

NON TRADE CONCERNS IN THE NEXT AGRICULTURAL NEGOTIATIONS

Submission by Argentina

The following paper has been received from the delegation of Argentina with the request that it be circulated to Members of the Committee on Trade and Environment as a contribution to work under Item 6. This paper was prepared by Argentina for the Committee on Agriculture's process of analysis and information exchange.

I. EXECUTIVE SUMMARY

1. Every economic sector interacts with many other aspects of reality and is inscribed in a complex scenario where nothing is isolated and everything is “multifunctional”. The so-called “multifunctionality” of the agricultural sector is a recognition of the complexity of reality and states a valid concept for all the trade sectors that fall within WTO disciplines, agriculture amongst them. This concept is referred to in Article 20 of the Agreement on Agriculture as “Non Trade Concerns” that have to be taken into account in the negotiations called for continuing the process of fundamental reform of the agricultural sector.

2. Every country has valid “non trade concerns” that have to be duly considered within the “long-term objective of (achieving) substantial progressive reductions in support and protection resulting in fundamental reform” of the agricultural sector as an ongoing process. Therefore, the key point is to identify how to better serve those “non trade concerns” while honouring that objective.

3. Since the WTO is meant to promote trade liberalization and to serve this purpose, Member States have assumed binding obligations and commitments, this approach should not need further justification. This paper argues that there are also economic and environmental fundamental reasons to avoid “exporting” our own “Non Trade Concerns” to our trading partners.

II. HEALTHY PRICES ARE FOR THE SAKE OF THE ENVIRONMENT

4. The environment is at the root of the “non trade values” of important and very active sectors of our societies. Environmental degradation is posing problems world-wide and despite income differences, all social sectors are affected. Environment protection is directly linked to natural resource management policies. Commodities are in general intensive in use of natural resources and agriculture production is no exception.

5. The liberalization of trade does not guarantee greater protection for the environment, particularly when the price of traded goods does not truly reflect their full production cost. According

to the World Bank,¹ among the most powerful policies to improve environmental management are those that use market and price signals to make the appropriate allocation of resources. Environmental resources (e.g. land, water, biodiversity) are typically underpriced in two ways: (i) by subsidies that actually reduce the cost of overexploiting or polluting the environment; and (ii) by the failure of markets that normally tend to reflect only the private costs of production, ignoring the damages inflicted on others by pollution and the depletion of natural resources. These two “failures” have been catalogued as “policy failures” and “market failures”.²

6. Therefore, in order to promote a cooperative relationship between environmental protection policies and international trade agreements, we should begin by eliminating those trade restrictions and distortions that prevent the true production costs from being reflected in the actual price of goods traded and, only then, attempt to counterbalance market failures. This is just like being faced with the problem of excessive heat in a room: before switching on the air conditioning, we need to try switching off the heating.

7. In a market economy, prices are the arbitration mechanism by which the remuneration is defined for each of the different factors involved in the production process (according to their position on the supply and demand curve). Prices determine decisions made by investors, producers and consumers. A distortion in price alters the message sent to all economic players, and this has a clear environmental impact, particularly when commodity prices are involved. There are three reasons for this: (i) commodities form the basis of the production process, so that any change in their prices has a knock-on effect for the remainder of the process; (ii) commodities have a cost structure that is much simpler than that of goods produced by a greater level of manufacturing, which means that an incorrect valuation of the natural resource being exploited (i.e. land, fishing grounds, forests, air, water) will have a much more appreciable effect than it would have on products with a more complex cost structure; and (iii) commodities are basically fungible³, so that any price distortion would easily be transmitted to the international system in which they originated.

8. Therefore, a price distortion results in an inaccurate message. The relative scarcity of any one single factor involved in production (i.e. natural resources, such as land or water) is obscured and this stands in the way of determining the system's capacity to sustain a given production over a period of time (known as sustainable production). Accordingly, ensuring that growth and sustainable development policies are compatible requires a two step reform: (i) moving towards free market prices, i.e. removing “policy failures” that impede prices to reflect full private marginal costs of production; and (ii) moving beyond free market prices, i.e. adopting policies that counterbalance “market failures” responsible for not allowing prices to reflect full costs of production.

9. Consequently, the removal of subsidies capable of distorting production and trade, hence prices, is an indispensable first step towards sustainable exploitation of natural resources.

III. NATIONAL POLICIES WITH GLOBAL CONSEQUENCES

10. The correct pricing of agricultural products is of utmost importance for the protection of the environment because of two reasons: (i) agricultural activities have a strong impact on the natural environment; (ii) they are characterized by large levels of support.⁴ Since we are moving towards a

¹World Bank, *Five years after Rio*, Environmentally Sustainable Development Studies and Monographs series, No. 18, Washington, 1997.

²OECD, *The Environmental Effects of Trade*, Paris, 1994, page 8.

³That can serve for, or be replaced by another answering to the same definition.

⁴Van Beers and André de Moor, *Scanning Subsidies and Policy trends in Europe and Central Asia*, Institute for Research on Public Expenditure, research funded by UNEP, The Hague, 1998, page 2.

global economy, if a subsidy policy which affects production were able to alter the international price of an agricultural product, the consequences of this distortion would be felt at a global level.

11. As was recognized in the *Río Declaration*,⁵ environmental protection and sustainable development requires that prices should reflect both the private costs of production and the environmental externalities caused during their production, distribution, consumption and disposal.

12. Full cost pricing is part of the economic chimera of an ideal world in which consumption and production patterns would tend to maximize social welfare. However, this rarely tends to happen since market prices hardly reflect external effects. Moreover, as we previously expressed, some public policies make market failures even worse, increasing inefficiency and further aggravating already existing environmental shortages.⁶ For instance, agricultural policies that subsidise both production and export artificially depress international prices, so that they do not even reflect the private cost of production and accordingly prevent any possibility of implementing environmental policies that would be conducive to incorporating an environmental externality in the prices.

13. As isolated markets are nowadays very much theoretical and the environment is typically a cross-boarder issue, cooperation and coordination are extremely necessary.

14. Developed countries, particularly the richest amongst them, are the only that can heavily subsidise agricultural production and exportation. When doing so, they are not only allocating internal budgetary resources but they are also distorting international prices. According to the OECD,⁷ in 1997, the level of support for agriculture within member countries was about US\$ 280 billion; this level of support was highly concentrated in a very few OECD countries and in one of the most distortive, inefficient and non-transparent ways of support: market price support.

15. Consumers are forced to pay and ignore what they are paying for. Tragically, and according to the OECD, only 20 per cent of the US\$ 280 billion spend during 1997 went to the pockets of farmers, the rest was capitalized into land values and captured by input suppliers. In highly intensive agricultural practices, this results in more fertilizers, more herbicides, more pesticides, more energy, more irrigation and, accordingly, more environmental degradation.

16. When a farmer decides how much of input is needed, such as fertilizers, pesticides, herbicides or irrigation water, this farmer considers both the benefit that is expected and the cost of inputs. Since much of the OECD agricultural subsidies are provided through price support policies, farmers use inputs until the marginal return obtained from using an additional unit of the input equals its cost. If you support prices you increase the returns and, consequently, you increase the input utilization.

17. Removing subsidies is, therefore, a sound first step toward ensuring that environmentally damaging inputs are used in a socially optimal way.⁸

⁵See Principle 16 of the *Rio Declaration on Environment and Development*, UN Conference on Environment and Development, 1992.

⁶*Op. cit.*, page 1.

⁷OECD, *Agricultural Policy Reform: Stocktaking of Achievements*. AGR/CA/MIN(98)1, Paris, 1998.

⁸World Bank, "Subsidy Policies and the Environment", in *Expanding the Measure of Wealth*, Environmentally Sustainable Development Studies and Monographs Series No.17, Washington, June 1997.

IV. GLOBAL CONSEQUENCES THAT NEGATIVELY AFFECT DEVELOPMENT COUNTRIES

18. Removing subsidies is also necessary to get prices right. Prices should “internalize” environmental costs of production. This is a common “mantra” that we all repeat since the Rio Summit in 1992, but we cannot build upon distorted prices, and we cannot build upon prices that do not even reflect private costs of production. As previously expressed, in a market economy prices portray a message that tells us about the scarcity of the natural resource involved in production. This message determines decisions made by investors, producers and consumers.

19. Some governmental policies such as subsidies covered by the Blue and Amber Boxes, and, even more dramatically, export subsidies, distort international prices and, consequently, negatively affect distant decisions that have to do with investments, production methods, international trade and consumption patterns. Everything suffers: economic efficiency, international trade and the environment. Thus, consumers in the subsidizing country, farmers located in third countries and, in the medium term, even farmers within the subsidizing country -- affected by the distorted market message -- suffer.

20. Unfortunately, these policies are also bad news for international income distribution, for food security and for the sustainable development of non-OECD countries.

21. Whenever a wealthy government decides to subsidise agricultural production and exportation, it is encouraging new investments in that sector and, consequently, preventing those investments to go elsewhere else, for instance, to developing countries, where agricultural production is less intensive and where poverty, particularly rural poverty, is responsible for the degradation of rural and urban environment.

22. Moreover, developing countries have no way of introducing sound environmental reforms if these kinds of policies continue. Short-term decisions are a matter of survival for many rural producers in developing countries. How could we ask an agricultural producer to stop soil degradation and to shift to environmentally friendly ways of farming, when overexploiting and exchanging some of the stock of natural capital for cash may be the only alternative to bankruptcy?

V. CONCLUDING REMARKS

23. In conclusion, trade distortive subsidies may affect national efficiency and result in local environmental damage. Unfortunately, the problem does not end there. In a global economy, we are living on one planet. Agricultural subsidies, even if allocated to local constituencies, may have harmful global effects. Definitely, we need to cooperate, and this means we should prevent transforming our own “non trade concerns” in “trade and non trade concerns” for our trading partners.

24. We are not trying to suggest that if the richest countries remove subsidies that encourage production and exports this will necessarily result in socially optimal outcomes. We will also need to cope with market failures, such as pointed out in the paper Norway submitted to the Committee on Agriculture, and create incentives to take environmental externalities into account.

25. What we do try to say is that we have to begin somewhere and that the best place to begin is by eliminating those subsidies that prevent prices from reflecting private costs of production. This will have positive consequences for the environment (by reducing overexploitation), for trade (by enhancing market opportunities for countries that cannot afford to subsidize local production), and for development (by reducing rural poverty and increasing food security in developing countries).
