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# Agricultural Liberalization and the Least developed Countries: Six Fallacies

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Abstract

Today, agriculture remains the most distorted sector of the world economy. Therefore, agricultural liberalization in the Doha negotiations is rightly the top priority. But the public-policy discourse on the subject remains fogged by a number of fallacies. These fallacies probably originated with the leadership of the World Bank but have now been embraced by the IMF, OECD, Oxfam and the leading academic critics of globalization. The paper identifies six fallacies and offers evidence and analysis to debunk them: (1) Agricultural border protection and subsidies are largely a developed-country phenomenon. (2) Developed-country agricultural subsidies and protection hurt the poorest developing countries most. (3) Developed-country subsidies and protection hurt the poor, rural households in the poorest countries. (4) Developed-country agricultural protection and subsidies constitute the principal barrier to the development of the poorest developing countries. (5) Agricultural protection reflects double standard and hypocrisy on the part of the developed countries. (6) What the donor countries give with one hand (aid), they take away with the other (farm subsidies).

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## 1. Introduction

Today, agriculture remains the most distorted sector of the world economy. The Uruguay Round Agreement on Agriculture took a major step forward by bringing the sector within the purview of the multilateral trading rules but its success in opening up the sector to global competition was at best limited. Therefore, agricultural liberalization is rightly the top priority in the Doha negotiations. On that much there is general agreement among informed analysts.

There remains considerable confusion, however, on who protects agriculture and how much, which countries stand to benefit from the liberalization most, and whether there are potential losers and if so what might be done about it. Because many of the potential exporters of agricultural products happen to be developing countries and many potential importers developed countries, liberalization in this area has an obvious North-South dimension. But beyond this simple generalization, the public-policy discourse remains fogged by a number of fallacies.

These fallacies probably originated at the beginning of this millennium with the World Bank leadership (as distinct from its technical and research staff)—most notably the outgoing President James Wolfensohn and his former Chief Economist Nicholas Stern—filling the media waves with the allegations that agricultural protectionism was almost exclusively a developed-country problem, that this protection represented hypocrisy and double-standard on the part of the developed countries, that it hurt the poorest countries most, and that it constituted the principal barrier to the latter's development. But today, the fallacies have been embraced more widely, including by the leadership of other international organizations such as the International Monetary Fund

(IMF) and the Organization of Economic Cooperation and Development (OECD), the non-governmental organizations (NGOs) such as the Oxfam, and numerous journalists. Remarkably, on this set of issues, we can scarcely distinguish the view of such mainstream international institutions as the World Bank, the International Monetary Fund (IMF) and the Organization of Economic Cooperation and Development (OECD) from that of the institutions that instinctively blame the rich countries for the ills of the poor countries including various United Nations agencies, South-South Center and a host of anti-globalization NGOs. Indeed, even the hardnosed financial newspapers such as the *Economist* and some of the prominent globalization critics among academics, most notably Nobel Laureate Joseph Stiglitz, have ended up giving a nod to some of the fallacies.

In this paper, I propose to carefully identify and debunk these fallacies.[1] In Section 1, I identify six fallacies relating to agricultural barriers and explicitly document their existence in some of the most powerful public-policy circles. In Section 2, I take apart each of the fallacies. In Section 3, I make some concluding remarks; in particular, I recall that economists have studied the possible adverse impact of developed country agricultural protection on the developing countries for more than four decades. But while advocating free trade policies in agriculture in the developed countries, these pioneering and widely read economists did not fall victim to the fallacies that the leadership of international organizations, NGOs and the press have embraced today.

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[1] See an earlier article by Bhagwati and Panagariya (2002) and Panagariya (2003a) for the discussion of several fallacies related to trade liberalization more generally.

## 2. The Fallacies and Evidence

At least six distinct fallacies, each having an important bearing on either the conduct of the Doha negotiations or the appropriate development strategy for the poor countries, can be identified:

**Fallacy 1**: Agricultural border protection and subsidies are largely a developed-country phenomenon.

**Fallacy 2**: Developed-country agricultural subsidies and protection hurt the poorest developing countries most.

**Fallacy 3**: Developed-country subsidies and protection hurt the poor, rural households in the poorest countries

**Fallacy 4**: Developed-country agricultural protection and subsidies constitute the principal barrier to the development of the poorest developing countries.

**Fallacy 5**: Agricultural protection reflects double standard and hypocrisy on the part of the developed countries.

**Fallacy 6**: What the donor countries give with one hand (aid), they take away with the other (farm subsidies). In effect, the benefits of aid to the poorest countries are more than offset by the losses from the developed-country subsidies.

Perhaps the clearest single source spelling out many of these fallacies is the "Declaration by the Heads of the IMF, OECD and World Bank on the Eve of the Cancun Ministerial Meeting of he WTO" issued on September 4, 2004 and available on the OECD website at the time of writing (Kohler et al. 2004). The statement has seven paragraphs in all.

In the first paragraph, the statement begins with the relatively benign assertion that ‘the Doha negotiations are a central pillar of the global strategy to achieve the Millennium Development Goals: a strategy to reduce poverty by giving poor people the opportunity to help themselves.’ In the second paragraph, it becomes more expansive, however:

> “Ambitions for Cancun must be commensurate with these objectives. We need a decisive break with trade policies that hurt economic development. Donors cannot provide aid to create development opportunities with one hand and then use trade restrictions to take these opportunities away with the other-and expect that their development dollars will be effective.”

In the third paragraph, the Declaration crucially states,

> “Agriculture is of particular importance to the economic prospects of many developing countries, and reforming the current practices in global farm trade holds perhaps the most immediate scope for bettering the livelihoods of the world's poor. Yet, developed countries impose tariffs on agriculture that are 8 to 10 times higher than on industrial goods. Many continue to use various forms of export subsidies that drive down world prices and take markets away from farmers in poorer countries. In every sector except agriculture, these same countries long ago agreed to prohibit export subsidies. Agricultural support costs the average household in the EU [European Union], Japan, and United States more than a thousand U.S. dollars a year. Much of this support depresses rural incomes in developing countries while benefiting primarily the wealthiest farmers

in developed countries, and does little to accomplish the environmental and rural community goals that developed countries strive to pursue."

The highly publicized Oxfam (2002a) report "Rigged Rules and Double Standards" that the NGO has aggressively pushed (including free hard copies to the faculty at the U.S. universities), conveys a similar message in its executive summary:[2]

> "In their rhetoric, governments of rich countries constantly stress their commitment to poverty reduction. Yet the same governments use their trade policy to conduct what amounts to robbery against the world's poor. When developing countries export to rich country markets, they face tariff barriers that are four times higher than those encountered by rich countries. Those barriers cost them $100bn a year - twice as much as they receive in aid."

The report further states,

> "Lack of market access is not an isolated example of unfair trade rules, or of the double standards of Northern governments. While rich countries keep their markets closed, poor countries have been pressurized by the International Monetary Fund and World Bank to open their markets at breakneck speed, often with damaging consequences for poor communities."

In the summary of yet another briefing paper entitled "Stop the dumping! How EU agricultural subsidies are damaging livelihoods in the developing world," Oxfam (2002b) offers the following message:

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[2] According to a fascinating account of the activities and reach of the Oxfam by Greg Rushford (2004) in the *Rushford Report*, the NGO spends *annually* some $500 million and has approximately 4000 employees worldwide. This makes Oxfam only a little less than half of the World Bank along some dimensions. The latter had 9,300 employees worldwide and an annual operating budget of $1.4 billion at the time of writing.

> "European Union agricultural subsidies are destroying livelihoods in developing countries. By encouraging over-production and export dumping, these subsidies are driving down world prices of key commodities, such as sugar, dairy, and cereals. Reforming a system in which Europe's large landowners and agribusinesses get rich on subsidies, while smallholder farmers in developing countries suffer the consequences, is an essential step towards making trade fair."

The argument that developed countries give with one hand and take it away with the other has found a dramatic expression in the Human Development Report, 2003, published by the United Nations Development Program (UNDP) (2003, p. 155). In chapter 8 entitled "Policy, Not Charity: What the Rich Countries can do to Help Achieve the Goals," the report prominently displays a chart that shows that the EU gave $913 per EU cow in subsidies but just $8 per person in aid to Sub-Saharan Africa in the year 2000.[3] This comparison has been reproduced over and over again by journalists, NGOs and the heads on some international institutions, as a quick search on the Internet would reveal.

In the book *Globalization and its Discontents*, which has captured the attention of many anti-globalization NGOs and developing-country policy makers, Stiglitz (2002, p. 6) expresses a similar view:

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[3] In so far as I am able to ascertain, the example on the subsidies to rich country cows originated in a lecture delivered by the then World Bank Chief Economist Nicholas Stern (2002) at the Center for Economic Studies (CES) after being named "Distinguished CES Fellow 2002." In the speech, Stern said, "But many of the barriers to expanding the trade of developing countries are not within their control. OECD countries continue to maintain major obstacles to imports from developing countries, notwithstanding pledges to remove or reduce them…For example, the average European cow receives $2.50 per day in government subsidies and the average Japanese cow receives $7.50 in subsidies, while 75 percent of people in Africa live on less than $2 per day."

> "The critics of globalization accuse Western countries of hypocrisy, and the critics are right. The Western countries have pushed poor countries to eliminate trade barriers, but kept up their own barriers, preventing developing countries from exporting their agricultural products and so depriving them of desperately needed export income."

Finally, even the *Economist* magazine, which can usually be trusted to demand the highest standards of proof and is known for its careful analytic approach to policy issues, has fallen prey to the dominant rhetoric. For example, in its lead editorial in the latest double issue (*Economist*, December 18-31, 2004), it identifies agricultural liberalization among the three main policy issues likely to dominate the policy agenda during 2005. It describes agricultural products as 'crucial to many poor economies, whose exports are treated harshly by America, Japan and the European Union.' In the concluding paragraph, it goes on to uncritically embrace the evidence and argument produced by Oxfam, "Trade liberalization, by contrast, ought to be a simple choice for poverty-fighting politicians. Oxfam, a campaigning group, estimates, for example, that a 1% increase in Africa's share of world exports would be worth five times as much as the continent's share of aid and debt relief…Thus, what deal, if any, is struck at the WTO meeting next December may provide the truest test of whether the will really exists to make poverty history."

## 3. Debunking the Fallacies

Let me now turn to a critical examination of each of the six fallacies I have identified and explain why and where its proponents have got the facts or the analysis wrong. As a starting point, a sharp distinction must be drawn among the poorest developing countries identified as the Least Developed Countries (LDCs) by the United Nations; the Cairns Group developing countries; and other developing countries. The first group contains virtually all countries in Sub-Saharan Africa; Afghanistan, Bangladesh, Bhutan, Cambodia, Lao, Maldives and Nepal in Asia; and Haiti in Central America. The second group contains Argentina, Brazil, Chile, Colombia, Costa Rica, Indonesia, Malaysia, Philippines, South Africa, Thailand and Uruguay, which are mostly if not exclusively middle-income developing countries and have a strong comparative advantage in agriculture. The third group contains other developing countries that include the relatively poor countries such as India that do not qualify as LDCs under the United Nations criteria as also the more prosperous developing countries such as China and the Republic of Korea that are not members of the Cairns Group.

Among developing countries, the major beneficiaries of agricultural liberalization by the developed countries will be the countries in the second group, which have pushed the hardest for the liberalization. The Cairns Group of countries was largely behind the inclusion of agricultural liberalization in the Punta del Este Declaration that launched the Uruguay Round negotiations and has been the principal driving force behind the push for agricultural liberalization since then. The other set of major beneficiaries of agricultural liberalization would be the developed countries themselves that bear the efficiency costs of protection and the costs of transfers to the importing countries resulting from the production and export subsidies that lower the international agricultural prices for the importers. As I will discuss shortly, the poorest countries—the LDCs—will actually be hurt by this liberalization.[4]

***Fallacy 1: Agricultural border protection and subsidies are largely a developed-country phenomenon.***

It is true that agriculture is heavily protected and subsidized in the developed countries. But the frequent implication that, by contrast, developing countries do not heavily protect or subsidize agriculture is false. Indeed, if we go by the tariff rates as measures of protection, the extent of protection in the major developing countries is greater than in the developed countries.

Thus, consider Table 1, excerpted from the World Trade Organization (WTO) (2001, Table III.3). The table shows the proportion of duty-free items in agriculture and the simple average of the ad valorem tariff rates in agriculture in a number of countries in various parts of the world.[5] Two estimates of the latter are shown, one by the OECD and the other by the World Bank. Because many countries employ per-unit rather than ad valorem tariff rates for some products, they have to be converted into the latter before the average rate is calculated. The differences in these calculations account for the small, occasional differences in the average rates calculated by the OECD and World Bank.

According to these tariff rates, the protection levels in the developing countries are hardly lower than those in the developed ones. The proportion of duty-free items is clearly higher in the developed than in the developing countries. In the United States and

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[4] In what follows, unless stated otherwise, the expression "poor countries" should be interpreted to refer to the LDCs.

[5] The country coverage in my Table 1 is the same as in the WTO table. The latter, in addition, provides information on industrial tariffs for the same group of countries. My concern in this paper being solely with agricultural tariffs, I suppress this information.

EU-15, more than a quarter of the agricultural products enter free of duty. In Canada, this proportion is even higher at 43 percent. On the other hand, with the exception of Malaysia, even the Cairns Group of developing countries, which have a strong comparative advantage in agriculture, allow duty-free less than 3 percent of agricultural products.

This comparison broadly carries over to the average tariff levels. Thus, the average bound tariff rates according to the World Bank estimates in the United States and EU are 9 and 20 percent, respectively. The most protectionist developed countries are Iceland, Norway and Switzerland with average tariff rates of 72, 50 and 47 percent, respectively. The most protectionist developing countries listed in Table 1 are Colombia and India with average tariff rates of 105 and 101 percent, respectively. Again, even many of the Cairns Group of developing countries exhibits high levels of protection. I have already mentioned Colombia as one of the two most protected developing countries. But Argentina, Brazil, Indonesia, Malaysia, Philippines and Thailand are all highly protected with average tariff rates that considerably exceed those of the United States, Canada and EU-15.

While the bound rate is the right one to consider in the context of multilateral liberalization, some may argue that the bound rates give a distorted view of the actual level of protection in the case of the developing countries since their actual, applied rates are far below their bound rates. Therefore, Table 2, which reproduces WTO (2001, Table III.5), shows the applied tariff rates for a group of developing and developed countries. The gap between developed and developing countries is now less but the general point that in terms of the average tariff rates the developing countries protect as much as or more than the developed countries remains valid.

Some may further argue that developed countries also impose tariff quotas that may have a protective effect. But this contention is incorrect since the tariff quotas are meant to be liberalizing measures. In negotiating the Agreement on Agriculture, it was feared that the member countries might replace the non-tariff border measures by prohibitive tariffs thereby eliminating even the existing market access. Therefore, it was agreed that countries should guarantee the level of market access already achieved through a quota with a within-quota tariff rate that was sufficiently lower than its MFN tariff binding to maintain at least the existing level of imports. Furthermore, in the case of the products that a country did not import at all or imported in minuscule quantities, the Agreement on Agriculture introduced *de minimus* imports through a tariff quota such that a lower tariff rate than the MFN rate would be applied to imports up to *de minimus* quantity. A removal of the tariff quotas while maintaining the current tariff rates would reduce, not increase, agricultural imports.

Finally, consider the issue of subsidies. Here the sins of the developed countries are well documented. But the lack of availability of data does not permit a comparison with the developing countries. The available information suggests, however, that the developing countries are not altogether innocent here. Countries such as Brazil Mexico, South Africa, Venezuela, India, the Republic of Korea and Thailand have had sizeable agricultural subsidies. Some of the developing-country subsidies are not subject to reduction commitments because of the "special & differential" treatment but that hardly makes them non-distortionary. The subsidies in the so-called Blue Box under the Special

& Differential provisions for the developing countries include such measures as price supports and input subsidies and are just as distortionary as the developed-country subsidies.

Pretending that the developing countries have low protection in agriculture when the evidence is to the contrary does the countries themselves no good. It only strengthens the hand of the protectionists within those countries by making it easier to claim that they do not need to liberalize. And if they then succeed, it only hurts the countries since their ability to export depends not just on the openness of the partner country markets but on their own openness as well.

***Fallacy 2: Developed-country agricultural subsidies and protection hurt the poorest countries (i.e., LDCs) most***

Of all the fallacies I have listed, this is the most crucial one to debunk not just because it enjoys the near-universal acceptance but also because a proper understanding of the effects of developed-country liberalization in agriculture has important implications for how best to assist the LDCs in their quest for development. The argument behind the assertion is that protection and subsidies by the developed countries together depress the world prices and limit market access of the LDCs thereby impacting adversely the quantity as well as value of their exports.

Two key points explain why this argument is seriously flawed and is, indeed, wrong. First, protection and output and export subsidies by the developed countries depress the world prices of agricultural products. As importers, LDCs have access to these low prices. Once the subsidies and protection are eliminated, the world prices would rise and hurt the importers. For many LDCs that are large importers of agricultural products, these losses could be substantial.

Second, under the Everything But Arms (EBA) initiative of the European Union, LDCs have quota- and duty-free access to the EU market.[6] This means that they can sell their exports at the internal EU price that is kept artificially high to protect the EU producers. In effect, the LDC sellers enjoy the same protection under the EBA as the EU producers. With some exceptions, the EU internal price is far more lucrative than the price that is likely to obtain in the absence of tariffs and subsidies.

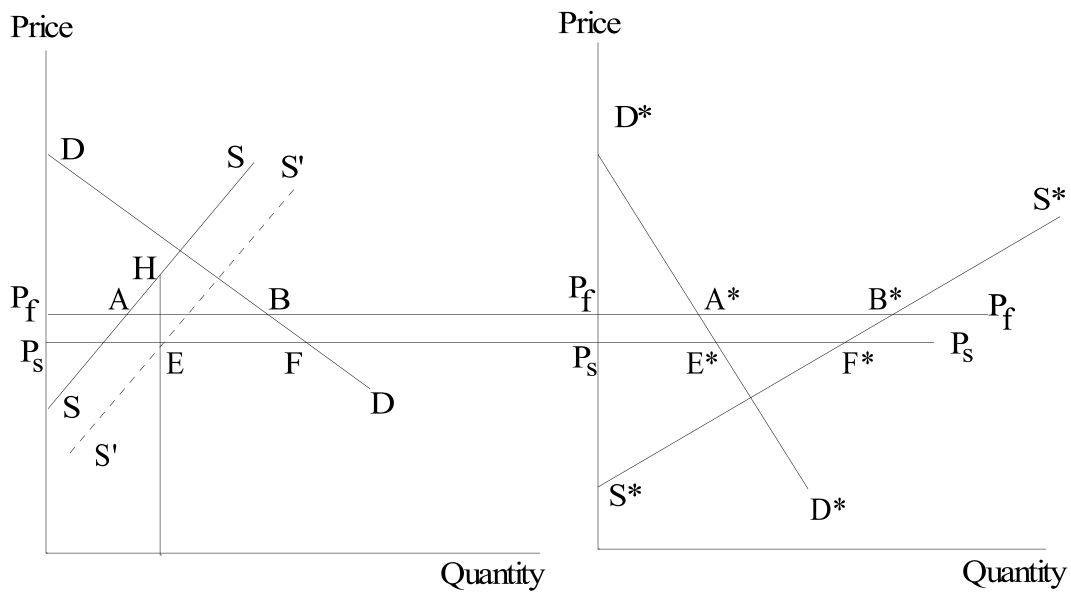


Figure 1: An EU Output Subsidy

Let me elaborate on these points. In the left-hand panel of Figure 1, DD and SS respectively show the EU demand and supply curves for an agricultural commodity, say, wheat. In the right-hand panel, D*D* and S*S* respectively show the demand and supply curves of the rest of the world for the same commodity. Under free trade, the EU

[6] Currently, there are three exceptions: bananas, rice and sugar where quotas exist. But the quotas are slated to end between 2006 and 2008.

is an importer of wheat with the price settling at $P_f$. At this price, the EU demand for imports, AB, equals the rest of the world supply of exports, A*B*. Here subtracting its total supply from its total demand at each price yields the EU demand for imports. Likewise, subtracting its total demand from its total supply at each price yields the rest of the world supply of exports.

An output subsidy by the EU shifts its supply curve down to S'S', where the vertical distance between SS and S'S' represents *per-unit* output subsidy. At the original price $P_f$, the EU supply is now larger and its demand for imports smaller than AB (=A*B*). The resulting excess supply of wheat in the world market pushes the world price of wheat down. The new equilibrium is reached at price $P_s$ with EU demand for imports, EF, equaling once again the rest of the world supply of exports, E*F*. The gross price received by the EU producers equals $P_s$ plus EH, where EH is per-unit output subsidy.

It is immediate that since the EU output subsidy, which lowers the EU demand for imports and thus works like a tariff, *improves* the EU terms of trade: the import price of wheat drops. From the viewpoint of the exporting countries, the terms of trade get worse and the rest of the world *as a whole* is left worse off. But it is important to remember that the right-hand panel in Figure 1 represents the *combined* position of the rest of the world that includes both exporters and importers of wheat other than the EU. The effects of the subsidy on these two groups are asymmetric, with the importers actually made better off in the post-subsidy equilibrium since they are able to buy wheat at the lower world price. Because their benefits are more than offset by the losses of the exporters, the rest of the world as a whole loses.

An export subsidy is often painted as impacting the rest of the world the same way as the output subsidy but actually works differently. In this case, it is the EU that is hurt as a whole while the rest of the world benefits. But as before, the world price of wheat falls so that the exporters of wheat in the rest of the world are hurt and importers benefit, with the gains of the latter more than offsetting the losses of the former this time around. This is shown in Figure 2, which assumes that the EU is a net exporter of wheat in the free trade equilibrium.

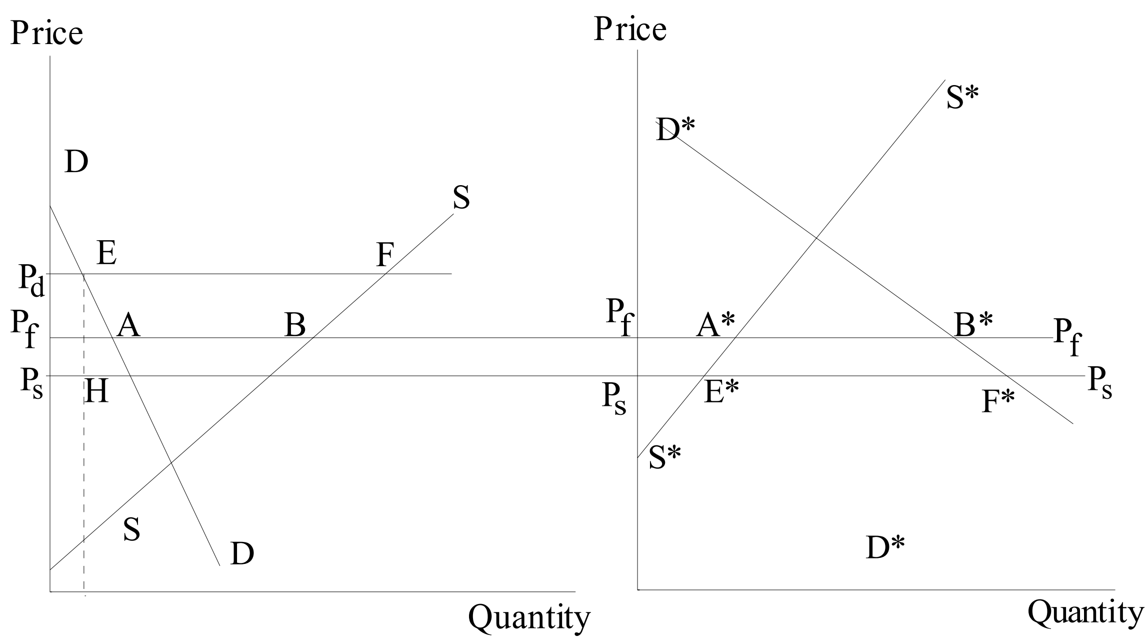


Figure 2: An Export Subsidy by EU

In the initial, free trade equilibrium, the price is $P_f$, with the EU exporting AB and the rest of the world importing A*B* such that AB = A*B*. The way an export subsidy works is that the producers can avail of the subsidy only if they export. This creates a wedge between the price at which they are willing to export and the one at which they are willing to sell in the domestic market, with the wedge equaling the subsidy per-unit. Therefore, in the new equilibrium, the internal price in the EU rises to $P_d$ while the world price falls to $P_s$. The price in the rest of the world drops to $P_s$, with imports expanding to

E*F*.  In the EU, the internal price being $P_d$, the demand drops to E along the demand curve while production rises to point F along the supply curve.  Producers sell EF (= E*F*) in the world market at $P_s$ but receive the same gross price as in the domestic market once we add the export subsidy.  As already noted above, the importers of wheat in the rest of the world are better off overall and the exporters worse off.

Those who argue that the removal of the output and export subsidies in the rich countries, represented by the EU in Figures 1 and 2, would benefit the poor countries implicitly assume that the latter are exporters of agricultural products.  But as I have argued forcefully in Panagariya (2003b, 2003c, 2004a), in reality a large number of the developing countries and the vast majority of the LDCs are net agricultural importers.  To restate this point, consider Tables 3 and 4, taken from Valdes and McCalla (1999), which indicate the importer and exporter status of various developing countries with respect to food and agricultural products.

The World Bank divides the total of 148 developing countries into 63 Low Income Countries (LIC), 53 Lower Middle Income Countries (LMIC) and 33 Upper Middle Income Countries (UMIC).  Based on the 1995-97 data on agricultural exports and imports, Valdes and McCalla further divide these countries into Net Food Importing (NFIM) and Net Food Exporting (NFEX) Countries on the one hand and Net Agricultural Importing (NAIM) and Net Agricultural Exporting (NAEX).

According to Table 3, as many as 48 out of 63 Low Income Countries are net importers of food.  Even among the Low Middle Income Countries, 35 out of 52 are net food importers.  In so far as the subsidies apply with potency to food items, their removal will raise the world prices of the latter and hurt the real incomes of the importing countries.

Table 4 classifies the three groups of countries according to their net position in agriculture as a whole rather than just food. Here more Low Income Countries appear as exporters—33 versus only 15 when we consider only food items. But the picture is more pessimistic if we focus on the LDCs only. At the time Valdes and McCalla wrote, there were 48 LDCs in the world. Of these, as many as 45 were net food importers and 33 net agricultural importers.

Some analysts argue, however, that the importers need not necessarily lose from the increase in agricultural prices that will follow the removal of the production and output subsidies by the EU (and other developed countries) because many of them will become exporters of the products at the higher prices. But two arguments can be offered why this assertion is unpersuasive. The first argument, discussed immediately below with the help of Figure 2, is a "likelihood" argument. The second one, discussed next, is logically tight and especially applicable to the LDCs.

In Figure 3, dd and ss respectively denote the demand and supply curves of a developing country that initially imports wheat. The world price of wheat in the presence of the production subsidy, given to their producers by the developed countries, is $P_s$. The developing country imports wheat and makes net gains from trade equaling the triangular area marked "a". The removal of the subsidy by the developed countries raises the price to the free trade level indicated by $P_f$. At this higher price, the developing country turns into an exporter of wheat. The gains from trade are now given by the triangular area b, which is smaller than area "a". Thus, the country loses on a net basis despite turning its status from importer to exporter. Only if the world price increases sufficiently to make area b larger than area "a" will the country make a net gain from the removal of the developed country subsidy.

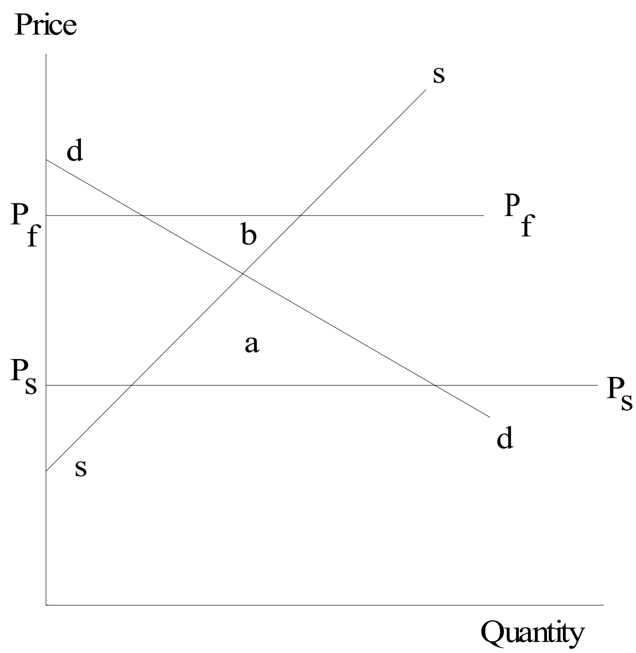


Figure 3: A developing country turning from a net importer to exporter

Indeed, the complete and realistic story from the viewpoint of the LDCs is even more pessimistic. In many products, under free trade, EU would be an importer. Yet, through a combination of export and output subsidies on the one hand and import tariff on the other, it maintains a regime in which it ends up being an exporter of the product. Thus, in Figure 4, let DD be the EU demand curve and SS its supply curve of wheat. By assumption, under free trade, EU would be an importer with the price settling at $P_f$ in the spirit of Figure 1. But an export subsidy combined with a tariff turns the EU into an exporter of the product.[7] Specifically, suppose it gives an export subsidy equal to $P_tP_s$

[7] To avoid clutter, I suppress the production subsidy now but the reader can readily include it by imagining that SS represents the production subsidy inclusive supply curve and modifying the remainder of the analysis accordingly.

per unit, complemented by a tariff at the same or higher rate. These measures push the external (world) price down to $P_s$ (since EU is a large exporter in the world market, the expansion of its exports depresses the world price) and the internal price up to $P_t$.

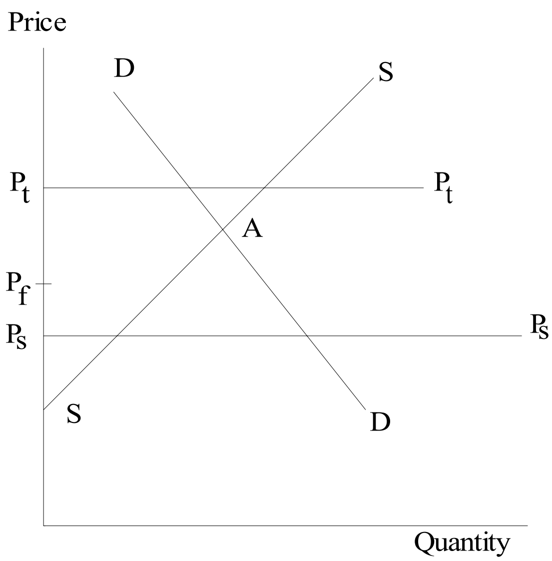


Figure 4: Under the EBA, LDC exporters sell at $p_t$ and buy at $p_s$. Under free trade they will have to buy and sell at $p_f$.

If we now start with the export subsidy and tariff in the initial equilibrium and consider their removal, the outcome will be similar to that in Figures 1 and 2. As there, the importers of the product will lose from the price rise and exporters will benefit. The key complication that we have not introduced so far and may now be considered is that in so far as the LDCs are concerned, under the EBA, they are currently allowed to export to the EU at its *internal* price; that is, at $P_t$. And those that import the product get to buy it at the lower world price $P_s$. When the subsidy and tariff are removed, both the EU and the world price converge to $P_f$, which is lower than $P_t$ that the LDC exporters received and higher than $P_s$ that the LDC importers paid earlier. Both exporting and importing LDCs are hurt from the liberalization.

The assertion that importers of agricultural products can benefit from the tariff-export-subsidy removal by turning into exporters can now be seen to have no logical basis in the case of the LDCs. Under the EBA, in the initial, distorted equilibrium, the importing LDCs face the price $P_t$ if it wants to export rather than import the product. If it is unable to export at that price, it surely cannot export at the lower, free trade, price, $P_f$. Needles to say that the analysis of Figure 4 is readily modified to include an output subsidy. All that is needed is to interpret SS as the supply curve inclusive of the output subsidy (similarly to S'S' in Figure 1) and $P_f$ as the world price with output subsidy but no other intervention.

Indeed, the danger that the LDCs will lose from the developed-country liberalization is even greater than that suggested by the analysis based on Figures 1-4 above. This is because, in anticipation of the liberalization under the Doha Round, the politics within the developed countries is already pushing the import barriers up in the form of Sanitary and Phytosanitary (SPS) measures. This process will escalate in the post-Doha world. And in so far as the LDCs are at a much greater disadvantage than their counterparts in the Cairns Group and the developed world at overcoming these highly sophisticated technical barriers, they are in danger of losing even some of their existing market access.

Given the above dissection of agricultural liberalization from the viewpoint of the LDCs, how do we explain the ruckus at Cancun over the cotton subsidies? Recall that some of the poorest countries were at the forefront of the demand for the removal these subsidies. The answer is that this case *is* consistent with the popular rhetoric of the developed-country subsidies hurting the poor countries. But it is also an exception.

Cotton happens to be a product in which the EU does not have major producer interests to protect so that its internal price is close to the world price. Therefore, the EBA is not much help in this product. Indeed, by far the largest subsidy on this product is given by the United States, followed by China, a developing country herself. But even in this exceptional case, I may note that by far the largest LDC in terms of population, Bangladesh, is a substantial importer and stands to lose from the end to the cotton subsidies.

A powerful example of the flaw in the populist view that the developed-country subsidies in agriculture hurt the poor developing countries (including but not limited to the LDCs) was provided recently by the WTO dispute settlement case on the EU export subsidies on sugar. The case was brought by Brazil, a middle-income developing country, which is also a member of the Cairns Group. The subsidized exports in this case had allowed the EU to import sugar from the African, Caribbean and Pacific (ACP) countries and India at its internal price. Not surprisingly, rather than support Brazil in its challenge and celebrate the ruling, these latter countries sided with the EU and saw the ruling as hurting their interests.

We may also ask how it is that many studies have shown or claim to show that the developed-country agricultural liberalization promises large benefits to the LDCs. The answer is that, to my knowledge, with one exception, no study has considered in isolation the impact of the developed-country liberalization in just agriculture on the LDCs while taking the role of the EBA into account.[8] For example, following my article in the

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[8] Researchers W. Yu and T. V. Jensen (2003) of the Danish Research Institute of Food Economics, who study the effect of EU liberalization in agriculture taking into account the EBA do find that such liberalization hurts the poor countries.

*Financial Times* (Panagariya, 2004b), William Cline (2004) of the Institute for International Economics claimed in a letter that even if net agricultural importing countries lose from the rise in the prices of agricultural products following the removal of the subsidies, his model shows that they will benefit from improved prices of their manufactures exports. But given the structure of the problem as expounded above in Figure 1, this is not plausible unless one is considering, not just agricultural liberalization, but the entire package including the liberalization of textiles and apparel and footwear by the developed countries, which is altogether a different question.[9]

Thus, for example, if we think in terms of a three-good model—an exportable agricultural product, an importable agricultural product and an industrial good that may be exported or imported—my analysis above shows that agricultural liberalization by the developed countries will lower the LDC price of the exportable agricultural product and raise that of the importable agricultural product in terms of the industrial product. Both of these changes represent an unambiguous deterioration of the LDC terms of trade.

Some studies also fail to identify the LDCs that lose because they lump them with other countries in the region that gain sufficiently that the region as a whole gains. Yet another common practice is to lump the developing-country liberalization with the developed-country liberalization. In so far as there are major gains from the liberalization by the developing countries including LDCs themselves, the net effect of the package on the LDCs may be positive even if the effect of the rich country liberalization in isolation is negative. While these are all legitimate and interesting

[9] See my reply to Cline (Panagariya 2004c) in this context.

exercises in their own right, they do not allow us to conclude that developed-country protection and subsidies in agriculture hurt the LDCs.

***Fallacy 3: Developed-country subsidies and protection hurt the poor, rural households in the poorest countries.***

This fallacy is to be distinguished from the previous one in that it focuses on the fortunes of a specific group within the developing countries rather than the countries as a whole. The essential argument behind the assertion is that even if the developed-country subsidies benefit an LDC that is predominantly an agricultural importer, they hurt the poor farmers within it since the latter earn their living by producing import-competing agricultural goods. In effect, the low price of farm goods results in a low value of the farmers' product at the margin.

For the LDCs, the logic behind this argument is hardly tight. Recall that the current regime keeps the prices of agricultural exports facing LDCs high and of the imports low relative to the respective levels that would prevail under a liberalized regime. If the LDC now happens to specialize in the production of the exportable products, the wages of the farmers vary directly with the prices of those products. The higher price of exports thus helps raise the farm wages. Indeed, in so far as the farmers may be consuming predominantly the imported agricultural products (recall that the vast majority of the LDCs are net food importers), the low import prices are to *their* benefit as well.

It is, of course, entirely possible to construct cases in which the current EU regime hurts the wages of the LDC farmers. In so far as an LDC produces both exportable and importable agricultural products, the net effect of the higher price of the former and lower price of the latter in terms of a third good, say manufactures, can be to lower the real wage. In non-LDC developing countries producing importable agricultural products, this outcome is even more likely.

But from the policy perspective, this outcome begs the question why no institution including the World Bank, IMF, OECD and Oxfam has advised the LDCs to impose countervailing duties on the subsidized imports till today. If the objective happens to be to maximize the incomes of the poor farmers in the LDCs, the better option would be to leave the EU protection and subsidies intact and encourage the LDCs to impose countervailing duties on their subsidized agricultural imports. Under this scenario, the internal price of the imported products would still rise without the deterioration in the terms of trade and the country will be able to generate extra revenues to affect further transfers to the poor. Those who make the above assertion have become prisoners of their own rhetoric and therefore failed to think through the available policy options.

***Fallacy 4: Developed-country agricultural protection and subsidies constitute the principal barrier to the development of many poor countries.***

This is perhaps the most dangerous of the six assertions considered in this paper. For one thing, the premise underlying the assertion is just not true. Despite the protection that remains, developed-country markets are sufficiently open that countries with good internal policies can readily expand their exports. As economist Robert Baldwin (1982) has demonstrated, protection is almost always porous so that determined exporters are able to find ways to enter their partner country markets. The exporters in the far eastern countries amply illustrated this in the 1960s and 1970s. Despite barriers in the industrial countries, those exporters found ways to expand their export sales. On the other hand, countries such as India that persisted in their belief that the world markets could not be relied upon languished. Today, countries such as Chile have found ways to expand even their agricultural exports to the United States. Sugar may be off limits but many fruits and vegetables are not. And in so far as the LDCs are concerned, as I have already explained at length, they have virtually free access to the EU agricultural market under the current regime.

As was true in the 1960s and 1970s, it is true today that much more serious barriers to development are the internal policies. The inability of the LDCs to export to the developed-country market is largely (though, admittedly, not exclusively) the result of the supply-side constraints that are of their own making. The sooner we recognize this fact the more urgently will the countries and international institutions focus their attention on how best to overcome these constraints. Telling the countries that the developed countries are responsible for their woes may make one popular but it does the countries no good. It only encourages complacency towards domestic policy reform in these countries and without those reforms no amount of opening up by the developed countries will kick off growth.

***Fallacy 5: Agricultural protection reflects double standard and hypocrisy on the part of the developed countries.***

The argument often made is that the developed countries have opened markets where they have comparative advantage but retained barriers on the products in which the developing countries have comparative advantage. This is said to be especially true of agriculture, which was kept essentially out of the discipline of the General Agreement on Tariffs and Trade (GATT) until the Uruguay Round and is still the most protected sector.

Again, such assertions betray basic misunderstanding of the history of trade negotiations. The continuing protection of agriculture in the developed countries is the result of two distinct forces.

First, by and large, the developing countries opted out of the multilateral negotiations in the 1960s and 1970s. Because they made no liberalization commitments in the multilateral rounds prior to the Uruguay Round, they got no liberalization commitments from the developed countries in the products of their export interest. The developed countries negotiated liberalization among them and therefore liberalized largely in products of mutual interest to them. In so far as the Most Favored Nation (MFN) principle extended this liberalization to all GATT members, countries capable of exporting the liberalized products got a "free ride." That liberalization was in part behind the phenomenal success of the far eastern countries in the 1960s and 1970s.

From one perspective, the position taken by the developing countries as a group may have been worse than that of indifference. In the 1960s and 1970s, they were wedded to the import-substitution-industrialization (ISI) policies, did not want to rely on agricultural exports, and actually pursued policies that repressed agriculture.[10] In addition, in so far as agricultural subsidies led to surpluses that were shipped to the poor countries as "food aid", as under the PL480 programs of the United States, principal recipients of such aid did not see the subsidies as harmful to their interests. Therefore, whatever demands they made on the developed countries on moral grounds did not include demands for market access in agriculture. As a part of the demands for the so-called New International Economic Order (NIEO) following the successful OPEC oil

[10] Victoria Curzon Price (2004) has made this point recently.

price hike in 1973, their demands included the *stabilization* of agricultural prices and the transfer of specific, labor-intensive manufacturing industries to the South but not an end to the subsidies and protection in agriculture.

The second force at work was internal to the developed countries themselves. Domestic politics in the Quad countries--the United States, European Community, Canada and Japan—favored protection to farmers. The pro-protection lobbies in this sector were far more powerful than the export interests. As such, whereas the export lobbies carried the day in manufacturing, the same did not happen in agriculture. Thus, the internal politics and the absence of external pressure for liberal regime rather than hypocrisy and wickedness combined to perpetuate a protectionist regime in agriculture.

***Fallacy 6: What the donor countries give with one hand, they take away with the other.***

This argument is often backed up by the example, noted earlier and highlighted in the UNDP Human Development Report, 2003, that Europeans gave only $8 per person in aid to Africa while giving as much as $913 per European cow in subsidies in 2000. Of course, a direct comparison of these numbers, while shocking, is downright silly. To begin with, all countries spend a lot more on internal redistribution of income than on the international redistribution. Developing countries themselves pursue policies aimed at the redistribution of income in ways that is comparable to the subsidy to the European cows.

But more to the point, a proper comparison should be between the harmful impact of the subsidies and the grant-in-aid equivalent worth of aid. As I have already argued in the context of Fallacy 2 above, in so far as the LDCs are concerned, the current tariff-subsidy regime works to their advantage in that it gives their exporters access to the high internal EU price and offers their importers the low international price. But even for the exporter countries that do not have access to the EU internal price and therefore suffer on account of the low international price at which they must sell, we must compute the loss to them from the deterioration in the terms of trade caused by the developed-country subsidies and protection. That loss is likely to be only a small fraction of the subsidies given to all European cows, acres, men and exports.

Symmetrically, what commonly passes as "aid" in the public policy discourse is not all grants-in-aid. Even the World Bank International Development Agency (IDA) funds take the form of loans at concessional terms so that only a fraction of the dollar flow is grants-in-aid. In addition, one must make the correction for conditionality that may accompany aid. If, for instance, aid is tied to a specific project or a specific market in which it must be spent, its real value further declines. The real value of the "aid" flow is thus likely to be less than the nominal value.

## 4. Concluding Remarks

There are compelling reasons to reject the view, popularized by many international organizations, NGOs and the media, that developed-country subsidies and protection hurt the poorest countries, the LDCs; that agricultural protection is principally a developed-country problem; that developed-country protectionism and subsidies constitute the principal barriers to the development of Africa; and that the developed-country protection in agriculture is the result of their hypocrisy and wickedness.

First, such simplistic assertions may make one popular with the poorly informed but they do no good to the poor themselves. If we persist in making these assertions and the poor eventually find out that the liberalization under the Doha Round ended up harming their interests, they would be disenchanted with liberalization and we would have compromised the cause of free trade in the long run.

Second, without recognition of the detrimental effects of the liberalization on the LDCs, we will fail to design compensation mechanisms and safety nets necessary to smooth out the adjustment to the more liberal regime. Developed countries have the necessary resources to come up with their own safety nets but the poor countries lack them and depend on the international transfers bilaterally or through such institutions as the World Bank.[11] Also important here is the needed focus on the creation of capacity for satisfying the SPS measures that are likely to become even more ubiquitous in the developed countries in the forthcoming years.

Finally, unless we point out to the poor countries that to take advantage of a more open and competitive world trading system they too must open up rather than seek exemption from such liberalization, we will condemn them to the same fate they currently suffer. Opening just the developed country markets will not be enough; the poor countries must generate the proper supply response through the reform of their own policy regime, which includes but is not limited to their own opening up.

Before I conclude, let me recall that there has been a longstanding tradition of the study of the implications of the developed-country agricultural policies for the developing countries among economists. Nearly four decades ago, Richard Snape (1963) and Harry Johnson (1966) produced quantitative estimates of the effects of sugar

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[11] Following pointed criticisms by Bhagwati and Panagariya (2002), The heads of IMF and World Bank, Kohler and Wolfensohn (2003), have belatedly recognized the merit of liberalization by both developing and developed countries under the Doha Round and the need for such adjustment assistance. In turn, Bhagwati and Panagariya (2003) have welcomed the conversion of the two institutions in favor of trade liberalization by the developing countries as well.

protection and the associated quota regime in the developed countries on developing countries and suggested how the latter could be assisted through better policies in the developed countries and a move towards free trade.  Based on the calculations he undertook, Johnson reached two conclusions (1966, 41-42):

> "The first, and firmer, is that the prevalence of sugar protection has substantial effects both in wasting resources and in reducing the earnings of the less developed countries that have a comparative advantage in sugar production. According to the rough estimates presented here, replacement of the present national system of protection by deficiency payments (scientific protectionism) would increase the export earnings of these countries by something in the neighborhood of half a billion dollars, and free trade would increase their export earnings from the seven major countries alone by something in the neighborhood of three quarters of a billion dollars…Free trade would free resources that would go automatically or could be contributed as foreign aid to the less developed countries to an amount in the neighborhood of half billion dollars (to be compared with the current foreign aid total of all countries and international organizations of about ten billion dollars, a figure probably nearly double the net transfer of real resources actually involved.)."

In stating the second conclusion, Johnson drew a sharp distinction between the developing countries that benefited from access to the developed country internal price through sugar quotas and those exporting at the world price.  Two years earlier, Raul Prebisch had argued in UNCTAD (1964) that developed countries give the other sugar exporters the same price that they give their own producers and the quota beneficiary countries. Johnson suggested that free trade offered a better deal for all. Thus, he wrote:

> "Secondly, and less surely owing to lack of quantitative information on the effects of existing preferences for the important group of less developed countries, it appears that the abandonment of sugar protectionism in favor of free world competition in sugar could increase the resources available to the less developed countries by more than could a Prebisch-type policy of 'internationalizing' sugar protection. Moreover, in contrast to the latter policy, which would merely transfer resources from developed to less developed countries through an increase in prices, a policy of free trade would make additional resources available without cost to anyone, [footnote] as a consequence of the increased efficiency of resource allocation it would produce."

Even back then, Johnson was cognizant of and sensitive to the adjustment costs that may accompany the free trade policy. In the footnote to the last sentence above, he added the qualification, "In the short run, there would be some costs involved in shifting resources out of sugar production, but it is reasonable to assume that resources are mobile enough in the developed countries to absorb a shift out of sugar production without intolerable social strains." The global community would do well by accepting an augmented version of Johnson's solution even today: free trade in both developed and developing countries that increases efficiency, and increased aid from developed to the developing countries, especially the LDCs, that can be used among other things to offer adjustment assistance to those free trade would temporarily displace.

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Table 1: Post-Uruguay-Round Bound Tariffs on Imports of Agriculture (Percent)

| Country | Share of Duty Free Tariff Lines | Simple Average (OECD Estimate) | Simple Average (World Bank Estimate) |
|---|---|---|---|
| North America | | | |
| Canada | 42.9 | 4.6 | 8.8 |
| United States | 27.9 | 5.5 | 9 |
| Latin America | | | |
| Argentina | 0.1 | 32.8 | 32.5 |
| Brazil | 2 | 35.3 | 35.2 |
| Colombia | 0 | 88.3 | 105.6 |
| Mexico | 0.1 | 42.9 | 25.1 |
| Venezuela | 0 | 55.4 | 67.7 |
| Western Europe | | | |
| EU-15 | 26.5 | 19.5 | 20 |
| Iceland | 21.1 | 48.4 | 72.1 |
| Norway | 23.4 | 123.7 | 50.4 |
| Switzerland | 28.2 | 51.1 | 46.9 |
| Turkey | 0 | 63.9 | 74.3 |
| Eastern Europe | | | |
| Czech Republic | 30.5 | 13.3 | 18.9 |
| Hungary | 8.4 | 22.2 | 6.7 |

| | | | |
|---|---|---|---|
| Poland | 2.9 | 52.8 | 38.3 |
| Romania | 0 | 98.6 | 130.2 |
| Asia/Pacific | | | |
| Australia | 32.6 | 3.3 | 2.5 |
| Bangladesh | 0 | 83.8 | |
| India | 1.6 | 124.3 | 101 |
| Indonesia | 0 | 47.2 | 59.9 |
| Japan | 31 | 11.7 | 29.7 |
| Korea, Rep. of | 2.2 | 62.2 | 39.6 |
| Malaysia | 14.2 | 13.6 | 39 |
| New Zealand | 50.6 | 8.7 | 0.7 |
| Philippines | 0 | 35.3 | 46.9 |
| Sri Lanka | 0 | 50 | 50 |
| Thailand | 0.7 | 34.6 | 43.2 |
| Africa | | | |
| Tunisia | 0 | 116.7 | 15.1 |

Source: World Trade Organization (2001, Table III.3).

Table 2: Actual and Bound Tariff rates

| Country | Definition* | Actual | | Bound (Final)** |
|---|---|---|---|---|
| | | Rate | Year | |
| Developed | | | | |
| Australia | HS | 1.2 | 1998 | 3.3 |
| Canada | WTO | 24.7 | 1998 | ? |
| Japan | WTO | 26.3 | 1996 | 25.3 |
| Poland | WTO | 34.2 | 1999 | 55.5 |
| United States | WTO | 10.7 | 1999 | 8.2 |
| Developing | | | | |
| Bangladesh | HS | 25.1 | 1999/2000 | 188.3 |
| Bolivia | HS | 10 | 1998 | 40 |
| Egypt | WTO | 64.9 | 1998 | 84.1 |
| Indonesia | HS | 8.6 | 1998 | 47.3 |
| Israel | HS | 21.9 | 1999 | 74.9 |
| Jamaica | HS | 20.2 | 1997 | 100 |
| Kenya | WTO | 16.7 | 1999 | 100 |
| Mali | HS | 28.7 | 1997 | 60 |
| Papua New Guinea | HS | 22 | 1999 | 45 |
| Peru | WTO | 17.8 | 1999 | 31.1 |
| Romania | HS | 32.3 | 1999 | 112 |

| | | | | |
|---|---|---|---|---|
| Singapore | HS | 0 | 1999 | 9.6 |
| Trinidad and Tobago | HS /WTO | 19.1(HS) | 1998 | 100 (WTO) |
| Thailand | HS | 32.1 | 1999 | 32 |
| Uruguay | HS | 13 | 1998 | 35.2 |

*Sectoral tariff averages vary with the definition used. The HS definition of agriculture (HS 01-24) includes fishing and forestry, while the definition of agricultural products used for the purpose of the Uruguay Round negotiations (WTO definition) excludes fish and fishing products (HS 03 and parts of HS 16) and includes items regarded as agricultural from HS 29, 33, 35, 38, 41, 43, 50, 51, 52 and 53 (Annex 1 of the Agreement).

** Developed-country Members have to implement reduction commitments over a six-year period commencing in 1995 while developing-country Members have the flexibility to implement reduction commitments over a period of up to 10 years commencing in 1995. Least-developed country Members are not required to undertake reduction commitments.

Source: WTO (2001, Table III.5)

Table 3

| | LIC | LMIC | UMIC |
|---|---|---|---|
| NFIM | 48 | 35 | 22 |
| NFEX | 15 | 17 | 11 |
| Total | 63 | 52 | 33 |

Source: Valdes, Alberto and McCalla, Alex F., 1999

Table 4

| | LIC | LMIC | UMIC |
|---|---|---|---|
| NAIM | 30 | 32 | 23 |
| NAEX | 33 | 20 | 10 |
| Total | 63 | 52 | 33 |

Source: Valdes, Alberto and McCalla, Alex F., 1999