of tariffs is under attack at the WTO.

Importance of the AoA for the Trading System

- It deals with a significant sector of world economic activity. In many countries, including many least-developed and developing countries, agricultural trade remains an important part of overall economic activity and continues to play a major role in domestic agricultural production and employment.
- It corrects serious economic and trade distortions caused by non-market-oriented mechanisms that result in grossly inefficient use of resources
- It could substantially reduce world poverty. The World Bank estimates that an end to trade-distorting farm subsidies and tariffs could expand global wealth by as much as 0.5 trillion dollars and lift 150 million people out of poverty by 2015.[xv]
- Developing countries are insisting that it should receive utmost priority if multilateral trade negotiations are to proceed.
- If developed countries with the most agriculture protection (the US, EU, and Japan) renege on their commitments to the agreement, they stand to lose credibility with developing countries in efforts to further liberalize trade

- It addresses food security issues. The trading system also plays a fundamentally important role in global food security. For example, it ensures that temporary or protracted food deficits arising from adverse climatic and other conditions can be met from world markets.

- It is long overdue. The products of greatest interest to the least-developed countries . many agricultural products, together with clothing and other labor-intensive manufactures are among the most heavily protected in the markets of their current and potential trading partners, both developed and developing. For the first time, member governments are committed to reducing agricultural export subsidies and trade-distorting domestic support. They have agreed to prohibit subsidies that exceed negotiated limits for specific products. And the commitments to reduce domestic support are a major innovation and are unique to the agricultural sector.

For other countries, including the poorest, the negotiations offer the possibility of improved growth through trade in products where they might have a competitive advantage if trading conditions were less distorted. This, in turn, will make it less attractive to grow illegal crops. There are many other instances where the agriculture negotiations hold out the possibility of win/win results. For example, cutting trade-distorting subsidies can both lower prices to consumers and reduce the incentive to farm in a way that is unfriendly to the environment.

CONCLUSION

In the initial stages the agricultural subsidies has been viewed by the

international community as an answer to tackle the issues related to <https://assignbuster.com/agricultural-subsidies-and-its-impact-on-developing-economies-economics-essay/>

agriculture i. e. provision of minimum support price to local farmers & to meet the ever growing demand for the food. But as the time progressed, the agricultural subsidies are misused by the economically powerful nations against the interest of other nations. As result the agricultural subsidies had ignited the problems relating to trade & environment which were elaborately discussed in the above Chapters.

In my view, the agreement on agriculture (AoA) is well equipped document to deal with the negative externalities of agricultural subsidies, but it is unfortunate that the implementation of AoA has not seen the light of the day because of the presence of strong opposition by the developed nations. The ministerial conferences held by WTO in past had witnessed a formidable opposition from the developing countries where India had played a crucial role. In order to cope up with the pressure exerted by the developed countries against 3rd World interests, the other nations have to unify their stand & should organize their protocol to protect their trade & environmental interests against the mighty influence that the developed nation have upon WTO. It is the responsibility of the developed countries to recognize the interest of 3rd world countries in the era of globalization where the economies & trade are inter-related.

Therefore, a conscious effort should be made to eliminate the negatives of agricultural subsidies.

ENDNOTES