Published in ***Development Outreach***, (World Bank), August 2003.

Agricultural Protectionism: Debt Problems and the Doha Round

By Julio J. Nogués

Through financial channels, agricultural protectionism imposes costs on efficient producers that are higher than those associated with negative allocative effects and export losses usually estimated. The link between protectionism and finance has a direct relationship with the WTO Marrakech Agreement of establishing coherence between international trade and financial matters (WTO 1995). Here, I will call attention to the fact that for efficient agricultural exporters there is little if any coherence between the trading system and the international financial system that they face. I will also present some numbers on the export losses from agricultural protectionism; describe the channels through which this protectionism increases financial costs; and

analyze dynamic and poverty effects. Although this article draws on the experience of Argentina, I believe the analysis applies to other indebted countries, particularly in Latin America, which are also net agricultural exporters. In conclusion, I will offer one suggestion for the Doha negotiations.

Agricultural protectionism and exports

Argentina is an example of how agricultural protectionism can have sizable negative macro-economic and poverty effects. The reason is that its exports are still composed predominantly of primary agricultural goods and agro-based manufactures (around 20 and 30 percent of total exports respectively). Clearly, under a well functioning multilateral trading system, Argentina would proceed with its development and growth through exports of these products and, later, would move into other types of exports. But agricultural protectionism implies increasing difficulties and uncertainties for efficient exporters who continue to see their access to foreign markets reduced and/or their terms of trade decline.

What is the magnitude of these losses? Let me start with the traditional estimates and then move to financial considerations. Keeping in mind the well-known limitations of general equilibrium models, recent estimates by van der Mensbrugghe (2002) presented in the following table, simulate the effects on exports of alternative liberalization scenarios for trade in goods. From other estimates such as those presented in Porto (2003), approximately three-quarters of the changes are explained by higher exports of agricultural and agro-based products.

These estimates indicate not surprisingly, that the increase in exports would be the greatest under a dismantling of trade barriers agreed in the WTO. The simulations also indicate that a free trade agreement with the EU would have an impact on exports that is not that different than the impact of a global agreement; this increase is approximately equal to 50 percent of 2002 exports. This is an indication of the huge damage inflicted upon Argentina by the EU´s protectionist agricultural policies.

The literature has also stressed the negative impact of agricultural protectionism on the instability of international prices. A pioneering article by Sampson and Snape (1980) showed how Europe’s variable import levies destabilized international agricultural prices. More recently Gardner (2002) has also addressed this issue and supported the conclusion that an important liberalization of agricultural trade would and reduce the variability of international agricultural prices perhaps by as much as 50 percent (see also Nogués 2003).

In spite of the Uruguay Round Agreement on Agriculture (URAA),

protectionism has continued to increase since the early 90s. First, implementation of the URAA has been mired with protectionist effects that go beyond what negotiators had in mind (OECD 2001, and Diakossavas 2001). Second, many regional trade agreements have diverted exports and robbed efficient exporters of important export and growth opportunities (Nogués 2003). Unfortunately, the prospects that this situation will change any time soon are rapidly vanishing (WTO 2003). Let me now turn to a discussion of the financial costs of agricultural protectionism.

ARGENTINA: Export Impact of Alternative Trade Agreements

	FTAA	NAFTA	EU	GLOBAL
	Change from base (million dollars)			
Brazil	-3,400	800	-1,700	-5,600
NAFTA	2,400	2,800	-800	900
Rest of LAC	4,800	500	-200	2,800
European Union	900	600	23,200	10,200
Rest of World	1,400	1,000	-3,000	9,700
Total	6,200	5,800	16,300	81,000

Source: van der Mensbrugghe (2002)

Agricultural protectionism and financial costs

In order to see how agricultural protectionism leads to debt problems, recall that in economies with open capital accounts the market clearing interest rate

for sovereign bonds, is approximately equal to the risk free international interest rate plus the premium for country risk. On the margin at this rate, foreign investors are willing to lend. Therefore, if protectionism increases risk, the cost to efficient country producers from high agricultural trade barriers are higher than what has usually been claimed by the literature.

There are two main channels through which agricultural protectionism can increase financial costs and worsen debt problems. First, to the extent that this protectionism reduces exports, the trade-output ratio of the efficient exporters is also reduced. Lower exports reduce the capacity to repay external debt, and this increases interest rates. Second, high international price variability and an excessive concentration of exports in a few commodities increase vulnerability.

I will concentrate here on the first of these channels. A growing number of analytical and econometric studies have analyzed the determinants of country risk. The following are some of the explanatory variables that have been uncovered by these studies: a) growth expectations: the higher the growth expectations, the lower the risk of investing in an economy; b) degree of solvency: the higher the burden of the debt and the lower the capacity to generate exports, the higher the degree of perceived insolvency; c) structural problems: the more serious the structural problems such as systematic fiscal deficits, the higher the country risk; d) contagion: risk is increased when other emerging markets face financial difficulties, and lenders "fly to quality"; and, e) political uncertainty: when there are important differences on economic policies among leading politicians, or when different forms of corruption including political corruption are rampant, risk is increased.

By how much does agricultural protectionism increase risks? Nogués and Grandes(2001) studied the determinants of Argentina’s risk with the explanatory variables discussed above, and found that all of them had contributed in a statistically significant way to the widening of the spread of sovereign bonds (in this case the floating rate bond over the U.S. treasury bond of the same maturity). Here I want to focus on the role played by the solvency variable, which we measured as the ratio of debt service to exports. We found that the elasticity of country risk with respect to this variable is 0.68. With this estimate, the impact of agricultural protectionism on financial costs can be simulated. For example, assuming that agricultural protectionism results in foregone exports equivalent to 25 percent of current exports, from earlier comments a conservative estimate, then country risk can increase between 10 percent and 20 percent depending on whether we assume an elasticity with respect to the solvency variable of 0.5 percent or 1.0 percent. This impact of agricultural protectionism on country risk and financial costs is sizable. For example, the average country risk during 2000 was 672 basis points but according to our estimate, with higher exports, it could have been at least 10

percent lower. When this difference is multiplied by the stock of debt, the added interest costs can be very high. Just to give an idea, at the end of 2000, the total stock of debt (private and public) was in the order of $280 billion dollars.

Agricultural protectionism, slower growth and increasing poverty

Two additional consequences can be linked to agricultural protectionism: slower and more unstable GDP growth, and increased poverty.

• *Slower and more unstable growth.* Higher interest rates slow growth rates and this is precisely what happens when agricultural protectionism increases the degree of insolvency in the countries that are efficient producers. Nogués and Grandes (2001) show a clear and statistically significant negative correlation between the level of country risk and the GDP growth rate. Clearly, the dismantling of agricultural protectionism would improve export performance and therefore, expected GDP growth; both of these effects would lower country risk.

Regarding price instability, I recall that between 1997 and 2000 Argentina's the export prices of its agricultural and agro-based manufacturers declined by 25 percent and 24 percent respectively. Not coincidentally these years also witnessed a massive increase of agricultural subsidies by OECD countries; between 1997 and 1999 this assistance increased from $329 billion dollars to $362 billion dollars. Much of this assistance was provided to compensate OECD country farmers from the negative income effects of declining international agricultural prices (OECD, 2000). Obviously this counter-cyclical protectionism led to further increases in measured risk of efficient country

producers.

• *Impact on poverty.* Paradoxically, there is very little knowledge on the impact that agricultural protectionism has on the poverty rate of the countries that are efficient producers. This lack of knowledge is a handicap and illustrates the weak negotiating ability of Argentina and other indebted countries in bilateral and multilateral forums. Recently, Porto (2003) has estimated the impact that the elimination of agricultural protectionism by the U.S. and the EU would have on Argentina's poverty rate. The estimates include the elimination of all support granted to agriculture including border measures, export subsidies and domestic assistance, as well as the elimination of tariffs on manufactured exports.

As his measure of poverty, Porto chose the proportion of people living below the poverty line. His conclusion is that: "foreign trade reforms would cause a decline in poverty of up to 11 percent from an initial head count of 25.7 percent to a post policy rate of 22.8 percent" or around 100,000 persons. For reasons explained above, this is a lower bound estimate.

Suggestions for the Doha Round

Clearly, agricultural protectionism has had significant negative effects on Argentina that go beyond the static welfare losses that have been traditionally estimated by general equilibrium models. My analysis has been focused on the years preceding the major crisis after the 2002 devaluation. I have done this because I believe agricultural protectionism partially explains the crises that Argentina is facing. Having said this, I want to make clear that protectionism contributed only a fraction of the crisis, while the bulk was generated at home by bad economic policies, including irresponsible fiscal deficits (Nogués and Grandes 2001) and more recently, by several violations of established institutions including the Constitution.

What is to be done? I started this note by citing the Marrakech Agreement of 1994, according to which the WTO, the IMF and the World Bank should work to achieve greater coherence in global economic policy making. This mandate has never been defined carefully but, while agricultural protectionism persists at its current irrational levels, efficient country producers face a multilateral trading system that is incoherent with the international financial system. This incoherence will be maintained as long as the powerful protectionist agricultural lobbies remain unchallenged.

How can this lobby be challenged? No indebted country would be wise to announce that agricultural protectionism is increasing debt problems; if they did, the perceived level of country risk would automatically jump with the

consequent negative effects on the economy. Therefore, the onus appears to be on the side of multilateral organizations. One possibility that might be worth exploring is to make the WTO Working Group on "Trade, Debt and Finance" a negotiating group in the Doha Round. The idea is to have creditor and debtor countries meet at the negotiating table in order to discuss the financial consequences of trade protectionism and the benefits that trade liberalization would have on the international financial system. By incorporating the interests of the creditors, most of whom are from industrial countries, there would be a domestic force fighting against the agricultural lobby; if my Government lowers the barriers that protect you, I have greater chances of recouping my credits. In order to strengthen the incentives in favor of lower barriers, indebted countries facing payment difficulties could tie part of their debt repayments to trade liberalization measures taken by the creditor countries. This proposal implies an important shift in the structure of incentives in favor of trade liberalization. After more than five decades of increasing agricultural protectionism, I believe that only a radical shift in the structure of incentives will start to reverse this trend. The proposal I have presented goes in that direction.

Julio J. Nogués is Consultant and Professor, School of Government, Universidad Di Tella, Buenos Aires
jnogues@infovia.com.ar

References

Diakosavvas, D. (2001). *The Uruguay Round Agreement on Agriculture in Practice: How Open Are OECD Markets?* Paper presented at the World Bank Conference on Leveraging Trade, Global Market Integration, and the New WTO Negotiations for Development, July 23–24, Washington, D.C.

Gardner, B. (2002). *North American Agricultural Policies and Effects on Western Hemisphere Markets.* Paper presented at the Seminar on "Agricultural Liberalization and Integration: What to Expect from the FTAA and the WTO?" Inter-American Development Bank: Washington D.C.

Nogués, J. J. and M. Grandes (2001). "Country Risk: Economic Policy, Contagion or Political Noise?" *Journal of Applied Economics*, IV, 1:125-162.

Nogués, J. J. (2003). *Agricultural Exporters in a Protectionist World: Assessing Trade Strategies for the MERCOSUR.* Draft paper prepared for the Inter-American Development Bank: Washington DC.

OECD (2000). *Agricultural Policies in OECD Countries: Monitoring and*

Evaluation, OECD: Paris.

OECD (2001). *The Uruguay Round Agreement on Agriculture: An Evaluation of Its Implementation in OECD Countries*, OECD: Paris.

Porto, G. G. (2003). *Trade Reforms, Market Access and Poverty in Argentina.* Mimeo, World Bank: Washington DC.

Sampson, G. and R. Snape (1980). "Effects of the EEC´s Variable Import Levies," *Journal of Political Economy*, 88: 5.

Van der Mensbrugghe, D. (2002). *Quantifying Trade Policy Options for Argentina.* Draft paper, World Bank: Washington DC.
World Bank (2002). Global Economic Prospects, World Bank: Washington DC

WTO (1995). *The Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts,* WTO: Geneva.

WTO (2003). *Negociaciones Sobre la Agricultura: Anteproyecto de Modalidades para los Nuevos Compromisos,* TN/AG/W/1/Rev. 1, WTO: Geneva.

Go Back to Top