Market Access: Agricultural Policy Reform and Developing Countries

Introduction
The conversion of all non-tariff measures into bound tariffs with reduction commitments and the introduction of minimum access commitments in the form of import quotas (as a share of domestic consumption) are two of the most important achievements of the Uruguay Round Agreement on Agriculture (URAA). Nevertheless, import protection for agriculture remains very high and nontransparent, especially in rich countries. The average agricultural bound tariff worldwide is estimated to be 62 percent, with a large variation of import protection rates among commodities and countries. In addition, about 28 percent of domestic production in countries belonging to the OECD is protected by import quotas with high out-of-quota tariffs. Tariff peaks remain very high—500 percent or more in some cases—and tariffs in many countries increase by degree of processing, creating an escalating tariff structure that limits imports of processed food products.

Within OECD countries, total transfers to farmers (from taxpayers and consumers) averaged to about USD 235 billion (B) per year in 2000–02. Although still a very high number, the rate of protection—support as a percentage of farm revenues at world prices—decreased from 62 percent in 1986–88 to 49 percent in 2000–02. Of these transfers, USD 148 B came from import barriers, down from USD186 B in 1986–88. The share of transfers to farmers from border measures declined sharply in that time period, from 77 percent to 63 percent currently.

The shift away from border protection in OECD countries to domestic support occurred mostly in the grains and oilseeds sectors (figure 1). The overall rate of protection for grains and oilseeds dropped rapidly after 1987, and has stabilized since. These developments came primarily because in 1986 and 1987, tariffs were abnormally high (when world prices were abnormally low), and were mainly due to unilateral policy reform, not binding WTO commitments. The overall rate of protection started at close to 120 percent in 1986 for grains and oilseeds and fell to a low of 50 percent in 1996, but stood at 77 percent in 2001. The cyclical component of protection over time reflects changes in world prices more than changes in policy. The overall average protection for grains and oilseeds is 80 percent for the time period 1986–2001. The growth in domestic support payments, especially in recent years, is evident.

The rates of protection for all other commodities, however, have a far less pronounced downward trend in protection, although the average rate of protection is lower at about 50 percent (figure 2). Purchased input subsidies and output price support have been fairly constant for the grains and oilseed sectors and all other commodities. Although support for these other commodities is still dominated by border protection, this is declining. Many developing countries have reformed agricultural policies and have lower protection rates. Several middle income countries, however, have moved toward more border protection in agriculture.
The URAA provisions on market access had only a modest impact on trade liberalization, mainly because tariff reductions were based on average reduction in tariffs, rather than a reduction in the average tariff, and because of the high tariff base year upon which reductions were made. Poor performance of global agricultural production should not be blamed on trade liberalization because very little has transpired and because increases in other forms of support have kept total support more or less constant since 1988. Even though rates of border protection are trending downwards, mostly in grains and oilseeds, the number of farms has declined even faster, so per farm subsidies have increased.

Although the URAA itself may not have led to much liberalization of agricultural trade, it does limit the type of border instruments countries can use. The new quantitative commitments now universally established in agriculture have made market access issues considerably easier to negotiate in the current WTO negotiations. Issues in market access that are particularly relevant for developing countries include:

- Lowering tariffs, tariff escalation and effective protection, tariff peaks and tariff dispersion across commodities and countries.
- Increasing import quotas.
- Improving the rules on quota administration methods (including State Trading Enterprises) to make them more transparent, to improve fill rates so imports are not discouraged or blocked, and to ensure access by lowest-cost suppliers.

- Limiting the application of special safeguard, anti-dumping and countervailing duties, and other contingent measures so that they are not used to unfairly restrict market access.
- Rationalizing product regulations such as sanitary and phytosanitary (SPS) conventions, labeling laws, other non-trade concerns, so that they cannot be formulated as non-tariff barriers.
- Devising rules of special and differential treatment for developing countries that provide greater benefits from a more liberalized trading environment.

This note discusses the first three of these negotiating issues and presents some ideas for reform.

**Import Tariffs**

The most relevant items on the agenda for market access are abnormally high tariffs, with bound rates higher than the applied rates (called “tariff overhang”) and a gap between the world price plus the applied tariff and the observed domestic price (also called “tariff water”). Water indicates that the protection provided by the tariff is redundant, and may occur when import quotas are binding, but with their tariff equivalent lower than the applied tariff, or when the product is exported or not traded, making the applied tariff irrelevant.
Barriers in market access were collapsed into two forms by the URAA: tariffs and formal tariff rate quotas (TRQs) (with a large number of agricultural and food products having tariffs and TRQs simultaneously); and remaining contentious non-tariff barriers like SPS. The tariffication process in the URAA assured access at bound tariffs for all commodities, but each country was also required to designate tariff rate quotas for most commodities where quantitative barriers were tariffed. Import quotas are commitments to allow access at least up to the quota level at the in-quota tariff rate. The quota specified was either the level of imports in the 1986–88 base period or 3 percent of domestic consumption (to increase to 5 percent by the year 2000) whichever was larger. Where prior imports exceeded these levels, countries were required to use TRQs based on current import market opportunities. Out-of-quota imports were allowed, but only at the (often much) higher out-of-quota tariffs. Out-of-quota tariffs were to be reduced by an unweighted simple average of 36 percent (minimum of 15 percent per tariff line) by 2000–01 (and four years later for developing countries).

Requiring an average cut in tariffs rather than a cut in average tariffs meant that a country could make a large cut in a tariff that was already low (for example, a cut from 2 percent to 1 percent represents a 50 percent reduction) or in sectors with low political sensitivity, while making only the minimal cut required in sensitive product categories. The effectiveness of tariffication was further compromised because out-of-quota tariffs were often initially set at such high levels (known as the process of “dirty tariffication”) as to effectively prevent all imports above the quota levels. To address the concern of sudden import surges or depressed import prices, a special safeguard for agriculture was added but only for products that had been tariffed. Developing countries were not required to undertake tariffication but instead could opt for ceiling bindings, and were not required to introduce TRQs nor to commit to tariff reductions on these products.

Regional average bound tariffs for WTO members range from an ad valorem equivalent of 25 percent to 113 percent. With the exception of Non-European Union Western Europe, the regional groups with the highest average tariffs are composed of developing countries. However, this comparison is not indicative of the actual protection used by developing countries because these bound tariffs are much higher than applied tariffs (tariff overhang). Because overhang is most common in developing countries, the estimated levels of tariff overhang for a selected group of commodities and developing countries are depicted in figure 3. On the other hand, tariff water occurs mostly in developed countries, where binding import quotas are prevalent. Some evidence of tariff water is given in figure 4 for some commodities in a selected group of OECD countries. The magnitude of both tariff water and tariff overhang implies that a substantial reduction in tariffs may be needed to achieve significant trade liberalization.

The average tariff for agricultural products in developing countries declined from 29.6 percent in 1990 to 22.9 percent in 1995 and to 18.4 percent in 2000–higher than tariffs on manufacturers of 11.4

![Figure 3: Estimates of Tariff Overhang for Selected Developing Countries (percent)](image)
percent in 2002. Annual average quota rents and tariff revenues world-wide are in the order of USD 49 B.

Although tariff quotas were to increase market access for commodities that previously faced quantitative barriers, the high in-quota and out-of-quota tariffs still remain. Across all WTO members, the average out-of-quota tariff for commodities with import quotas is 123 percent while the simple in-quota tariff average is 63 percent. The average tariff mark-up of out-of-quota tariffs over in-quota tariffs is 336 percent.

Of the 46 commodity aggregates, average tariffs on 18 of the groups are above the global agricultural tariff average of 62 percent. These commodities include tobacco, dairy, meats, sugar, vegetables and grains. Data demonstrate there is a high dispersion in tariff rates in OECD countries, with a large number of tariff peaks for products of interest to developing countries, such as sugar and rice. A uniform tariff structure is preferred over highly dispersed tariffs because resource misallocation is exacerbated with an increasing degree of tariff dispersion.

Average tariffs on processed agricultural products are found to be systematically higher than raw materials or products with low levels of processing, phenomenon known as “tariff escalation.” Escalation is a pervasive feature in both developed and developing countries. It biases exports towards unprocessed resource-based commodities, characterized by low value added. This is an obstacle to commodity dependent developing countries in their attempt to diversify their export base.

**Suggestions for New Rules on Tariff Reduction Commitments**

The process by which the URAA intended to increase market access has made only limited progress toward its goal. The current regime in agricultural trade is dominated by mechanisms that are non-transparent (e.g., quotas, specific tariffs) and highly trade-distorting. The current negotiations should make the system more transparent and significantly increase access by achieving cuts in tariffs that are sufficiently deep to “squeeze out” the existing water and reduce the tariff overhang, as well as ensuring that the influence of quotas and other non-transparent protective devices is minimized. Several options are presented here and in box 1 for making progress toward these objectives.

- Aim for larger reductions in high tariffs in order to reduce tariff dispersion and tariff escalation, perhaps using a Swiss-formula type mechanism.
- Establish a maximum tariff with a more liberal tariff rate quota for products at or near the maximum tariff.
- If countries are to have flexibility in reducing individual tariffs, ensure that there are incentives for larger reductions in higher tariffs.
- Reduce all in-quota tariffs to zero.
- Tighten the rules on anti-dumping, countervailing and special safeguard duties—although a limited set of safeguards may be required for politically sensitive commodities in developing countries.
- Convert all specific tariffs to ad valorem equivalents.
Box 1: What Should be Done? Expand Quotas or Reduce Tariffs?

Trade liberalization with import quotas is very complex, involving two tariffs, a quota, and sometimes several specific situations such as over-quota imports at the in-quota tariff, quota under-fill, preferential quotas, and preferential tariffs. Given that only minimal market access has been ensured by the implementation of quotas, what is the appropriate objective for trade negotiators? Negotiators should focus on reducing out-of-quota tariffs, especially in those cases with out-of-quota imports or if the out-of-quota tariff is close to the tariff equivalent of the binding quota. If this tariff equivalent is far below the out-of-quota tariff, increasing the quota will have a greater chance of liberalizing trade in the short run. A reduction in in-quota tariffs will liberalize trade only if the out-of-quota tariff is close to or below the in-quota tariff, in which case both tariffs need to be reduced, or if under-fill is significant because the in-quota tariff is binding—otherwise, quotas will also have to be increased in order to obtain trade-liberalizing effects. But as long as quota rents remain with a tariff quota regime, beneficiaries will resist trade liberalization. The best solution would be to eliminate quotas altogether and reduce the out-of-quota tariff significantly, given the prevalence of tariff water and tariff overhang.

- Do not employ tariffs to fulfill “non-trade” concerns.

Import Quotas

Since 1995, 1,425 TRQs have come into effect as a result of the URAA. Rents generated by import quotas provide an opportunity for firms to spend resources in competing for these rents, with the amount of rents wasted depending on the method by which import quota licenses are allocated across firms and countries. No specific provisions were approved in the URAA regarding administration of quotas, although relevant WTO rules for import quotas in general were to apply. Imports are technically allowed to exceed the quota, but a higher tariff is paid on the out-of-quota imports. The higher tariff can be prohibitive and as a result, effective entry of the product is often limited to the import quota.

Understanding the characteristics of efficient tariff quota administration methods is a requisite step toward reform. An efficient tariff quota administration method allows the lowest-cost importing firm or exporting country to obtain the licenses or quotas. Transparency is key and can be accomplished with a simple regulatory system including tradability of licenses and quotas.

Almost 50 percent of the total tariff quotas notified to the WTO is administered with applied tariffs, which means no quota shares are allocated and imports are permitted at unlimited quantities at the in-quota tariff rate or lower.

Of the other methods, “license on demand” is the most commonly used. Import licenses are allocated in relation to quantities demanded and requests are typically reduced pro rata if the total request exceeds the quota volume. This allows inefficient firms to remain in business. Each firm is allocated the same number of licenses, depending on the number of trading firms requesting licenses, regardless of the underlying cost structures of the participating firms. Inefficiency results because low-cost firms on average get relatively fewer licenses than is optimal, and quota under-fill also results because high-cost firms use licenses only up to their desired level of imports.

“First come, first served” is the next most commonly used administration method. This allows imports at the in-quota tariff rate until the quota is filled. This method is prone to wasting resources by concentrating imports at the beginning of the season, increasing storage costs for importers, and discriminating against competitive exporters with different seasonal prices. The cost to traders of establishing a business relationship over time with importers is a factor contributing to quota under-fill.

“Historical allocation” is a method whereby licenses are issued in relation to past imports. Either import licenses are allocated to importing firms or country specific export quotas are granted to exporters on the basis of historical shares. This leads to a waste of global resources if the lowest-cost exporting country or importing firm does not receive the rights to import, because the historical share of imports does not reflect changes in market conditions or comparative advantage across trading firms or countries over time.

The impact on efficiency when a “State Trading Enterprise” (STE) controls the import quota depends critically on its objective function (whether to maximize producer income or self-sufficiency, etc.). The impact also depends on the STE’s degree of control, whether it has an obligation to fill the
quota or not, how quota rents are distributed, and the level of the quota relative to in-quota and out-of-quota tariffs. However, a general conclusion is that STEs may have fewer incentives to fill the quota. Allocating quotas to STEs, especially pro-
ducer-representing ones, can reduce efficiency if they discriminate across countries or choose low quality products for political reasons, even with 100 percent fill rates.

The “lottery” option for distributing import quotas is not discussed in WTO documents but is used by many countries including the US. Lottery is efficient in that a firm cannot affect the likelihood of obtaining the license, and so has no incentive to engage in lobbying activities. Nevertheless, there are incentives for firms to break down into many small firms to increase the probability of receiving a license. Such rent-seeking activities involve economic inefficiencies. Furthermore, high-cost firms may win the lottery and this, if the licenses are non-tradable, results in economic waste.

“Auction” is the remaining method of administration. Under auctioning, licenses are allocated on the basis of a competitive bid system. While the auction itself is a relatively efficient way of distributing quotas, many times other conditions are attached to quota allocations. Additional conditions can take various forms, including a domestic purchase requirement (a condition requiring the purchase of domestic production of the product in order to be eligible), limits on tariff quota shares (which limits the maximum share or quantity of the quota allowed), export certificates (a condition that requires an export certificate administered by the exporting country), and past trading performance (which limits eligibility to established importers of the product concerned).

Additional conditions can lead to wasteful rent-seeking activities as well. A domestic purchase requirement increases the cost for some importing firms and encourages high-cost domestic production. Thus, part of the quota rent is dissipated and fill rates are lower as domestic consumption declines and production increases. Limits on quota shares do not allow for economies of size and coordination, again resulting in the dissipation of quota rents. Limits on quota shares discriminate against more distant suppliers for whom shipload amounts are the economic size of shipment, rather than truckload lots, for example.

The method of quota allocation can have significant implications for trade liberalization. The best option is to replace all tariff quotas by complete tariffication. The second best outcome is to reform current quota administration rules. In order to make quota administration rules more transparent, to improve quota fill rates and to ensure access by low-cost suppliers, negotiators should consider the following options for reforms:

- All countries could adopt auctions of quotas to the highest bidder and eliminate all other quota administration methods listed above. This has significant advantages over other schemes. Not only does it ensure that quotas are allocated to the lowest-cost producers who would be able to bid the highest, but it also ensures that quotas are fully utilized.
- All quotas and licenses could be tradable between firms and countries. This has the same advantages as distribution by auction. Even if not originally auctioned, these quotas would be purchased and used by the most efficient producers.
- All preferential quotas could be collapsed into the proposed “development box” put forward by a number of developing countries. This would help ensure that only developing countries benefit but in a fair way.
- State trading enterprises (STEs) could be disciplined to provide greater transparency in their quota administration activities.
- All “additional conditions” could be eliminated in the administration of tariff quotas.

This note is based on “Market Access: Economics and the Effects of Policy Instruments,” by Harry de Gorter, Merlinda Ingco, and Laura Ignacio and “Quota Administration Methods: Economics and Effects With Trade Liberalization,” by Harry de Gorter and Jana Hranaiova, both in Agriculture and the WTO: Creating a Trading System for Development.

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