Submission to Joint Standing Committee on Treaties Inquiry into Australia's Relationship with the World Trade Organisation

August 2000

Opening Remarks

AWB Limited welcomes the opportunity to provide comment to the Joint Standing Committee on Treaties' inquiry into Australia's relationship with the World Trade Organisation. Under the *Wheat Marketing Act* 1989, AWB Limited (AWB), through its subsidiary AWB (International) Limited, has the sole authority for the export of wheat from Australia while operating domestically in open competition. It is 'single desk selling' of Australian wheat exports which has prompted consideration of Australian wheat exports from the international trade perspective.

The single desk has been a choice made by growers acting in their own self interest, recognising the changing shape of the grains industry such that value chains compete against value chains and an approach to marketing which brings the needs of the consumer of a product and the producer of a product together. Marketing wheat is we believe, about ensuring we have the best, most efficient **system** to address the needs of the grower and the customer and the single desk provides this. AWB's focus is on being a value added integrated marketer which proactively markets and delivers services up and down the agricultural value chain.

As one of Australia's largest exporters, AWB is subject to the vagaries and distortions of trading in the world wheat market. While acknowledging the progress made in the Uruguay Round towards liberalising agricultural trade, there remains enormous scope for further progress to ensuring trade in agricultural products is free from distortion.

AWB's response to this inquiry should be viewed in the context of our continued participation in the Agricultural Trade Consultative Group and our close working association with key Commonwealth Departments in the ongoing development and formulation of Australia's negotiating position on agriculture.

Outcomes of the Uruguay Round

The impact on agricultural trade of the successful conclusion of the Uruguay Round, particularly the Agreement on Agriculture, should not be underestimated, with significant agricultural reform occurring in the US and EU as a result.

The outcomes of the Uruguay Round have been extremely well documented. **Attachment A** contains a brief summary and assessment of these outcomes. The principal importance for AWB, and hence Australian wheat farmers, was that as part of the outcomes of the Round, the first major steps were taken to liberalise agricultural trade. However it is well recognised that the achievements of the Round were only a first step and that further and more comprehensive reform of agricultural trade would be necessary. This much was recognised by the WTO under the Uruguay Round Agreement on Agriculture (URAA) which mandated that new negotiations begin before the end of 1999. Article 20 of the URAA clearly indicates the objectives of the forthcoming agriculture negotiations should be to continue the reform process commenced in the Uruguay Round and to achieve "a substantial progressive reduction in support and protection".

The principal significance of the URAA was to bring agricultural trade into a rules based system but as the International Policy Council noted, 'the URAA runs out of steam about the time its commitments begin to bite". With any rules based system, over time participants will begin to exhibit behaviour which seeks to circumvent the rules although in general there is a lag between rules formulation and action to circumvent as parties come to grips with the scope of the rules and establish the possible means for their circumvention. AWB would submit that we have now reached the critical juncture where parties are actively seeking to circumvent the rules established under the URAA and that further reform is necessary to minimise the trade distorting effects of this behaviour.

Trade liberalisation that was achieved under the URAA was by way of countries agreeing to numerical targets for cutting subsidies and other forms of protection while increasing the transparency of protectionist (quantitative trade restriction) measures through a process of conversion into tariff rate quotas (TRQs). The major problem with this approach and an area for continued negotiation is that the base starting point was so low that any gains could at best only ever be modest, with 'plenty of room for disputes over compliance during the implementation period and for further reductions in the new millenium'.

Distortion in the World Agricultural Market – The Need for Continued Reform

Despite the progress which the Uruguay Round achieved in terms of reform of agricultural trade, it still remains substantially distorted through foreign government intervention. Governments in many countries insulate farmers from the signals of the market through support arrangements which subsidise production and exports and which boost returns. As noted above, this has been further exacerbated by the fact that the reductions which were achieved in the Uruguay Round trade negotiations – capping of export subsidies and of domestic production support payments - under the WTO have been circumvented by governments utilising other measures to support local agriculture. For instance, export subsidies in Europe have been supplemented by direct compensation payments covering exports and domestic production for local consumption.

Recent estimates by the OECD and ABARE of agricultural support in OECD countries show the level of support arrangements for agriculture has returned to the high levels of the early 1990s. The international wheat market is characterised by high levels of government intervention – either directly through the provision of subsidies for wheat exports, or through the impact that domestic policy decisions have on production, consumption and imports.

The latest study by the OECD of agricultural supports in OECD countries illustrates the magnitude and impact of government intervention. The impact on the market cannot be underestimated. For example, the OECD estimated that production support per farmer in the US rose from $US12,000 in 1997 to $US21,000 in 1999 (compared to an OECD average of US$10,000 in 1997 to $US11,000 in 1999). This level of support is again on the increase and its repeated use generates a further expectation of continued support altering future production decisions.

Producer support estimates (PSEs) for European farmers (all farms) for the period 1997-99 were US$801/ha, in the United States US$85/ha and only US$3/ha in Australia. In Australia, support to agricultural producers is the second lowest in the OECD (behind New Zealand) and at 6 percent of farm production value, is less than one sixth the OECD average. In contrast, percentage PSE levels in the United States reached almost 25 percent in 1999 and 49 percent in the European Union. **Attachment B** contains a summary of EU and US agricultural policies that have directly contributed to wheat price variability in the international market.

For a country such as Australia, heavily reliant on the export of agricultural commodities and with no real opportunity to financially match the policies of our larger competitors, the WTO is by far the best forum for addressing the issue of trade reform and continue to press for progress above and beyond that achieved in the Uruguay Round. It is for these reasons that Australia's continued participation in the WTO, as an individual member and as a leading participant in the Cairns Group, is critical.

What Happened in Seattle

In December 1999, the Seattle World Trade Ogranisation Ministerial Conference was held with a view to launching a new multilateral round of WTO trade negotiations.

Seattle demonstrated what can occur when the trade debate becomes highly politicised, as it has in the US (with the forthcoming Presidential elections) and the EU (with heavy pressure from the farm sector to preserve export subsidies). Whilst the failure of the WTO to come to agreement in Seattle may not have been entirely unforeseen, the major concern now lies in the prospect of political pressure in the US and EU to increase farm assistance programs due to the failure in Seattle – in other words, the farm lobby may seek to argue that in the absence of trade reform, the government must provide further support.

As a result of the Seattle Ministerial, it is likely that the WTO will look at ways of increasing the transparency of its decision making processes and it will probably begin to push towards a 'more inclusive' agenda, aimed at the 'civil society'. Of course, this raises the issues of whether an organisation like the WTO should be responsible for trying to deliver what are essentially non-trade outcomes.

AWB's view is that the WTO is not the appropriate forum for such issues and that there are other organisations which are better equipped to examine and address these concerns.

From an agriculture perspective however, Seattle was not a complete loss and it is therefore important that the Australian Government maintain both its commitment to this process and pressure on other signatories to resume negotiations. Had the outcome been dependant only on the Agriculture Agreement, consensus would have been reached. Whilst the lack of agreement was obviously disappointing, from AWB's perspective **progress was made** because the draft declaration being negotiated noted that:

- Agriculture could be treated the same as all other goods and services (average agricultural tariffs are around 40% while for manufactured goods, tariffs average 4%);

- Market access negotiations would be "comprehensive";

- Export subsidies would be reduced (possibly) leading to eventual elimination – although no time frame was stipulated;

- Domestic support would be reduced – although questions still remain over the definition of what constitutes a 'non-trade distorting' (or green box) measure;

- There was no mention in the draft declaration of 'multifunctionality' or the 'precautionary principle' – in other words trade restrictive measures aimed at achieving non-trade outcomes.

This draft declaration is broadly consistent with AWB's stated negotiation position, which was presented to the Government in May 1999 as part of the Government's industry consultation process for developing Australia's negotiating platform.

Where to from here?

The failure to agree on a declaration in Seattle has probably set back the trade reform agenda by around 12 months with many people now questioning the lack of leadership from the US on trade reform. Progress in this forum is now at a critical juncture and it is important that the Australian Government actively build on the outcomes of Seattle and, importantly, prevent backsliding by the major trading blocs on what was agreed to date.

It can be seen from the above that, whilst progress in the WTO is by no means going to be easy, it still remains Australia's best opportunity to push for meaningful reform in agricultural trade and build on and maintain the momentum of the significant outcomes produced in the Uruguay Round. In this light, from AWB's perspective, it is absolutely critical that the Government maintain and build upon its relationship with the WTO (as an individual member and as a leading member of the Cairns Group) as well as continuing to proactively include Australian industry in the development of its negotiating positions.

ATTACHMENT A

OUTCOMES AND ASSESSMENT OF THE URAA

(Extract from AWB Limited's submission to the Department of Foreign Affairs and Trade *"Australia's apprach to further multilateral trade negotiations"*, May 1999)

Market Access

Under the URAA all WTO members are required to convert nontariff barriers to tariffs and to reduce them by a simple average of 36% over six years, with a minimum tariff reduction of 15 per cent. The introduction of nontariff barriers to trade is not permitted. In respect of nontariff barriers restricting imports, minimum access requirements were to increase to 5 per cent over the implementation period. Tariff rate quotas (TRQs) were also established with low tariffs on imports up to the minimum access level and additional imports facing a much higher level of protection.

Two principal concerns exist. Firstly, the reduction commitments relate to the weighted average of products and reductions for actual commodities may be much less than this. Secondly, a process of dirty tariffication has occurred (see Anderson 1988) so little by way of genuine reduction has actually occurred – the average world wide agricultural tariff remains high – at around 40 per cent (compared to non-agricultural of 4 per cent) and tariffs can still be used as an effective stablisation tool. In other words, effective tariff levels can be so high as to act as quantatiive restrictions.

Seeking to reduce tariffs in the forthcoming negotiations may be difficult in terms of what sort of reduction is required. In the case of some agricultural tariffs, a 50 per cent reduction may still leave tariffs of between 50-100 per cent and this may prompt consideration of a sliding scale of reductions. Alternatively, an across the board increase in minimum access levels may effectively negate the impact of high tariffs, although access levels could be increased for low grade (eg feed) product in order to minimise impact.

Export Subsidies

Export subsidies are to be reduced by 21 per cent in terms of quantities and 36 per cent in terms of budget outlays by the end of the implementation period. Concern with this provision relates to the ability of members to continue existing subsidies within limits established rather than promoting their removal. As prices change greater volumes of product may be subsidised without increasing outlays. **It is AWB's clear position that all export subsidies should be closely examined given their ability to distort agricultural trade**.

Problems also exist with the definition of 'subsidy'. For example, the provision of export credit and credit guarantees *on non commercial terms* has the same impact on export markets and domestic production decisions as a subsidy. The URAA has no provision for the administration of export credit arrangements and we have recently seen the United States in particular, use export credit as a tool for securing market share.

Provision of GSM credit for wheat sales on terms up to 10 years in markets such as Pakistan may provide advantage to American wheat exports on grounds other than quality/price while credit terms need only reflect the normal commercial milling cycle (180-360 days). We would submit that any terms beyond this threaten Australian sales on grounds that struggling economies such as Pakistan may find US wheat attractive solely on grounds of cheap long term credit.

Questions also exist in relation to whether or not "existing subsidies" exempt under the Uruguay Round will be considered as "existing" at the commencement of the next Round (and so exempt again). Targetting of subsidies to particular markets is not prevented under the URAA and this is of particular concern. Given the relatively small number of players in the world wheat trade, targetted subsidies can be particularly damaging in that they directly displace commercial (non subsidised) product.

In particular, the United States continues to make annual allocations to its Export Enhancement Program up to the maximum allowable level under the URAA. Although the program has not been active since 1995/96 we remain extremely concerned at the prospects of its reintroduction, particularly in light of the current farm outlook. During the period of its operation the late 1980's and early 1990's, over 168 million tonnes of wheat was sold under the program at an average subsidy of US$30.59, with total payments of US$5.5 billion. Over US$1.5 billion is still scheduled to be allocated to the program leading up to the end of the implementation period.

The presence of these sorts of subsidy programs which, are targeted to specific markets and commodities, creates a two tier price market – one driven by the market and one driven by subsidies. Such programs directly lower exprot prices in targeted markets and given that the impacts cannot be isolated, also place downward pressure on export prices in non targeted markets. In the case of EEP, a bonus is paid to US exporters (not to the targeted country) but the purchasers in that country benefit because the bonus allows the US exporter to charge a lower price. The net effect is to depress average prices received for exports in both the US and competing countries.

Estimates by ABARE place the direct impact on Australian wheat farmers of EEP at up to A$32/tonne (being the difference of prices received for wheat sold in non-EEP markets to that sold in EEP markets). We would submit that this is a conservative estimate as account should also be taken of the effect on farmers production decisions both in the United States and its competitors including Australia.

- Firstly, faced with lower prices, an Australian farmer is likely to plant less wheat and will shift into other crops or activities and this involves establishment costs and possibly lower returns. For example, ABARE estimated in 1987/88 that EEP resulted in a reduction in production of up to 1 million tonnes and we would submit that this figure would have ben higher in the early part of the 1990's when EEP outlays were much higher than in the study period.

- Secondly, farmers in the US produced more wheat in the knowledge that EEP subsidies were available which led to overproduction. As surpluses were disposed of on world markets this had a further depressing efect on world wheat prices.

It is also worth noting that in addition to actual subsidy payments, compensation payments for subsidy reductions may continue to distort production decisions through providing cash flow, influencing risk profiles and capital investment strategies.

Domestic Support

The concept of an aggregate measure of support (AMS) was introduced to deal with domestic supports. Domestic subsidies are to be cut by 20 per cent from average levels of support aggregated across all commodities from the base period. Reduction commitments were also made on the basis of the AMS but not for specific commodities. However, given both EU and US support spending was already below the Agreement's limits, no (significant) reductions were required.

The URAA defines both "blue box" and green box" and the implications of these measures is discussed further below. Sufficient to say, **AWB would urge the Government to push for the total removal of blue box supports and to have the criteria for green box supports revised in light of current domestic support practices including the provision of significant compensation**. Even with the green box, we would question decoupling of income supports is in fact possible. Any form of support to producers is likely to influence cash flow and hence production decisions. Support payments may provide additional capital to fund investment and in this way, influence production. Such payments may also prevent longer term structural adjustment and result in long term over production.

Sanitary and Phytosanitary Meassures

The Agreement on Sanitary and Phytosanitary Measures (SPS Agreement) allows members to adopt and enforce measures that they deem appropriate to protect human, animal or plant life or health as long as such measures are not applied in an arbitrary and unjustified manner. Higher standards may be impsed if based on scientific justification and risk assessment.

The SPS Agreement is by its nature,very broad. Concerns surround the nature of scientific justification (due to the vague nature of terms) and the time taken to resolve disputes - for example, the beef hormone dispute. **AWB urges the Government to remain firm on the importance of the SPS Agreement as the appropriate mechanism for dealing with SPS concerns such as biotechnology and genetically modified organisms (GMOs)**. Australia should continue to promote the use of internationally agreed standards wherever possible.

Dispute Settlement

The URAA established new and strengthened dispute resolution proceedures for disputes under any of the Uruguay Round agreements. A major achievment was the removal of a member's effective right of veto of a dispute panel's decision. **The Government may wish to consider the process of dispute resolution to determine whether compensation is appropriate** (i.e does it lead to corrective behaviour or do countries make an assessment that the benefits of retaining protectionist policies outweigh the costs of paying compensation) and also the potential for delays in both hearing and resolving a dispute.

ATTACHMENT B

Agricultural Policies of Major Wheat Producers

The international wheat market is characterised by high levels of government intervention – either directly through the provision of subsidies for wheat exports, or through the impact that domestic policy decisions have on production, consumption and imports.

The principal reasons for the relatively high level of intervention relates to:

- the role wheat plays as a staple food product. In many countries, adequate grain supplies are a vitally important factor for economic and political stability; and

- the importance of wheat in contributing to farm incomes and the desire on the part of policy makers to keep farmers on farm – the so called 'family farm' argument.

The following outlines the major forms of intervention practiced by Australia's major competitors in the market. Policy changes in the EU and the USA in particular, have directly contributed to wheat price variability on the international market over the last twenty years[1]. With long run trend analysis suggesting a continued decline in real world wheat prices, it is unlikely that there will be any major shift away from policy intervention and so we can expect the international wheat market to continue to exhibit the characteristics of an imperfectly competitive market. The impacts of farm policy may be direct – e.g. production subsidies which result in wheat being exported at less than market value; or indirect by affecting producers risk and decision making profiles leading to oversupply which will also force down world prices.

United States

The "Freedom to Farm" or the Federal Agricultural Improvement and Reform (FAIR) Act (1996) forms the basis for US farm policy. The FAIR Act provides for a range of domestic support measures and is focussed on giving farmers greater flexibility in their decision making (by supporting income rather than production) and moving policy away from supply side management. The FAIR Act underlies a complex array of farm policy tools which aim to provide a 'safety net' for US farmers. In the 1999 calendar year, total government assistance paid to US farmers totalled USD$23 billion[2]. In 2000 this will climb to over USD$25 billion.

The impact of these farm policies on production decisions was recently highlighted in a report by the United States General Accounting Office which noted that "an incentive has

[1] Johnson, D.G., (1990), 'North America and the World Grain Market', in Antle and Smith, p.33.
[2] Pasco, R. (1999), 'Final Emergency Farm Aid for 1999', *The Agricultural Law Letter*, McLeod, Watkinson & Miller, Washington, Nov/Dec 1999

been created to plant crops in response to government payments rather than to market demand"[3].

The FAIR Act (1996) provides:

- Direct cash payments under flexibility production contracts (PFCs) (producers receive payments regardless of price levels), based on historical acreage. Total spending on PFCs in 1998 was estimated at USD$5.8 billion which will decline to USD$4.0 billion by 2002. With no set-aside provisions (as there was under previous US Farm Bills), there is nothing to counteract incentives to over-produce in times of surplus production and low market prices. In addition, in 2000/01, the USDA will also pay USD $3.1 billion in supplemental income assistance payments.

- Nonrecourse marketing assistance loans and loan deficiency payments with loan rates set at historical price levels. The loan rate is set nationally and regionally and when prices are low producers will remain willing sellers in the market because they will receive loan deficiency payments (LDPs), with the loan rate establishing a floor in the market. LDPs for wheat were estimated to be in the vicinity of USD$3.5 billion for each of the last two years (the 'loan rate' for wheat is $2.58/bu). Combined with PFCs, the "price safety net" for growers is $3.24/bu[4]. In other words, as a result of Government intervention, ***the US wheat farmer is responded to a price of not less than $3.24/bu or USD$119/tonne*** which is above the current world price.

- The Conservation Reserve Program takes land out of production under ten year contracts in an attempt to lower the supply of commodities that would have otherwise been grown on the land and pays farmers rental for the land enrolled. Almost 36 million hectares of land is enrolled in the program at a cost to the US Government of more than USD$1.3 billion. CRP payments can represent a significant source of extra income for farmers and provide cash flow to fund other on-farm activities including production.

- The Federal Crop Insurance Program administered by the USDA's Risk Management Agency (RMA) for the Federal Crop Insurance Corporation (FCIC). These agencies regulate and promote insurance coverage, set terms (including premiums), ensure contract compliance, provide premium and operating subsidies (up to 75 per cent of the total premium) and reinsurance (government sharing of underwriting risk). Both crop and revenue assurance alter a farmer's risk profile such that they may chose to produce in the knowledge that any losses will be mitigated through (subsidised) insurance products. Over-production can force down world prices to the detriment of other producers supplying into the competitive world market. In the 1999/00 Budget provision was made for crop insurance subsidies totalling USD$6.1 billion over five years.

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[3] United States General Accounting Office, (1999), 'Marketing Assistance Loan Program Should Better Reflect Market Conditions', *Report to the Honourable Kent Conrad*, November, p.3
[4] Frerichs,S. and Pasco,R., (1998), '1999 – The Year of the Safety Net?', *The Agricultural Law Letter*, McLeod, Watkinson & Miller, Washington, Nov/Dec 1998.

- Emergency Relief Programs: Over the last three years the US Government has acted to provide additional 'emergency relief' to farmers in response to low prices, particularly in the wheat and corn markets. These packages, the major portion of which is aimed at enhancing AMTA payments have totalled in excess of USD $21 billion[5]. In addition, in 1998/99 – 1999/00 the USDA entered the domestic wheat market purchasing in excess of 6 million tonnes of wheat for donation as aid (worth approximately $1.5 billion), in an attempt to raise prices (USDA has also indicated an intention to purchase a further 3 million tonnes in 2000/01). Much of this wheat has been monetised and sold directly into commercial channels displacing demand for wheat from other suppliers including Australia. In short, these programs also result in farmers continuing to produce independent of market signals because various support mechanisms effectively provide a revenue floor.

- GSM 102 and GSM 103 Export Credit Programs: The US Administration operates two export credit guarantee programs, GSM 102 and GSM 103, which guarantee short term loans of 6 months to 3 years (GSM 102) and intermediate loans of 3 to 10 years (GSM 103). The US Government guarantees private bank loans at commercial interest rates with funding for both programs authorised for 2000/01at US$3.8 billion. Use of these programs by the US directly affects buyers' incentives to purchase US wheat. In other words, the allocation of credit guarantees to markets, which traditionally do not purchase on credit, on non-commercial (government backed) terms, may create a credit dependency inconsistent with normal commercial practice. This may retard the long-term development of the market and damages the market for those countries supplying on normal commercial terms.

European Union

Agricultural policy in the European Union is determined by the Common Agricultural Policy (CAP). The CAP was originally instituted in an attempt to promote food security and self sufficiency in Europe. However, given that support levels have been established, on the whole, well above world prices, the European Union has moved from being a net importer of major agricultural commodities, to a net exporter. Further more, in order to "move" production surpluses, exports have been heavily subsidised[6].

The EU operates a range of domestic supports and export subsidies in the wheat industry. The European Commission controls the market via export volumes through issuing mandatory export licences and controlling prices by setting subsidy levels. EU growers can deliver grain into intervention stock (effectively to the Commission) or directly to the free trade. Underlying the marketing system is the supportive price paid for intervention grain, which sets a "floor" for domestic prices. The current intervention price

[5] Source: USDA Budget Papers 2000/01

[6] "Reform" of EU support programs has been proposed as part of the Agenda 2000 reform process. Agenda 2000 has been touted as 'the most fundamental reform to (EU) policies and structures since Agriculture Ministers agreed to the MacSharry reforms in 1992' however negotiations would be 'fraught with difficulties as Member States attempt to reconcile the need for change with nationally dictated positions'. (Bureau Européen de Recherches SA (1999), 'A Background and Preliminary Assessment of Agenda 2000', Brussels, p.1)

at 110.25 euro/tonne and is above world market prices. As a result, EU grain production is consistently above consumption, providing an exportable surplus. As domestic prices are greater than world prices, subsidies must be provided in order to export wheat.

The Commission on a weekly basis assesses bids from the trade and offers intervention stock at a subsidised level and/or refunds to be used against "free stock". The level of subsidies and subsequent prices are intended to track SRW prices, although predominantly EU prices are lower. In short, the mechanisms that operate are:

- Direct area supports provide payment to farmers based on historical average yields (54.34 euro/tonne, increasing to 63 euro/tonne). These are paid regardless of production levels and are designed to supplement farmer's cash income.

- Intervention support prices (110.25 euro/tonne, but with monthly increments of 1 euro/tonne – this will fall to 101.31 euro by 1 July 2001) establish the desired price level that the European Commission determines European farmers should receive for their wheat. Hence, any imports have tariffs imposed to make imports more expensive than domestic product and exports are subsidised to ensure preservation of a minimum price.

- Export subsidies (restitutions) (32.50 euro/tonne in December 1999) are paid to farmers to ensure the maintenance of a minimum (Commission established) price. Given that the Commission has established an intervention price, excess production must be exported onto the world market. In most cases the world price is below the intervention price thus requiring a subsidy in order to secure sales at the lower world price.

- Import duties applied on the basis of a (EU) calculated reference price of 194.04 euro/tonne and resultant duty on high, medium and low quality wheat (52.98 euro/tonne for medium quality (US HRW No 2 11.5% or equivalent) wheat in June 2000). Duties or tariffs are designed to preserve the internal intervention price. The duty imposed seeks to raise the price of imports to 155% of the intervention price.