After Hong Kong:
Potential Impacts of the WTO Doha Round

SPECIAL REPORT

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EXECUTIVE SUMMARY

The purpose of this special report is as follows:

- To review the negotiating proposals of various member-blocs participating in the Doha negotiations
- To provide analysis of the potential impacts of those proposals on US farm subsidies
- To gain perspective on the potential magnitude of the market opportunities afforded to exporting countries resulting from the market access components of the proposals
- To assess the anticipated impact on Canadian agri-food

In order to meet the above, we first describe the major components of the proposals of the US, EU and G20 countries. Then, we apply USDA baseline forecasts of commodity production and prices through 2014 to estimate the potential liabilities of the US programs relative to the reduced protection commitments under the proposals. This data is used to analyze the potential effects of the proposals on US subsidies as well as the commodity-specific spending caps that have already been accepted in principle in the Doha Round. Finally, we examine them in light of the recent cotton dispute at the WTO, which the US lost.

Following this, we examine the implications to Canada's supply managed industries of both reduced tariffs and the number of so-called "sensitive" products in each of the three proposals. We also note that recent work by the United Nations indicates that average tariffs in 106 countries are around 70% for pork and 75% for beef. The implications to Canada's export-oriented industries, were these tariffs to be reduced, are also examined.

The results show the following:

- The proposals by the US, EU and G-20 all call for significant change:
    - Domestic support
        - Aggregate Measure of Support (AMS), the most distorting subsidies
            - US cut 60 – 70%
            - EU cut 70 – 83%
            - Japan cut 60+ - 83%
            - This moves the US down from an allowed level of $19.1 bil/yr to $5.73 – $7.64 bil/yr.
        - Other Distorting Subsidies (ODS). This includes the AMS above plus "Blue Box" and *de minimis* payments; these have never been limited in the past. The proposals are
            - US cut 53 – 75%
            - EU cut 70 - 80%
            - Japan cut 53 – 75%
        - *De minimis* would be reduced by 50 – 80%. Currently, a country can spend up to 5% of the value of production on the most distorting product and non-product specific programs without it counting toward their AMS limit.
        - Product specific caps would be set at historic levels. Therefore, countries would be unable to spend more than in a late 1990s base period.

  - Market access
    - Tariffs would be cut by about 55% - 70%, and the highest cuts would be on the highest tariffs, which tend to be on value added products
    - From 1% to 8% of agri-food products would be designated as "sensitive", which would make them eligible for smaller tariff reductions.
  - Export competition
    - Export subsidies would be phased out
    - Export credits would have more discipline as subsidies
    - Monopoly export privileges for State Trading Entities would be ended.

- The differences in the proposals are relatively small. They lie mainly in detail on percentages. These "details" of course amount to billions of dollars, but if there is political will, one would expect an agreement can be reached.

The analysis of farm program liabilities and domestic support commitments showed the following:

- Most current US farm programs are "amber" or "blue" and would be limited by the proposals. This follows from:
  - The reduced limits discussed above and,
  - The potential liability, if market prices fall, given the structure of the loan deficiency and counter cyclical components of the program and,
  - The fact that the US lost the WTO cotton case and,
  - Commodity specific payment limits
- This will reduce pressure on Canadian farmers because of production distorting incentives in the US programs.

With regard to market access, the following was observed:

- The proposals would reduce tariffs by from 55 to 70% and the highest tariffs would be reduced by the highest percentage
- The proposals would leave Canada's supply managed industries with tariff protection of 75 - 125% after a phase-in period. They would also allow for 1 – 8% of Canada's agri-food products to be designated as sensitive. The latter would be protected either by a combination of lower tariff reductions and increases in tariff rate quotas.
- The proposals would be a major potential benefit to the more than 80% of Canadian agriculture that is export oriented. Using beef and pork as examples, average tariffs in 106 countries average 70 - 75%. The proposals would reduce these tariffs to 30 - 35%.
- Consistent with what occurred following the Uruguay Round, reductions in trade barriers for these industries would provide very substantial export opportunity both for primary production and processing in Canada. More aggressive cuts in protection suggest even greater growth in Canadian exports of agri-food products than occurred in past trade agreements.

The above implies that any of the proposals would substantially reduce the scope for production and trade distorting subsidies by the US, especially in view of the loss of the WTO cotton case by the US. Therefore, because of the WTO, the US has only one alternative to changing the nature of its farm support programs. That is to break the rules, thereby essentially ensuring that there are no rules for trade. The US has generally been unwilling to pursue this latter alternative.

On balance, we cannot accept the view that these proposals are anything but positive for Canadian agri-food. Not to pursue them, at a time when much of Canadian agriculture is suffering from relatively low prices and when the official government policy is to encourage differentiation and exportation, would be a mistake. If this round of the WTO negotiations is going to have any positive outcome, everyone will need to give up something. Once an agreement is reached, whether Canada has contributed to or resisted it, Canada will have no choice but to sign it. Canada is too dependent on exports, too dependent on innovation, and too dependent on investment to not be part of the international rules and to have the same market access as everyone else to the majority of the world's economy.

Therefore, it would seem far more positive for Canada in the long term if it returned to its historic role as the country which finds the compromise. The current proposals are close enough that a good mediator should find a middle ground. Moreover, we seriously doubt that the US has the political will to deliver all of what it has offered in the negotiations. Therefore, finding a middle ground that is actually closer to the EU proposal would be a function that would provide great value.

1.0 Introduction

The WTO-Doha Round of international trade negotiations progressed through its Hong Kong Ministerial meeting in mid-December, 2005. The meeting was conducted amongst much angst that the entire Doha Round would fail if Hong Kong was not a success. While Hong Kong will hardly be regarded as a resounding success, the Doha Round did not fail, and the negotiating positions and their potential impacts are now clearer. Now the process limps along toward yet another important deadline at the end of April, which may or may not be met.

Concurrent to the Hong Kong session, some Canadian publications (e.g. Gray and Furtan, Brink) produced research that questions the potential net benefit to the Canadian agri-food sector of the proposals for lower farm subsidies and better access to markets. These gave support to the conclusions of the Honourable Wayne Easter in his report on a consultative process with Canadian farmers that resulted in little support for freer trade, and actively promoted bilateral trading relationships.

Specifically, these reports argue that even if the Doha proposals were accepted and implemented, they would not materially restrict US farm subsidies. Therefore, Canadian grain producers would gain little, while supply managed commodities would lose considerably because of the loss in market protection that is inherent in the Doha proposals.

In this report, we want to re-visit these analyses because, in our view, they have elements that either understate the nature of US agricultural subsidy policies and the volatility of agricultural markets, or ignore the potential gains from reduced trade protection that could accrue to Canada.

This special report has a number of purposes:

- To review the negotiating proposals of various member-blocs participating in the Doha negotiations
- To provide analysis of the potential impacts of those proposals on US farm subsidies
- To gain perspective on the potential magnitude of the market opportunities afforded to exporting countries resulting from the market access components of the proposals
- To assess the anticipated impact on Canadian agri-food

Section 2.0 below provides a description of the major areas that are subject to negotiation within agri-food in the Doha Round, and characterizes the trading positions following the Hong Kong Ministerial. Section 3.0 places the potential impact of these proposals in context. Section 4.0 concludes the paper by interpreting the potential impact on Canada.

2.0 Progress in the WTO Doha Round

The Doha Round began in Doha, Qatar in November, 2001. The principal agricultural items that are its focus are as follows:

- Domestic farm support – i.e. domestic farm subsidies
- Market access (levels of tariffs and tariff rate quotas – TRQ's)
- Export competition in agricultural products – (export subsidies and State Trading Entities)
- Special provisions for developing countries

In addition, the Doha Round involves discussions related to trade in intellectual property and services.

2.1 Negotiating Positions Pre-Hong Kong Ministerial

Domestic farm support and market access are the two most controversial aspects of these negotiations. The argument of many developing countries is that the industrialized countries, especially the US, EU and Japan protect and subsidize their farmers to a high degree. Developing countries aren't envious of the industrialized countries, rather they argue that the policies of these countries make it difficult for developing countries to compete and, therefore, to industrialize themselves. Moreover, they argue that the industrialized countries have done little since the Uruguay Round to reduce the inequities.

At the time of the Uruguay Round, a producer support equivalent (PSE) measure was developed. This measure combines direct subsidies and benefits from border measures such as tariffs to provide an overall measure of support. The interpretation is that it is the percentage of gross farm income made up from subsidies and measures of protection. PSE's for a number of countries both before and after the Uruguay Round are contained in Table 2.1. These data show that the level of support is very high in Japan, the EU and the US compared to other countries. It also shows that, unlike other countries, the levels of support for farmers declined very little in Japan, the EU, and the US after the Uruguay Round. This is the focus of the agricultural negotiations.

Table 2.1: PSE's For A Range of Countries, Pre- And Post-Uruguay Round

	1986-1988 Average	**1998-2003 Average**
Australia	7.8	4.3
New Zealand	11.2	1.4
Japan	61.1	58.9
EU	38.9	36.1
US	25.3	21.5
Canada	33.6	18.9

Source: PSE, OECD database, 2005

While data are sketchy for developing countries who are not members of the Organization for Economic Co-operation and Development (OECD), available data for China, Brazil and India

place their average PSE's since 1998 at under 4% for China and Brazil and under 10% for India. Comparing these to the PSE's for Japan, EU and US, one begins to understand the arguments of the developing countries.

By the fall of 2005, well developed negotiating positions on the major issues of liberalization in farm product trade were presented by the key players. Several important positions are summarized below.

2.2 Positions on Domestic Support

Table 2.2 presents the proposals of major trading blocs regarding domestic farm support. The rows of the table outline the various aspects of domestic support; the columns of the table present the positions of each of the US, the EU, and the G-20 group of agricultural trading countries with respect to how much each of the various countries should reduce their support to farmers.

Table 2.2 Positions of Major Trading Blocs on Domestic Support

	Proposal by United States – October 10, 2005	***Proposal by EU – October 28, 2005***	***Proposal by G-20 – Some elements updated Oct. 12, 2005***
Cut in Total Aggregate Measure of Support (AMS)	EU 83% Japan 83% USA 60% Canada 37%	EU 70% Japan 60% USA 60% Canada 50%	EU 80% Japan 80% USA 70% Canada 60%
Reference Period for Caps on Product Specific AMS	1999-2001	1995-2000	1995-2000
Cut in Overall Distorting Support (ODS)	EU 75% Japan 53% USA 53% Canada 31%	EU 70% Japan ? USA 60% Canada 50%	EU 80% Japan 75% USA 75% Canada 70%
Cut *de minimis* % by	50%	80%	Adjust to overall reduction
Cap on blue box at	2.5%	5%	5%
Green box	"no material changes", no caps	"review and clarify"	Identifies specific issues for "review and clarification"

Source: Brink, 2005

The table illustrates that the proposals call for reductions in different "bands", i.e. those countries with the highest current level of support would reduce support the most. Therefore, the EU would make the highest proportional cut, with the US making the next highest proportional cut, and other countries, including Canada, making lower levels of cut. This is done with the intent of "leveling the playing field". The position of Japan in this regard is ambiguous, with the US and G-20 proposals placing it in the top band for support reduction, and the EU proposal placing it in the second band, despite its higher PSE's.

Key features of the proposals are the reduction in amber-box subsidy programs (AMS) and the reduction in overall distorting support (ODS). The negotiations envisage a cut in AMS by the US of 60-70% and 70-83% by the EU, as well as a cut in ODS by 53-75% by the US and 70-80% by the EU.

To add some context to these proposals, the U.S. would need to start cutting from the AMS level of $19.1 billion and their estimated ODS base of $47.9 billion. The AMS reflects support that is considered trade distorting and the ODS base includes all support that "has more than minimal distorting effects" (i.e. AMS, blue, de minimis). More will be said about this in subsequent sections.

Several aspects of these proposals are important to understand. Most obviously, all of the proposals, at least nominally, call for substantial cuts in support. Some have pointed out that these cuts are from the current limits, not from actual levels of support. This is true and the implications of it are discussed in section 3.0. A second, and related, aspect is that on the surface the proposals are not drastically different. However, not surprisingly the US calls for relatively greater reductions by the EU, while the EU calls for relatively greater reductions by the US. This is because of differences in definitions of the bands in each proposal. But, fundamentally, all of the proposals call for substantial cuts in allowed levels of support. A third aspect of some importance is the proposal about *de minimis* levels of support. The WTO defines *de minimis* as follows:

"When all of the exempt measures have been accounted for, the residual non-exempt domestic support is quantified in monetary terms on a product-specific and, in case of sector-wide measures, a non-product-specific basis. When such subsidies are below *de minimis* levels, they too are deemed to be exempt from reduction commitments. The *de minimis* level is defined as a percentage of the value of production for the product concerned (or the total value of agricultural production for the non-product-specific measures). The levels are 5% per cent for developed country Members and 10% for developing country Members."
(http://www.wto.org/English/thewto_e/whatis_e/eol/e/wto02/wto2_72.htm#note8)

This means that Members can provide support up to 5% of the value of the production of an individual commodity by way of product-specific support, as well up to 5% of the total value of production of non-product specific support, that does not count toward their AMS spending limit. For example, the de minimis level for corn in 2001 was $944 million. Therefore, the U.S. could have provided up to this level without it counting towards their spending limit. The non-product-specific exemption similarly enables the U.S. to exempt up to approximately $10 billion in support as de minimis.

What the proposals would do is to make the definition of *de minimis* much smaller. The US proposal would cut it in half - i.e. from 5% to 2.5% for developed countries. The EU proposal would cut it by 80% - i.e. to 1%. Therefore, some subsidies that presently do not count toward spending limits would do so with the new proposals. For example, the US spent $6.8 bil on non-product specific subsidies in 2001. This is about 3.4% of the total value of their agriculture. Since it was less than 5%, it did not count toward their limit. With the US proposal of 2.5% in Doha, almost $2 bil of it would count. Under the EU proposal of 1%, almost $5 bil of it would count.

In addition to the foregoing, the general Doha agreement has already decided that caps will be placed on commodity-specific support. No decision has been made on how they will be determined. The EU and the G-20 propose to base them on the average of actual commodity-specific support from 1995-2000. The US proposal is based on 1999-2001, and the US is not explicit about whether the determination is based on the average or the highest year. The choice here will have quite a significant impact on the economic implications, and more will be said about this in section 3.0.

2.3 Positions on Market Access

Table 2.3 presents negotiating positions on market access. The key aspects of the major trading blocs' proposals relate to tariffs and "sensitive" products. The latter are products that will likely be subject to smaller reductions in tariffs and/or will likely face increases in tariff rate quota (TRQ).

Table 2.3 Positions of Major Trading Blocs on Domestic Market Access

	Proposal by United States – October 10, 2005	***Proposal by EU – October 28, 2005***	***Proposal by G-20 – Some elements updated Oct. 12, 2005***
Tariffs	Minimum cut of 55% Max cut 90% Cap at 75%	Average 54% in bands 20-45% in lowest band Cap at 100% for developed countries and 150% for LDCs	Average 54%, with max of 36% for developing countries Cap at 100% for developed countries and 150% for LDCs
Sensitive Products	1% of tariff lines	8% of tariff lines	

Source: Brink, 2005

All of the proposals have a banded approach that reduces the highest tariffs by the largest percentage. The US proposes tariff cuts of between 55% and 90% with a maximum *ad valorem* (percentage) tariff of 75%, and with up to 1% of tariff lines registered as *sensitive*.

The EU also proposes a banded approach in which the average tariff cut in each band is 54%, with *ad valorem* tariff cuts in the lowest band of 20-45%. The EU proposes a tariff cap of 100% with an allowance for developing countries of 150%, and proposes that 8% of tariff lines be registered as sensitive. The G-20 proposal is similar to that of the EU, but with lower percentage cut in tariffs within the bands.

Clearly, the US proposal calls for larger cuts in tariffs and for a much smaller number of products in the sensitive category. These proposals will be analyzed more fully in section 3.0.

2.4 Positions on Export Competition and Export Subsidies and Export Competition

Table 2.4 presents negotiating positions of trading blocs regarding export subsidies and export competition. As shown in the table, all major trading blocs agreed that export subsidies should

be phased out. Again, to add some context here, the US is currently allowed to spend up to $475 million per year on export subsidies as a result of the Uruguay Round Agreement. While the US has not used its total eligibility for several years, this proposal means it would eventually lose the right to spend anything on agricultural export subsidies.

There was also broad agreement among the US and EU regarding liberalization of export credit programs, state trading enterprises (STE's), and food aid.

Finally, there is substantial agreement that state trading entities such as the Canadian Wheat Board would face limits on their monopoly positions and would be restricted in terms of trade that provides unfair benefits.

Table 2.4 Positions of Major Trading Blocs on Export Competition

	Proposal by United States – October 10, 2005	***Proposal by EU – October 28, 2005***	***Proposal by G-20 – Some elements updated Oct. 12, 2005***
Export Subsidies	Eliminate all export subsidies	Eliminate all export subsidies, at an agreed to end date	Eliminate direct subsidies in 5 years (60% in first year, 20% in third and fifth years)
Export Credit Programs	Establish specific disciplines to bring programs in line with commercial practices Max repayment period of 180 days	Eliminate all export credits with repayment periods beyond 180 days Disciplines when these credits provide subsidies or distort trade	
STEs	New disciplines that end monopoly export privileges, prohibit export subsidies and expand transparency	End use of all privileges and benefits of STEs which distort trade (i.e. price pooling, anti-trust immunity, single-desk selling, etc.)	
Export Taxes	End tax provisions that encourage export of processed products		
Food Aid	Est. disciplines on food aid shipments Remove obstacles to emergency shipments Objective test to identify commercial displacement	Phase out food aid that leads to commercial displacement Move towards 'untied' and 'in-cash' food aid	Fully untied and in grant form only

2.5 Progress at the Hong Kong Ministerial

The general consensus was that little was accomplished at the Hong Kong Ministerial. However, agreement was made that the Doha Round will continue (unlike what occurred at Seattle in 2000). In addition, specific agreement was also obtained on the issues described above:

- The nature of domestic support "bands" within which countries will fall was clarified. The EU falls into the top band, the US and Japan fall into the second, although Japan would have an additional "premium" over others in the band because of its high relative subsidy level. That premium has not yet been decided. Other WTO members (including Canada) will fall into the bottom band.
- It was agreed that export subsidies and equivalent measures would be eliminated by 2013.
- It was agreed that specific disciplines to be applied to export credit programs, STE's, and the status of food aid will be determined by April 30, 2006.

3.0 Potential Impacts of Proposals

To put the above multilateral trade liberalization proposals into further context, it is necessary to consider their potential impacts on countries. What effects will the domestic support limits have on US farm programs? What will be the result of cutting tariffs roughly in half?

The best way to gauge these issues is in the context of anticipated future market conditions. For example, when domestic support is tied to commodity prices as in the US, then the support reductions will have no practical impact if commodity prices don't fall. Similarly, if existing product tariff levels are not particularly high, negotiated reductions in tariffs would not be material. This section considers this materiality.

3.1 Potential Impacts of Reductions in Domestic Support

To consider the potential impact of negotiated reductions in support, we consider the impacts on the US. First, this is because under the US farm program the impact of support reductions is directly related to the prices of crops. Second, because of the richness of its farm programs, the US has major negative consequences on Canadian markets, especially our grain and oilseed markets. So, the question is whether Canada will gain relief from production distorting US subsidies under the alternative proposals. The section below addresses that question in three ways. First, we examine future market scenarios that may affect the proposed US limits on their AMS support (section 3.1.1). Second, in section 3.1.2 the implications to the US of the WTO case on cotton are examined. Finally, we examine the implications of the proposed commodity-specific support caps in section 3.1.3.

3.1.1 Analytical Approach

As discussed in section 2.0, the US, EU, and G-20 proposals all contain significant but different levels of reduction in domestic support for agriculture. The analysis of these proposals proceeds as follows:

- We note the existing allowable level of US domestic support both as amber-box (AMS) and estimates of the US ODS.
- We observe the liability that the US has to its main support programs that are triggered on price, for major crops. We consider the anticipated liability the US has to its marketing loan program, direct payment program, and counter-cyclical payments program for corn, soybeans, wheat, and rice. To calculate this liability:
- We compare forecast US prices and production from USDA baseline estimates with existing loan rates, direct payment rates, and target prices at appropriate acreage and yields
- For the marketing loan program, it is assumed that 90% of production of the crops considered would be placed under loan
- For the direct and counter-cyclical payments, actual program acreage and yield data were obtained from the USDA to calculate liability to the program
- Baseline estimates are compared against the triggers for payments under farm programs, and the magnitude of implied payments compared against payment limits in the Doha Round proposals

Based on the results of the Uruguay Round, the US has an allowable AMS of $US 19.1 billion; this constitutes the base from which its AMS reductions will be made, i.e. a 60% reduction would mean that maximum allowable would decline to $7.6 bil/yr. (Table 3.1) Brink (2005) estimates the US base ODS levels to be $US 47.9 billion.

From these levels, Table 3.1 presents the implications of the various proposals on allowable AMS and ODS in the future. Allowable AMS would range from $US 5.7 billion (a 70% reduction) to $US 7.6 billion (a 60% reduction), while allowable ODS would range from $US 12 billion (a reduction of 75%) to about $US 22.5 billion (a 53% reduction).

Table 3.1 Current and Proposed Levels of Domestic Support, US ($Bil)

	Current	US Proposal	EU Proposal	G-20 Proposal
AMS	19.1	7.64	7.64	5.73
ODS	47.9	22.5	19.2	12. 0

Source: Brink, 2005

Table 3.2 presents the USDA baseline crop estimates for 2003/04 to 2014/15. The first four columns present price forecast data, with the last four columns presenting production data. The table shows that the USDA anticipates US production of these crops to grow, and at an increasing price. This rather curious projection is key, and will be discussed further below.

Table 3.2 USDA Baseline Estimates

	Price				Production			
	$US/bushel			$/cwt	Million bushels			Million cwt
	Corn	Wheat	Soybeans	Rice	Corn	Wheat	Soybeans	Rice
2003/04	2.42	3.40	7.34	7.49	10,114	2,345	2,454	199.2
2004/05	1.90	3.35	4.95	7.25	11,741	2,158	3,150	227.7
2005/06	2.00	3.00	4.50	7.35	10,715	2,155	2,910	219.0
2006/07	2.15	3.05	4.60	7.55	10,850	2,120	2,925	221.6
2007/08	2.25	3.15	4.85	7.87	11,055	2,140	2,935	223.8
2008/09	2.35	3.25	5.25	8.23	11,265	2,185	2,955	227.9
2009/10	2.40	3.35	5.50	8.62	11,475	2,220	2,970	232.0
2010/11	2.45	3.40	5.55	8.91	11,690	2,260	3,010	235.4
2011/12	2.45	3.50	5.60	9.14	11,900	2,280	3,040	239.0
2012/13	2.45	3.50	5.65	9.40	12,120	2,340	3,055	241.6
2013/14	2.45	3.55	5.65	9.61	12,255	2,360	3,085	244.2
2014/15	2.45	3.60	5.70	9.85	12,395	2,400	3,115	246.9

Source: USDA Economic Research Service

Table 3.3 presents the US farm program parameters applied in our analysis. The table presents current loan rates, direct payment rates, and target prices that apply under the current US Farm Bill, along with the production base to which triggered payments would apply. Under the marketing loan program, payments apply to actual product, so there is no reference to an historic production base, and it was assumed that 90% of production would be placed under loan. For the direct and counter-cyclical payment programs, 2004 base acreage and program yield data were obtained from USDA and were assumed to be the future base for payment eligibility under the two programs. The base acreage is the same under the direct payment and counter-cyclical

payment programs; however the program yield applied is significantly higher under the counter-cyclical program.

Table 3.3 US Farm Program Parameters

	Marketing Loan		**Direct Payment**		**Counter-Cyclical Program**	
	Loan Rate	Scope of Payment	Rate	Base Acreage* Program Yield[2] (bil)	Target Price	Base Acreage* Program Yield (bil)
Corn (bu)	$1.95/bu	90% of total Production	$0.28/bu	8.98 (bu)	$2.63/bu	10.04 (bu)
Wheat (bu)	$2.75/bu	90% of total Production	$0.52/bu	2.63 (bu)	$3.92/bu	2.75 (bu)
Soybeans (bu)	$5.00/bu	90% of total Production	$0.44/bu	1.64 (bu)	$5.80/bu	1.82 (bu)
Rice (cwt)	$6.50/cwt	90% of total Production	$2.35/cwt	0.22 (cwt)	$10.50/cwt	0.23 (cwt)

Source: USDA Economic Research Service

Before considering the analysis of liability against US farm programs, some observations can be made by comparing Tables 3.1-3.3.

- Comparing the data in Tables 3.2 and 3.3, it is evident that for the most part the baseline price forecasts do not fall below the loan rates.
- The exception to this is soybeans, for which the baseline prices fall below the loan rate in the early years.
- The baseline estimates forecast prices to increase over time, while US production increases as well. Usually in agricultural markets, production increases result in price decreases. This should especially be the case since the 1996 Farm Bill which did away with storage programs that placed a floor under commodity prices and replaced them with loan deficiency payments that are subsidies to make up the difference when actual market prices are lower than the loan rate. USDA's baseline forecasts seem to have somehow magically simultaneously ended the price problem that agriculture has faced for the past century or so and to have repealed the laws of supply and demand!

The baseline estimates present a bit of a dilemma – how can both prices and production continue to trend upward over time? And if they do in reality, then why does the US need to have a commodity-specific farm price support program? A positive answer to the first question can only occur if demand grows faster than supply, and the only way that is likely to happen is through alternative energy programs. But even there, technology is moving so rapidly that less costly material than grain may soon be used to produce energy. Therefore, the assumption of increasing price of grain with increasing production, a series of events without historic precedent assumed by USDA, is at least optimistic and at worst simply assumes the commodity problem away. As will be discussed below, we examine two alternatives to the baseline scenario.

[2] 2004 base acreages were applied under both the direct payment and counter-cyclical payment programs. However, 2004 program yields obtained from USDA were sharply different for the two programs. Clearly, higher program yields applied to the counter cyclical program

Results

To consider the sensitivity of program payments to deviations in prices from baseline estimates, scenarios representing price outcomes of 100%, 85%, and 75% of baseline estimates over the 2005/06 to 2014/15 time period were examined. This was done by assuming the baseline market prices for all crops decreased to the foregoing levels with baseline production held constant at the USDA levels. The support that would result from each of these scenarios was then calculated using the program parameters. Payments made under the marketing loan program were counted as AMS payments, with combined marketing loan, direct payment, and counter cyclical payments counted as ODS.

The results of this analysis are presented in Table 3.4 below. At baseline price levels, corn, wheat, soybeans, and rice would trigger about $US 1.5 billion in AMS and about $US 8.1 billion in ODS. However, if prices are at a level of 85% of that forecast by the
USDA, AMS payments double to over $US 3 billion and ODS payments increase to over $15 billion. Finally, if price levels for these crops are 75% of the level forecast by USDA, AMS payments would be about $US 6.5 billion and ODS payments would exceed $US 23 billion.

Table 3.4 Sensitivity of Support Payments to Crop Price Levels

	Baseline	**85% Baseline**	**75% Baseline**			
	2014/15 Price	**2014/15 Price**	**2014/15 Price**	**Loan Rate**	**Direct Payment**	**Target Price**
Corn ($/bu)	2.45	2.08	1.84	1.95	0.28	2.63
Wheat ($/bu)	3.60	3.06	2.70	2.75	0.52	3.92
Soybeans ($/bu)	5.70	4.85	4.28	5.00	0.44	5.80
Rice ($/cwt)	9.85	8.37	7.39	6.50	2.35	10.50
Implied Avg. Annual AMS ($bil)	$1.51	$3.07	$6.51			
Implied Avg. Annual ODS ($bil)	$8.12	$15.20	$23.05			

These results suggest the following.

The level of support that will be paid by the US in the future is very sensitive to the level of future prices. Deviations of 15% and 25% in the prices of the four major support crops could increase the AMS by $US 5 billion and the ODS by $US 15 billion. In the work by Brink and Furtan and Gray, only the base-line forecasts were used. But since they include rising prices that are generally above US loan rates, how can it be surprising that the resulting levels of support are relatively low? In the real world, grain prices don't rise continuously. In fact, they tend to be falling over time. And if they did rise, there would be no need for at least two of the three components of the US program (LDP and counter-cyclical).

We have only considered four major program crops; there are several other crops (including cotton – see below) and an additional number of non-product specific programs. But under a low price environment even the liability to these four crops would exceed bound WTO levels and ODS levels, even under the EU proposal to cut support as described in Table 3.1. Moreover, the US would only be able to spend about $1-2 billion on everything else to stay under the new lower AMS limits. From 2000 – 2006, total US AMS ranged from $7 bil to more than $16 bil when all their reported programs are taken into account (Sumner). With projections for increasing production of grain until 2014, it is hard to imagine how an AMS cut from $19.1 bil to even the least stringent proposed level will not affect the ability of the US to continue subsidizing its farmers as it has done in the past.

3.1.2 Cotton and the WTO Cotton Case

It is important to note that cotton was excluded in the analysis above. The USDA does not publish baseline projections for cotton prices and for the counter-cyclical payments. However, cotton subsidies should not be ignored, particularly considering that the US lost the cotton case that was brought before the WTO, and also given the fact that the text from the Hong Kong ministerial addresses domestic cotton subsidies by stating that "trade distorting domestic support for cotton should be reduced more ambitiously than under whatever is agreed…and over a shorter period of time". The US, not surprisingly, was opposed to this text.

From 1995-2004, the US paid out over $15.7 billion in cotton subsidies. In comparison, corn subsidies were over $41.8 billion, wheat over $19.8 billion and soybeans over $13 billion. Although subsidies paid out for corn are more than for cotton, it should be noted that historically, corn acreage is much higher than cotton acreage Clearly the cotton program would still add a considerable amount to the program payments estimated above, thereby easily threatening the lower proposed AMS limits.

What may be more important is the fact that the US lost both a WTO dispute on the cotton program and an appeal of the WTO decision. This is important because the cotton program is structured similarly to the grain programs. This implies, as will be discussed below, that the countercyclical payments under the 2002 Farm Bill and, likely, the direct payments, should be included as part of the AMS.

A report by Sumner (December 2005) analyses how the cotton case ruling would affect the US ability to stay under the AMS cap, which is currently $19.1 billion. The WTO dispute tribunal ruled in March 2005 that the U.S. cotton program, specifically the countercyclical program[3], gives direct support in excess of the amount that had been agreed to in the Uruguay Round. In effect, this means programs that the United States had previously claimed were "green" subsidies, such as counter cyclical payments and direct payments[4], were deemed trade distorting and should be claimed under the AMS .

According to Sumner, with the proper re-classification of US subsidies into the AMS and ODS "boxes", the US has been far exceeding the $19.1 billion cap on AMS. Sumner shows that adding countercyclical and direct payments to the US subsidies under the AMS classification

[3] The decision on countercyclical is clear and unambiguous.
[4] It is less clear about the direct payment program.

would have resulted in only **one year (2002) since 1999 when the AMS did not exceed** the limits proposed by the US and EU in the Doha negotiations. In that year, the total AMS would have been $7.0 bil against a proposed $7.4 bil limit. In the remaining years, the totals ranged from $9.5 bil to $29.1 bil. In several years, the new totals exceeded even the ODS limits that are proposed in Doha by the EU and US.

3.1.3 Proposed Commodity-Specific Caps

As indicated in section 2.0, there is already agreement in principle to place caps on commodity-specific support based on actual support in a base period. What is not decided is how the caps will be calculated. The US proposes that they be based on actual commodity-specific support during 1999 – 2001, but they don't say how the calculation would be done, i.e. average of those years or the highest. The EU and G-20 countries propose the average of 1995 – 2000.

Not surprisingly, 1999-2001 were the three highest years of US product-specific support! So, the choice of the US or EU/G-20 proposal makes a huge difference. Using averages, the estimated caps from the two sets of proposals for major US crops are as shown in Table 3.5.

Table 3.5 Potential Commodity-Specific Limits for the US of the EU/G-20 and US Proposals

	EU/G-20 Proposal Billion	US Proposal Billion
Corn	$1.2	$2.2
Upland Cotton	$0.8	$2.1
Soybeans	$1.3	$3.4
Wheat	$0.4	$0.7

Source: Various WTO Notifications by the U.S. (e.g.G/AG/N/USA/51), Supporting Table DS:4

It is a little difficult to determine how effective those caps would have been had they been in effect since 2000 because the US has not reported in that period. However, a USDA website provides data on payments made by commodity under the loan deficiency and marketing loan programs, which make up the bulk of commodity-specific payments. In at least one case, payments for corn exceeded the estimate above using the US proposal, and others occasionally exceeded the EU/G-20 proposal.

Following the foregoing section regarding the cotton case, the EU/G-20 adds the counter-cyclical and direct payments to other commodity-specific payments. These can be used to get an idea of the total compared to the proposed caps in Table 3.5. Even using the US cap, the result is payments were over the cap in every year for wheat, in all but 2002 for corn, all but 2004 for cotton, and only in 2001 for soybeans.

Given all of the above, it's hard to argue, even without the cotton case, that US farm programs would not be constrained under either the US or EU proposals for Doha.

For these reasons knowledgeable people in the US, such as Barry Flinchbaugh at Kansas State University, and Bob Thompson at the University of Illinois, argue that the 2007 Farm Bill will substantially reduce the loan deficiency and countercyclical components, and replace them with

a less distorting direct payment and a "market" component that encourages alternate uses of grain such as energy production.

3.2 Potential Impacts of Reduction in Tariffs and Increased Export Competition

The potential impact of liberalized market access under the WTO-Doha Round depends on the initial level of trade protection that exists. If tariffs are low and TRQ's are large, then little would be gained from liberalization of these measures, and there would be little reason to negotiate. Conversely, if protection is high, very high tariffs and small TRQ's, then there is more to gain from their reduction. Thus, the magnitude of existing trade barriers needs to be understood. Similarly, the loss of benefits from a state trading entity depends on the magnitude of the benefits it provides.

In this section we examine the implications of the proposed changes in the WTO on Canada's supply managed industries, its export-oriented industries, and the implications of losing the single desk status of the Canadian Wheat Board.

3.2.1 Implications for Canada's Dairy and Poultry Industry

Canadians in supply management have been clear that they will be threatened by major reductions in tariffs. While a range of products and tariff rates exist, current tariffs for dairy products are roughly 250%, and for poultry products they are 140 to 150%. The EU proposal would reduce these tariffs by about one-half, and the US proposal would reduce them by a little more than half over at least a six-year phase-in period. In fact, the proposals, as they stand presently, would reduce dairy tariffs by more because, as shown in Table 2.2, the US proposes to cap tariffs at 75%, while the EU proposes to cap them at 100%.

To ensure clarity, what do these tariffs mean in everyday language? Assume a shipment of butter arrives at Canada Customs from the US or New Zealand and the invoiced value to the Canadian importer is $7.00/kilo. If the tariff is 250%, then the customs agent levies a tax of 250%, i.e. $17.50/kilo, bringing the total cost to $24.50/kilo. If the tariff was eventually reduced to 100%, then the tariff would decline to $7, i.e. the total cost would be $14.00.

There are several ways to think about the implications of tariffs[5]. First, the higher they are, the more protection they provide. If butter is priced at $9 in Canada, it is unlikely that any will be imported when the world price is $7 and Canada's tariff is 250%. In fact, none would likely be imported with a tariff of 100% in this example. That is the second point: very high tariffs remove import competition until the tariff gets low enough to make the imported product competitive with domestic product. In this example, the tariff "threshold" would be just under 30% before the imported product would be comparable in price to the domestic price.

A third aspect is the potential effects of competition. Some would argue that potential pressure from imports is good because it places pressure on the domestic industry to be as efficient as possible. And this leads to a fourth, and most important, consideration, which is the so-called welfare implication. In a traditional economic sense, the argument would be why Canadian

[5] This discussion assumes that butter from the two sources are equal in quality, safety, etc. If one is superior to the other, then they have different values.

consumers should pay high cost Canadian producers more than their efficient New Zealand competitors. And why shouldn't the Kiwi's have the money so they can use it to buy something from us that we're good at? It is likely that one counter argument would be that Canadian producers are higher cost because of conditions imposed by Canadian law or regulation, or the import competition is unfair because of subsidies or other benefits enjoyed by the exporter. So, if we have synthetically higher costs than New Zealand, isn't it fair to make sure those who impose the costs also pay them?

The latter is one of the fundamental arguments that has led to the spiral in subsidies and protection in agriculture, thus making it such a central focus in the WTO talks, i.e. our system of laws and regulations makes us higher cost; therefore society should compensate us either through transfer payments or through border protection. This is why it is important to look at all aspects of the trade negotiations simultaneously: market access, domestic support, export subsidies, and dispute settlement as a whole, not just the parts. By establishing rules in as many areas as possible, the intention is to establish as "level a playing field" as possible so that people everywhere can compete fairly.

Clearly, reducing tariffs would affect the Canadian dairy and poultry markets[6] because Canadian producers would have less protection from competing with other countries. Furthermore, the implied effects on dairy and poultry prices would affect quota values. In our view, quota values would fall because the expected returns from holding quota would decline.

Two additional factors need to be considered here. The first are the proposals to allow "sensitive" products. As noted in section 2.0, the US proposes 1% of tariff lines be so-designated, while the EU proposes 8%. Sensitive products have not been fully defined. Some would prefer that no tariff reduction be allowed, while others argue they should face a lower tariff reduction than "non-sensitive" products, and/or be allowed to increase the percentage of domestic consumption that would be available to imports under tariff rate quotas. This area is hotly debated and the likely outcome is not clear, although we anticipate that the number will be closer to 8% than 1%, and that protection will need to fall somewhat for these products.

Whether the final outcome is 1%, 8%, or some other factor is significant. Canada has roughly 1350 tariff lines for agri-food products. So, at 1% Canada could declare 14 products as sensitive. At 8%, it would be 110. Toward the upper end of the range, it would appear that most supply managed products could be protected as sensitive products. Of course, the larger the number of sensitive products, the less benefit from freer trade would occur because other countries would be able to protect more of their producers.
The sensitive product issue is a source of considerable conflict within Canadian agriculture: a higher number and lower reduction helps protect dairy and poultry. But obviously it also means that products Canada wants to export, such as beef and pork, will have a higher probability of being protected by potential importing countries.

[6] In our opinion, it would affect dairy more than poultry because milk prices in Canada are relatively closer to the "import ceiling" (defined by the "world" price plus transportation costs and tariffs) than poultry prices. Also, the dairy industry faces two additional problems. The first is a "structural" surplus of skim milk powder that occurs as a by-product of butter production.; enough butter for Canada produces too much skim milk. The second, and related, problem is that Canada chose to control export pricing of milk, and lost a WTO dispute that concluded all Canadian exports are subsidized. The one agreement made to date in the Doha Round is that export subsidies will be ended. Therefore, the structural surplus problem is exacerbated.

The second issue is the implication of the entire package of reforms on world prices given the "percentitis" of tariffs. The argument has been made that domestic and export subsidies encourage over-production and, therefore, lower world prices for products. Therefore, if export subsidies are ended and domestic subsidies are substantially reduced, production should decline and world prices should rise. This is especially true for dairy, an industry which is protected and subsidized by a large number of countries. It has been argued in the past that most international trade in dairy products, with the likely exception of those from New Zealand, are subsidized or dumped.

No one really knows what will happen to prices with WTO reforms because we have no history without them, although Gifford and Diamond have recently argued that they would rise substantially for dairy products.

We expect some rise in world dairy prices, and likely less for poultry, depending on what happens to feed grain prices in the longer term. At any rate, it is important to illustrate the impact of "percentitis" in the tariffs. The important point is that if tariffs fall and world prices rise, the reduction in protection will not be as great as the decline in tariffs. To use a simple illustration, consider a country whose tariff is 100% and the world price of a product is $40. Obviously, the tariff is $40. If tariffs are reduced to 50%, one would expect this would take the tariff down to $20. But if prices rise to $60, then a 50% tariff is $30.

Our own expectation is that if the reforms are put in place, even the EU proposal, that prices for most commodities will rise marginally. We expect dairy prices to rise significantly, but not to the levels forecast by Gifford and Diamond. The reason for the different expectation on dairy is as given above, because dairy has been protected by so many countries there is too much production in the wrong places and exports are subsidized or dumped. Reducing domestic support, phasing out export subsidies, and reducing tariffs will lead to a reduction in dairy production and a shift toward production being done where it is most efficient, and without trade at less than cost. Our forecast of marginal increases in other prices is based on the expectation that some marginal land will be removed from production if it is not subsidized. We also expect greater volatility in prices because programs like those in the US will not hold resources in production of a commodity when prices fall, and there will be more reallocation of land among different commodities when distortions such as US loan rates are removed. In turn, increased volatility will result in lower use of intensive inputs because of additional risk.

3.2.2 Implications for Canada's Export-Oriented Products

It is tempting to say that the opposite holds true for export-oriented products. The effect on Canada's export-oriented industries obviously depends upon the level of tariffs and world price levels. Morgan at the Food and Agricultural Organization of the United Nations recently did a brief analysis of applied tariffs on a small number of product lines in 106 countries. Her data for beef and pork (meat) are presented in Tables 3.6 and 3.7 below. They are likely somewhat representative of many products.

Table 3.6 reports tariff data for beef. The table shows that the highest beef tariffs are over 300% and that the average tariff is about 68%. Table 3.7 presents tariffs on pork for ten countries, some of which are among the highest in the world, and the 106 country average. The table shows that pork tariffs commonly exceed 100%, with an average of 73%.

The EU tariffs are interesting. Our understanding is that ECU's were converted to Euros when the Euro was introduced. On this basis, the current rate of about C$1.4:1, and recent North American meat prices, the EU tariffs are in the range of 5-10%.

Table 3.6 Selected Country and Average Tariffs on Beef Reported in 2001

Notified Bound Tariffs on Beef in 2001	
Country	**Final Bound Tariffs (%)**
Norway	344
Iceland	304
Romania	292
Morocco	239
Colombia	108
Japan	50
Korea*	40
Thailand**	50
European Union***	2143 ECU/T
106 Country Average	**67.8**
Applied year was in 1999* * Applied year was in 2000* ****The EU reports a Bound Specific Tariff on a per tonne basis*	

Source: UN-FAO

Table 3.7 Selected Country and Average Tariffs on Pork Reported in 2001

Notified Bound Tariffs on Pork in 2001	
Country	**Final Bound Tariffs (%)**
Iceland	457
Norway	363
Romania	333
Maldives	300
Belize	110
Colombia	108
Korea*	24
Thailand**	33
European Union***	674 ECU/T
106 Country Average	**73.2**
**Applied year was in 1999* ***Applied year was in 2000* ****The EU reports a Bound Specific Tariff on a per tonne basis*	

Source: UN-FAO

These examples suggest that tariffs applied to agri-food products, at least in the case of meats, are very material and, therefore, have the impact of impeding trade. Reducing tariffs by, say 55%, when they average 70% is a significant reduction. For beef cuts worth, say $5 per pound, this reduces the tariff from $3.50 to $1.75. In addition, note that a number of countries' tariffs would exceed the caps proposed by the US and EU even with a 55% reduction. Therefore, the very high tariffs would be reduced by a greater percentage. This is also a further indication of the potential conflict regarding sensitive products: one would expect those countries with high tariffs to be the most likely to designate those products as sensitive.

Finally, what is not shown in the tables is that tariffs in most countries are higher on higher value products. This is done to encourage the import of raw materials so that the processing can be done in the importing country. This is generally a high-cost approach to trade. For example, Japan has no tariff on canola, but its tariff is more than 150% on processed canola oil. Since the oil crushing process is weight-losing, it would be cheaper, and more energy efficient, to process canola in Canada and ship the oil. But we export the seed because of the onerous tariff, and Japan gets the employment benefits.

When viewed this way, the potential benefits to Canada's export-oriented industries begin to be obvious. The proposals to reduce tariffs in the Doha Round are as follows:

- To reduce average tariffs by a minimum average of about 55%. This would reduce the averages for beef and pork from about 65 – 75% to about 25 – 35%.

- To reduce higher tariffs by a higher factor. This would mean a country like Canada that produces raw products like grains and oilseeds would have a much greater chance of being able to do the value adding at home instead of just shipping the raw product. It would also give farm producers a better chance of understanding what attributes consumers in importing countries want, and thus a greater chance of obtaining quality premiums.

- To place tariff caps of 75 or 100% on agricultural products. This would emphasize both of the foregoing points for countries and/or products that have extremely high tariffs.

The potential significance of the market access proposals can be seen in figures 3.1 and 3.2, which contain the value of Canada's agri-food exports to the US and the rest of the world. These are classified into bulk (e.g. grains and oilseeds), intermediate (e.g. live animals), and consumer ready (meat) products. Note that since the early to mid-1990's, almost all of the growth in exports to both the US and the rest of the world has been in the intermediate and consumer ready categories. This is because, in the case of the US, the tariffs between Canada and the US were removed by the Canada/US Trade Agreement (CUSTA). The highest tariffs, as suggested above, were on the highest value products. Therefore, when they were removed, production tended to take place where there was the greatest comparative advantage. In many cases, this was in Canada.

Similarly, in the case of the rest of the world, growth in Canada's intermediate and consumer ready product exports occurred mainly after 1994. 1995 was the beginning of the phase-in of The Uruguay Round WTO Agreement. One manifestation of actual freer trade in that agreement was that a number of Asian countries lowered their tariffs on a range of products. Canada took advantage of the additional market access. These tariff reductions were not as great as those being proposed by even the EU in the Doha Round.

No analysis will give a credible forecast of what will happen if either the US or EU proposals are accepted in this round. The actual outcomes will depend on comparative advantage and the ability of entrepreneurs to innovate. However, we believe it is safe to say that Canada's export-oriented industries will benefit considerably more with these proposals than after the Uruguay Round. There are at least three reasons for this conclusion:

- The proposed reductions are larger than they were in the Uruguay Round.
- More countries will be affected by these proposals than in the Uruguay Round.
- Because a number of countries did lower their tariffs in the last round, further reductions will be more significant in providing a threshold of imports. This means that, for example, a reduction in tariffs from 200% to 100% still leaves a very high tax. Reducing a 60% tariff to 30% means that the absolute tax is much lower and is more likely to be enough to make imports feasible.

With the foregoing, it is hard not to conclude that the export-oriented components of Canada's agri-food sector are likely to reap substantial benefits from the market opportunities offered by reduced tariffs.

It also follows from the foregoing that there is likely more opportunity for gain by the export-oriented industries than potential loss to the supply managed industries. This inference results from three factors.

- The "threshold" argument above.
- More important is that supply managed industries are a relatively small part of the sector. The most positive way to measure this is as a percentage of gross farm income. In recent years, dairy and poultry represent just under 20% of total farm receipts. It is true that these industries make a larger contribution to net farm income; however, the argument about net gains from trade will be decided on the basis of the amount of resources, especially land resources, devoted to an industry. The very fact that the supply-managed commodities contribute a higher percentage to net farm income than to gross income is an indication that their resource use is a lower percentage.
- Most important of all is that supply managed commodities will likely be protected as sensitive products.

3.2.3 Losing a Mandatory Canadian Wheat Board

At the beginning of this report, we cited three recent reports that question the value of the proposals at Doha for Canada. One of them is by Gray and Furtan. One of their arguments is that Canadian agriculture would be worse off without a mandatory Canadian Wheat Board. As well, they raise issues about the loss of protection for supply management, and questions about whether US subsidies would be affected. So far in this paper we have addressed the issues about domestic support and reduced trade barriers. It is necessary to address the wheat board arguments as well since it would appear that none of the proposals would allow for the CWB to continue in its current form. Gray and Furtan made a number of arguments regarding this. They are summarized below with our response to each.

- Loss of premiums gained in many export markets. They cite two studies (Kraft, Furtan, and Tyrchniewicz, 1996; Schmitz, Gray, Schmitz, and Storey) that say the CWB gains $10 - $25/tonne for wheat. The cause is explained as "the CWB can effectively negotiate with some customers who prefer Canadian wheat or barley. If the CWB loses its status as the only seller of Canadian wheat and barley, the market would develop many different sellers of Canadian wheat and barley. Customers of Canadian wheat and barley will then be able to choose among the many sellers of Canadian wheat and barley who will compete to make the sale".

The results of these studies are impossible to verify because CWB transactions and prices are not public; the authors of these studies had special access to CWB information. Others (Carter and Loyns, Veeman) question the results. Those not privileged to see the data question what data were provided and what questions were asked. One of the most fundamental causes of skepticism lies in the fact that the CWB is the ***only seller of Canadian wheat***. In the first place, as Gray and Furtan point out later in their paper, a large portion of the wheat is actually sold by private grain companies acting as agents of the Board, but who are in competition with each other. So, the assertion is questionable.

Even more to the point, the CWB is not the only seller of wheat, indeed not the only seller of spring wheat. Wheat from other countries is substitutable for Canadian wheat. So, Gray and Furtan's argument would have us believe that buyers in importing countries are willing to pay a premium for Canadian spring wheat simply because the CWB sells it. Economic theory might suggest that a small premium exists because the CWB is the largest seller in an oligopolistic market. But no one should be surprised that there is a degree of skepticism about $10 -$25.

One can then ask, what is the source of the so-called premium? We suggest there are two:

Quality resulting from Canada's grading and quality system. This is Veeman's argument. The Canadian grading and quality system requires that grain be shipped before cleaning to export ports, where it is graded and cleaned before shipping. The US system is less stringent and grading/cleaning is done at country points of origination. It is therefore handled several more times after grading, giving it opportunities for quality deterioration, and Canadian wheat can go directly for flour milling for bread in a number of import countries without having to be stored and re-cleaned. Therefore, a premium may well exist, but because of the quality system, not because of market structure. This also raises a question about the benefit/cost ratio of the premium – the cost of the Canadian system is clearly higher, especially in a market that is short of rail cars, to ship dirty grain to the port and screenings back to the prairies. So, how much of the premium is quality and how much gets back to farmers.

The CWB is truly a monopoly seller in only one market in the world – the market for wheat and barley for human consumption in Western Canada. It would appear that the CWB tends to price wheat and barley for human consumption in Western Canada at freight over Minneapolis, the major US destination for Canadian grains. Generally in commodity markets, buyers in surplus producing areas enjoy the benefit of location and do not pay the freight for shipping product to their competitors. This means that prices to grain growers are higher than if Western end users received the benefit of their location. It also means that less is sold for human consumption in Western Canada because end users are priced out of many markets, especially export markets, since they need to pay the freight on the raw product as well as the final product when they are competing with end users from the importing region.

- Gray and Furtan argue that with the loss of the single-desk selling authority, the current price-pooling mechanism could not continue, and that most farmers want pooling. They assert that pooling would not be possible because "producers will be able to enter or exit the price-pool at any time depending upon if the spot prices are moving up or down during the crop year. This will guarantee that the price-pool has a low value and will thus be unattractive to producers."

Our response to this is simple; change the rules so that farmers can't opt in or out. Cooperatives run voluntary pools in many jurisdictions and the Western pork boards run them for hogs. A voluntary CWB would simply require producers who want to be in the pool to contract all or part of their acreage in a given year. If the majority want pooling, it will be obvious as a result of the contracts.

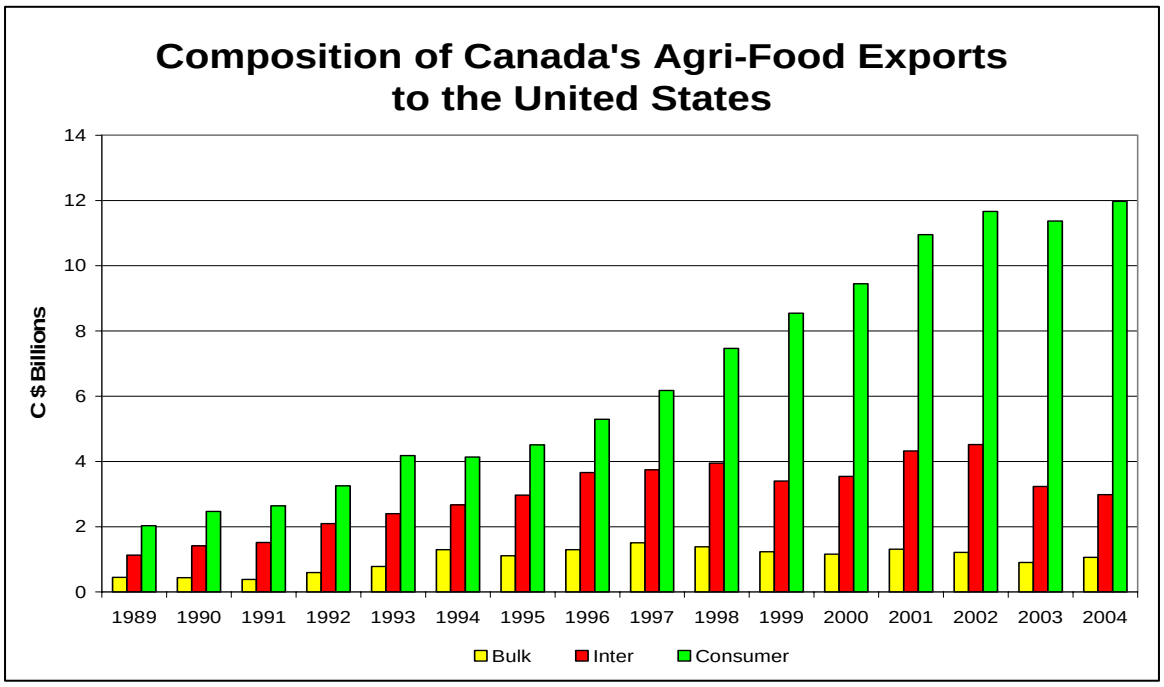
- A third argument from Gray and Furtan is that "price transparency would be become a major issue for producers in the absence of the CWB. Prior to the establishment of the CWB, commodity exchanges played a significant role in creating price information. It is unclear how price signals would be established in the absence of the CWB. With the lack of a sizable domestic market for wheat and the concentration of grain firms, it is unlikely that a viable commodity futures market for export wheat would be established. In the absence of such a market, firms would contract with producers, who would have very little information about basis levels."

Our response to this is two-fold. First, how the current system is "transparent" is a bit of a head-scratcher. Second, and more importantly, the answer to this question is very clear. Either a reliable and liquid Canadian futures market would develop in Canada, or the wheat industry would do what the oats, corn, soybean, beef and pork industries have done, and what grain industries in other countries have done. That is to use pricing institutions that are already available. The Canadian corn, soybean and oat industries routinely discover prices and manage risk off the Chicago Board of Trade grain contracts, and the Chicago Mercantile Exchange International Currency market. Many Canadians now use Chicago corn futures to manage barley price risk and many use the soybean futures complex to manage risk for canola. Minneapolis, Chicago and Kansas City all have liquid futures markets for wheat that are routinely used around the world. This is simply not a major issue.

- The remaining arguments from Gray and Furtan are too complex to address in detail here, but they relate to the cost and structure of the grain handling system. In our view, the wrong question is being asked, for at least three reasons:
    - The potential for substantial reductions in tariffs for finished products because of the WTO will, as we argued above, change the nature of what Canada exports.
    - The current bulk grain handling system at the West Coast has extreme excess capacity served by an increasingly antiquated set of rolling stock.
    - The current handling system for containerized products at the West Coast is usually short of capacity as soon as the last major expansion is completed.

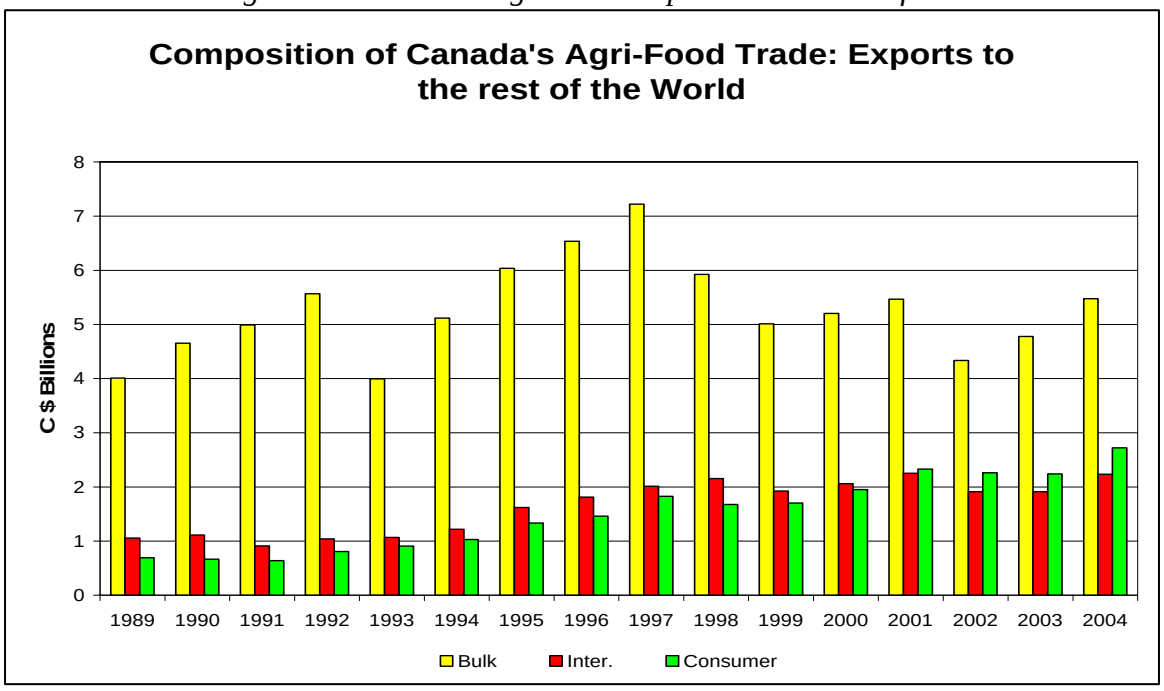
  The current system is not sustainable. Given all of these things, it would seem that the real questions relate to what kind of transportation and handling system is appropriate for the future and what does Canada need to do to achieve it? It is past time to argue about a system that is out of date.

Figure 3.1 Canada's Agri-Food Exports to the United States



Source: Agriculture and Agri-Food Canada

Figure 3.2 Canada's Agri-Food Exports to the Rest of the World



Source: Agriculture and Agri-Food Canada

4.0 Summary, Conclusions and Implications

The agricultural negotiations of the WTO are approaching a critical point. Either there will be agreement on significant breakthroughs or there will be failure in the next few months. A number of Canadian writers (Gray and Furtan, Brink, Easter) have argued that the current US and EU proposals would lead to very little or negative net benefit for Canada's agri-food sector.

Moreover, Parliament last fall unanimously directed Canada's trade negotiators to seek an outcome that would simultaneously give up no market access to imports for dairy and poultry, and would maximize access to other countries' markets for products that Canada exports. On the surface, this appears to be a rather oxymoronic signal to send into a negotiation that, by definition, is about give and take. It would also seem like a directive from a country that has little interest in contributing to a successful outcome in the negotiations.

Is it true that there would be few net benefits? And is this good policy from Canada's perspective? This special report addresses those questions by describing and assessing the implications of the proposals that have been made for agricultural reform in the Doha round of the WTO. In particular, the aim is to assess the potential effects of the proposals on US programs that distort production and trade, and on export market access. These implications are then related back to Canada's agri-food sector.

4.1 Summary

In order to accomplish these purposes, we first describe the major components of the proposals of the US, EU and G-20 countries. These are categorized by proposals on domestic support, including commodity-specific spending caps, market access, export subsidies, and export competition.

Then, following Brink, we used USDA baseline forecasts of commodity production and prices through 2014 to estimate the potential liabilities of the US programs. We note that USDA's baseline forecasts call for continuous increases in production of major grains, and increasing prices. Since this phenomenon has never been observed in history and is actually the reverse of the general trend, we also test the sensitivity of the results at 85% and 75% of the baseline price forecasts.

The potential effects of the proposals on US subsidies are also examined using the commodity-specific spending caps that have already been accepted in principle in the Doha Round. Moreover, we examine them in light of the recent cotton dispute at the WTO, which the US lost.

Following this, attention is turned to the market access component. We examine the implications for Canada's supply managed industries of both reduced tariffs and the number of so-called "sensitive" products in each of the three proposals. Subsequently, we note that recent work by the United Nations indicates that average tariffs in 106 countries are approximately 70% for pork and 75% for beef. The implications for Canada's export-oriented industries, if these tariffs were reduced, are also examined.

Following this the paper addresses the implications of the proposals to completely phase out export subsidies and to change rules on export competition. The latter will affect the Canadian Wheat Board. Again, implications are addressed.

4.2 Conclusions

The following summarize the conclusions we draw from this study. They are organized into several components.

Conclusions About The Proposals

- All three of the proposals call for significant change. We often hear people say that not much will change. But the magnitudes are quite significant when they are compared, and much more ambitious than in the Uruguay Round. Below, we summarize the ranges of all the proposals on important issues.
    - Domestic support
        - Aggregate Measure of Support (AMS), the most distorting subsidies
            - US cut 60 - 70%
            - EU cut 70 - 83%
            - Japan cut 60+ - 83%
            - This moves the US down from an allowed level of $19.1 bil/yr to $5.73 – $7.64 bil/yr.
        - Other Distorting Subsidies (ODS). This includes the AMS above plus "Blue Box" and *de minimis* payments.
            - US cut 53 - 75%
            - EU cut 70 - 80%
            - Japan cut 53 - 75%
            - These trade-distorting subsidies have never been limited in the past. They will be now. In the case of the US, the current ODS is about $47.9 bil. This would be reduced to between $12 and $22.5 bil.
        - *De minimis* would be reduced by 50 – 80%. Currently, a country can spend up to 5% of the value of production on the most distorting product and non-product specific programs without it counting toward their AMS limit. For corn, the US value of production is about $20 bil. Thus the US can spend up to $1 bil that doesn't "count" toward the AMS (it is included in the ODS). Under the proposals, this would drop to between $200 and $500 mil. Therefore, the AMS limits are much lower, and much more needs to be reported. The US often exceeds the current *de minimis* levels for both product and non-product specific payments.
        - Product specific caps will be set at historic levels. Therefore, countries will be unable to spend more than they did in a late 1990s base period.
    - Market access
        - Tariffs would be cut by approximately 55% - 70%, and the highest cuts would be on the highest tariffs, which tend to be on value added products
        - Between 1 and 8% of agri-food products would be designated as "sensitive", which would make them eligible for smaller tariff reductions

  - Export competition
    - Export subsidies would be phased out
    - Export credits would have more discipline as subsidies
    - Monopoly export privileges for State Trading Entities would be ended.

- Differences in the proposals are relatively small. They lie mainly in detail on percentages. These "details", of course, amount to billions of dollars, but if there is political will, one would expect an agreement could be reached.

Conclusions About the Benefits of Reduced Domestic Support

- Most Canadian farm programs are likely "green" under the WTO and would not be affected by the proposals
- Most current US farm programs are "amber" or "blue" and would be limited by the proposals. This follows from
  - The reduced limits discussed above, and
  - The potential liability, if market prices fall, given the structure of the loan deficiency and counter cyclical components of the program, and
  - The fact that the US lost the WTO cotton case, and
  - Commodity specific payment limits
- These facts are causing leading US analysts to conclude that the 2007 Farm Bill must change policy instruments substantially
  - to reduce reliance on those that are trade distorting, such as the LDP and counter cyclical components, and
  - to put more reliance on "green" programs such as whole farm income insurance, conservation programs, and alternative energy programs.

  This will mean considerably less pressure on Canadian farmers caused by production distorting incentives in the US programs.

Conclusions About The Benefits of Market Access Proposals

- As indicated above, the proposals would reduce tariffs by 55 to 70% and they would reduce the highest tariffs by the highest percentage
- The proposals would leave Canada's supply managed industries with tariff protection between 75 and 125% after a phase-in period. They would also allow for 1 – 8% of Canada's agri-food products to be designated as sensitive. The latter would be protected either by lower tariff reductions and/or by increases in tariff rate quotas.
- The proposals would be a major potential benefit to the more than 80% of Canadian agriculture that is export-oriented. Using beef and pork as examples, average tariffs in 106 countries average 70 - 75%. The proposals would reduce these tariffs to 30 - 35%. We make no claim that beef and pork are representative. However, we do know that many tariffs around the world are high, especially on value-added products that Canada could produce. Moreover, beef and pork are two products that Canada now exports in substantial quantities.
- Canada's exports of intermediate and consumer-ready products to the US exploded following removal of tariffs in the Canada US trade agreement (CUSTA). Similarly, our exports grew to the rest of the world following relatively minor tariff reduction in the Uruguay Round. Reductions in trade barriers for these industries would provide very substantial opportunities both for primary production and processing in Canada.

Conclusion About The Loss of a Mandatory Canadian Wheat Board

The discussion in section 3.2 about the pros and cons of a mandatory versus voluntary Canadian Wheat Board cannot likely be proven one way or the other. This debate, like the debate on the Crow rate, has gone on for years and the true outcome will only be known if the system changes. To its credit, the CWB has changed substantially in the past few years. We also believe it would continue to change and evolve if it were voluntary.

4.3 Implications

At the beginning of this summary, two questions were posed. Is it true that Canadian agri-food would receive few or negative net benefits as a result of the proposals for WTO reform? Is it good policy on the part of Canada to oppose these proposals?

The previous sections reveal our conclusions about the first question. Any of the proposals would substantially reduce the scope for production and trade distorting subsidies by the US, especially in view of the loss of the WTO cotton case by the US. Therefore, because of the WTO, the US has only one alternative to changing the nature of its farm support programs. That is to break the rules, thereby essentially ensuring that there are no rules for trade. The US has generally been unwilling to pursue the latter alternative.

Either the EU or G-20 proposals would allow up to 8% of products to be designated as sensitive. They would also keep tariffs for supply managed products in the range of 75 – 100%. The US proposal would only allow 1% of products to be designated as sensitive. At 7 or 8%, this provides a substantial amount of protection for the supply managed industries. We do expect these proposals would put downward pressure on domestic prices and quota values, especially for dairy. This is, in part, because of the unique situation with respect to the structural surplus of skim milk powder, and an export pricing mechanism that has resulted in all Canadian exports being regarded as subsidized.

The proposals for increased market access will be a potential boon to the more than 80% of Canadian agri-food that is not supply managed, as discussed above.

On balance, we cannot accept the view that these proposals are anything but positive for Canadian agri-food. Not to pursue them at a time when much of Canadian agriculture is suffering from relatively low prices, and when the official government policy is to encourage differentiation and exportation, is like asking a bird to fly when he has one wing tied down and is already malnourished.

Therefore, is Canada's directive to its trade negotiators to seek an outcome that gives up no market access for dairy and poultry, and that maximizes access for the rest of Canadian agriculture a good one? Is there an alternative?

If this round of the WTO negotiations is going to have any positive outcome, everyone will need to give up something. Once an agreement is reached, whether Canada has contributed to it or resisted it, Canada will have no choice but to sign it. Canada is too dependent on exports, too dependent on innovation, and too dependent on investment not to be part of the international rules and have the same market access as everyone else to the majority of the world's economy.

Similarly, holding out for a position that is likely untenable in the agricultural negotiations will, at most, only slow the conclusion. But any final decision is going to be made by the US, Europe, major developing countries and Japan. What they finally decide will be signed by Canada. Therefore, it would seem far more positive for Canada, in the long term, if it returned to its historic role as the country that finds the compromise. The current proposals are close enough that a good mediator should be able to find a middle ground. Moreover, we seriously doubt that the US has the political will to deliver all of what it has offered in the negotiations. Therefore, finding a middle ground that is actually closer to the EU proposal would be a function that would provide great value. It would likely be beneficial to start with a focus on a realistic definition of sensitive products, and then work from there to bring the sides together on domestic support and tariff reduction.

When these negotiations are over, countries will have substantial opportunity to reward and punish those who helped or impeded getting to a solution. If, for example, the negotiations end with something in the neighborhood of 8% of product lines being declared sensitive, and if sensitive products have increased tariff rate quotas, then decisions will be made about who gets the tariff rate quotas. It is our impression that Canada got very few TRQ allocations in the last round, in part because Canada was not seen as being helpful in getting to a solution. One would doubt that this was good policy.

Finally, it has been suggested in some quarters that it would be in Canada's interest to discourage multilateral trade negotiations and pursue bilateral negotiations on a country by country basis. In our view, this is extremely shortsighted. The only reason the negotiations at WTO have moved as far as they have in terms of reduced subsidies and market access is because of the combined pressure placed on the US, EU and Japan by developing countries. It is hard to imagine how that could have been done on a one-to-one basis.

It is particularly hard to imagine when one realizes that the US ***is*** increasingly pursuing a bilateral strategy, and watches how it uses carrots and sticks in implementing that strategy. Finally, it is impossible to imagine that Canada has either carrots or sticks of a similar size to use in bilateral negotiations.

Therefore, moving forward with a multilateral, rules based, process appears clearly to be in Canada's favour. Nothing illustrates the value of the multilateral process as well as the cotton case which has been alluded to several times in this paper. As Dan Sumner has said in the title of his paper, the US is truly “boxed in” as a result of losing this case. There will be a day of reckoning very soon when the U. S. must decide whether it will abide by the international rules or abdicate and, therefore, bring down the system. Without the system, there is no possibility that this crossroad would have been reached. And with a burgeoning trade deficit that places the US currency teetering on the edge of a precipice, we think we know which road they will choose. We're glad the road is there, and Canada should make sure that road is well maintained.

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