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Trade Note 8

Export Subsidies: Agricultural Policy Reform and Developing Countries

Introduction

Export subsidies, like import taxes, highly distort trade. Consequently, the WTO should act vigorously to achieve their phaseout. Commitments in the Uruguay Round Agreement on Agriculture (URAA) on export competition focused mostly on explicit taxpayer financed export subsidies. Twenty-five countries agreed to limits on and reductions in both the volume and value of export subsidies (and the prohibition of new subsidies) for 23 product categories. Each country committed to reduce the volume of subsidized exports by 21 percent over 6 years from the 1986–90 base period level (14 percent over a 10-year period for developing countries), and reduce the value of export subsidies by 36 percent (24 percent for developing countries). Temporary exemptions for developing countries allow subsidies for marketing, cost reduction and transport, while the least developed countries are not subject to reduction commitments at all.

After the URAA, the European Union (EU) accounted for around 90 percent of the total global explicit export subsidies that averaged about USD 6.5 billion (B) per annum, well below the aggregate limit of approximately USD 10 B. Apart from some isolated instances of limit breaches and the addition of export subsidies for some developing countries after the URAA, the commitments were met. But this was primarily due to the fact that the base period from which reductions were made was characterized by low world prices

and high levels of export subsidies, making the targets unusually easy to achieve. Furthermore, there were also loopholes used (described below); and abnormally high world prices in 1997–98, exchange rate developments, and domestic policy reforms all contributed to the ease with which countries fulfilled their commitments.

Many implicit export subsidies can also be disbursed indirectly and in a nontransparent way through the use of food aid programs, actions of state trading enterprises (STEs), publicly underwritten export credits, export promotion activities, and domestic policy levers that can, in combination with one another, act like an export subsidy. These non-transparent mechanisms had few disciplines in the URAA and so are key issues for the current negotiations. In fact, the issue of export credits was remitted to the OECD, which issued a report, while the issues relating to STEs were taken up by a WTO committee for study.

Export taxes, used in periods of high world prices to keep domestic prices low, are not constrained by the URAA. Their use increases the cost of food procurement for net importers and so some food importing countries are pressing in the current negotiations for both constraints on export taxes and for greater flexibility for themselves to protect their own food crop sectors to increase self-sufficiency.

This note evaluates the effectiveness of the disciplines imposed on export subsidies and presents options for new multilateral rules. We show how countries circumvented their commitments on explicit export subsidies and describe the issues related to indirect export subsidies, as well as some omissions



and improper measures associated with export competition reduction commitments.

How Explicit Export Subsidy Commitments can be Circumvented

Several loopholes made reduction commitments in direct export subsidies less effective than they appear:

- Countries were allowed to designate a different base period (1991–92) other than the initial 1986–90 average. In anticipation of this option, some countries actually increased subsidies in the 1991–92 period to assure an artificially high level from which to begin reductions. This practice, known as “front loading,” provided countries with an added advantage against making difficult but necessary reductions.
- Subsidy commitments could be banked across years if unused, a practice known as “rollover,” or shielded under commodity group aggregates. Rollover allowed countries to increase subsidies when world prices were low, further depressing the world price to the detriment of producers in developing countries. Because reduction commitments were tied to commodity groups, countries could avoid reductions on selected products while meeting their aggregate commitment by withdrawing the full reduction commitment from other lines in the same group. In fact, some countries actually increased support to specific products without affecting the overall product group’s goals. These two features provided an extraordinary opportunity for countries who misused them to avoid or delay reduction commitments.
- As opposed to the discipline on tariffs, where the per-unit or *ad valorem* duties are bound, only the total amount of the expenditures of export subsidies (or volume exported) is regulated. This implies that there is less control over the trade distortions caused by export subsidies, because the same value of export subsidy allocated to a commodity can have different effects on the quantities exported, and therefore on world price. The data on export subsidy equivalents confirm that these differences are significant across countries, commodities, and over time.

- Failure to restrict per unit subsidies also allows “seasonal” subsidies, where exports receive high subsidies during part of the year, although the total of the period does not exceed the constraint. During the season of high subsidy, the impact on world price can be substantial.
- Countries were allowed to use “tailor made” product aggregation in the baseline as a means to circumvent commitments. Under the current rules, products are aggregated into 23 commodity groups (22 groups plus “other agricultural products”). However, the aggregation differs across countries and in the units reported. The aggregation of different products into the same group (such as “fruits and vegetables” for example) poses problems when comparing figures across countries that may refer to completely different products. The units used to report volumes for meats can be carcass weight or product weight, and for eggs they can be dozens, tons, or tons of shell-equivalents. Such non-standardization opens possibilities for circumvention.

The experience of the Uruguay Round has important implications for the current negotiations. The objective of reducing, “with a view to phasing out, all forms of export subsidies” must necessarily close opportunities for avoidance of and delay in implementing trade liberalization.

Issues Related to Implicit Export Subsidies

Indirect export subsidies are not only more difficult to measure but also involve programs that under some circumstances are beneficial or crucial, such as food aid. Hence, any rules to discipline their use must be carefully designed and will involve more disciplines on reporting and monitoring than will those on more explicit forms of subsidy.

Food Aid

Food aid can have similar market effects as an export subsidy. However, food aid is not included in the schedule of reductions. While crucial in cases of national disaster, food aid has been used by developed countries as a means of surplus disposal, budget support for the recipient government, or a tool of foreign policy. This has created serious problems. When given in kind, food aid may be



detrimental to local producers by lowering prices and by altering traditional dietary preferences. When distributed outside of normal commercial distribution channels—as it usually is—in-kind food aid also disrupts the development of those channels and halts the movement of food to the deficit areas from surplus regions in the country and neighboring countries. This can then increase the likelihood and severity of future famine situations. Cash aid or vouchers placed into the hands of needy consumers avoid these risks. Conversely, cash aid supports local producers and traders. For these reasons, cash aid is often preferable to in-kind distribution. The exceptions are crisis situations where transportation is severely disrupted or markets are not functioning, or when there are good reasons to believe that in-kind food distribution can be better targeted to those with the greatest need.

Export Credits

Officially supported export credit programs average about USD 6.5 B per annum, with the United States providing around 50 percent of the total. The programs involve credit guarantees, interest rate subsidies, public assumption of risk, and insurance subsidies. It is very difficult to measure the value of the export subsidy associated with these programs because the value of the risk reduction they provide is difficult to estimate. At the same time, export credit programs enhance food security for countries suffering from financial or food crisis, thereby expanding exports to every exporter's benefit. However, only about 20 percent of agricultural export credit is extended to poor developing countries. Although the subsidy component of these credit programs is found to be small, disciplines are required for all such public expenditures (with exemptions for poor country importers in emergency situations).

State Trading Enterprises (STEs)

STEs and domestic policies that allow for market segmentation and protection of domestic markets can subsidize exports through price discrimination, that is, by using revenues from high domestic prices to subsidize fixed costs for the rest of production,

which is then exported. STEs and domestic marketing arrangements can also be used to pool revenues to farmers, which constitutes an export subsidy if domestic consumer prices are higher than world prices. Domestic production expands with pooling, and consumption in this case declines, just like a taxpayer financed export subsidy. Pooling can occur across markets, time or commodities.

Some export STEs may provide countervailing power to multinational trading firms and hence may improve competitive conditions in the market.

Disciplines are needed to ensure that STEs are subject to the same general rules as private firms. In particular, disciplines should be placed on price pooling and on any taxpayer support to STEs (e.g., for credit guarantees or promotion), with targets for eventual phaseout. More stringent reporting requirements for STEs on acquisition costs and prices are required to ensure that any price discrimination is within normal business practices, and that no product is sold on world markets consistently below domestic prices. There should be no discrimination against private firms' participation in the market; this will serve to discipline any use of discriminatory practices on the part of the STE. Special financing privileges should be also disciplined, with exemptions for poor countries dealing with inadequate institutional infrastructure.

General Objectives for Negotiators

Some lessons can be drawn regarding the general principles upon which an effective agreement should be based, and some specific holes can be identified that need to be eliminated. To minimize the adverse effects of export subsidies on the world trading system as a whole and specifically on developing countries, some options that should be considered are as follows:

- A firm deadline for eliminating export subsidies should be agreed upon.
- Significant reductions in MFN tariffs should be agreed upon, since reductions in import barriers will automatically strengthen disciplines on export subsidies.

**Box 1: How Use of Price Discrimination and Pooling in Combination is Export Subsidy.**

The mechanics of an export subsidy with price pooling and price discrimination are quite complex and can occur in different settings. Price pooling is an export subsidy because the extra revenues from price discrimination are “pooled” and then “averaged” to farmers, thereby acting as a production subsidy, while higher prices to consumers act like a consumption tax. No tax revenues are involved, but the outcome is identical to that of a standard taxpayer-financed export subsidy: supply is increased and demand is reduced at the same time. Indeed, these practices can be termed “consumer-financed” export subsidies.

Price discrimination with pooling can be undertaken by an STE or simply by government legislation that fixes domestic prices. Furthermore, an export subsidy can also occur with a non-traded domestic product (e.g., fluid milk) and an implicit export subsidy can still prevail if one or more products are sold at world prices. Although the milk itself is not traded, the high price for it can be used to cross subsidize exports of other products like cheese or milk powder. Finally, if an STE price discriminates within different world market segments only, then pooling revenues from different prices in different markets in the world constitutes a production subsidy only, since domestic consumers are not “taxed.”

The URAA has no disciplines on this type of export subsidy.

- *Ad-valorem* (percentage) limits on the per-unit subsidy on a commodity-by-commodity basis (as a percentage of the world price) should be introduced, combined with a ceiling on the total value of exports that may be subsidized. The *ad-valorem* limit will place a constraint on the difference between domestic and world prices, while the value limit will constrain the impact of export subsidies on world markets. The value limit became less binding during the URAA implementation period, so new commitments need to eliminate the “water” in the current level of commitments as a minimal starting point.
 - Monitoring of export subsidies should be strengthened by coordinating data collection with other organizations (e.g., the OECD or the WTO). One possibility is to consider mandating the WTO Trade Policy Review Mechanism to provide an annual evaluation of the effects of export subsidies, focusing in particular on developing countries.
 - The banking or “rollover” to subsequent years of export subsidies should be banned.
 - All commitments should be made on a per product basis, with a uniform agreed system of classifying products.
 - Opportunities for delaying or avoiding reductions similar to “frontloading” should be anticipated and prevented.
- Specific Omissions: Plugging the Holes in the URAA on Export Subsidies**
- There are no rules that directly constrain export credit, payment guarantees, and direct financing. As these policies have the effect of subsidizing exports, such rules are needed as part of the disciplines on export subsidies. A methodology could be developed to include the export subsidy component of these measures, and this could be counted against reduction commitments.
 - All expenditures involving direct in-kind disposal of public stocks in export markets should be subjected to the same rules as normal export subsidies.
 - URAA provisions on food aid should be tightened to facilitate genuine food aid while preventing the abuse of aid to circumvent export subsidy restrictions. Proposals include limiting food aid to the form of grants only, and to provision in-kind only in response to appeals from the United Nations (UN) or other appropriate international bodies. Donations in cash or channeled through international agencies would be most desirable (TN/AG/6 pp. 58–61). Though some of these are beyond the purview of the WTO, several principles should govern the provision of food aid:
 - Food aid should be in full grant form, and only for needs of well defined vulnerable



- groups or in response to an emergency as determined by the UN.
- Cash aid should be used unless there are clear reasons why cash aid is infeasible or in-kind food aid is a more appropriate response to the crisis (e.g., because marketing channels are not functioning, in-kind aid can be better targeted, etc.)
 - Food aid should be purchased from other developing countries and from food surplus areas of the country assisted, as a first priority.
 - Food aid should never be used as surplus disposal by industrial countries.
 - Food aid—particularly if given in kind—should be targeted to those who would otherwise be unable to buy food, in order to avoid disrupting local markets.
 - An impact assessment on marketing and local incentives should be undertaken when food aid is used. The designs of the program should be altered or mitigation undertaken if significant negative impacts are observed.
 - Food aid should be integrated into a broader rural development and development strategy which looks at the best forms of investment to provide food security and poverty reduction. This will almost always mean a rapid phase out of the food aid once growth starts.
- Food for work should be the exception. Work for cash should be the norm.
 - Stronger disciplines on state trading enterprises (STEs) are needed, at a minimum subjecting STEs to the same rules on export subsidy as private sector enterprises. These must include increased notification and transparency requirements to prevent disguised export subsidies. An option would be to strengthen and extend the disciplines of GATT Article XVII and Article II on state-trading exports to include limits on the *ad valorem* subsidies.
 - Rules are needed to constrain consumer-financed export subsidies, especially revenue pooling arrangements or cross subsidization through price discrimination.
 - Export taxes should be constrained and eventually phased out. For any developing countries that still depend on these taxes as an important source of government revenue, the phaseout period could be prolonged.

This note is based on “Export Competition Policies,” by Harry de Gorter, Lilian Ruiz, and Merlinda Ingco, in *Agriculture and the WTO: Creating a Trading System for Development*.

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