



Implications for Brazil of July 2008 Draft Agricultural Modalities



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LIST OF ABBREVIATIONS AND ACRONYMS

AMS	Aggregate Measurement of Support
DC	Domestic Consumption
DDR	Doha Development Round
NPS	Non-Product-Specific
OTDS	Overall Trade Distorting Support
ODC	Other Duty and Charge
OCD	Ordinary Custom Duty
SPs	Special Products
SSG	Special Safeguard
SSM	Special Safeguard Mechanism
S&D	Special and Differential Treatment
TL	Tariff Lines
TRQ	Tariff Rate Quota
VOP	Value of Production
UR	Uruguay Round
WTO	World Trade Organization

1. INTRODUCTION

Brazil is recognized today as one of the most important countries in the Doha Development Round (DDR) negotiations. Not merely is it one of the leaders of the G-20, one of the most influential negotiating coalitions, it has also been taking part in all spheres of the Doha Round negotiations, both formal and informal. Although this paper will also examine the likely impact of the Doha Round on Brazilian domestic support levels and tariffs, Brazil's position in all three pillars of the Doha Round agricultural negotiations - domestic support, market access and export competition - is offensive¹. Brazil is one of the world's largest agricultural producers and exporters and aims to reduce protection levels in order to be able to expand its agricultural export potential.

With the end of the bottom-up approach, in which the WTO (World Trade Organization) Members defined the parameters for agricultural modalities, the top-down approach, based on documents prepared by the chair of the Special Session of the Committee on Agriculture, has prevailed in negotiations. Based on the last version of the agricultural modalities document of July 10th 2008 (referred to in this document as the Draft Modalities), this paper seeks to:

- (i) Evaluate the implications of commitments set forth in the modalities on domestic support and market access for Brazil's agricultural sector: in other words, how do the proposed disciplines affect applied levels of domestic support and tariffs?
- (ii) Discuss whether Brazil's offensive interests will be satisfied. Are the disciplines proposed for export competition, domestic support and market access for Brazil's agriculture sector likely to create trade opportunities for Brazilian

agribusiness exporters? As most of the parameters for the three pillars are already well defined in the last Draft Modalities, this paper provides a critical analysis of the level of ambition within the document.

For Brazilian domestic policies, this paper focuses on two pillars of the agricultural negotiations, namely domestic support and market access. The paper first analyses how the proposed disciplines could affect Brazilian agricultural policy in the area of domestic support. It then examines how the tariff reduction formula is likely to affect Brazilian bound and applied tariffs. Because the actual result of the Round may entail political decisions concerning the choice of products to be treated differently from the general rules - as special products (SPs) or under the SSM (Special Safeguard Mechanism) - we have opted for a simulation of these choices.

In the case of Brazilian offensive interests, the three pillars are analyzed, and consequences for specific industries are highlighted.

Brazil's gains from the Doha Round will depend on whether border protection and domestic support levels of third countries will be reduced, leading to a less distorted world agricultural market. It is worth mentioning that one of the Doha Round's main objectives is precisely to support the development of poor countries by increasing their agricultural trade.

This paper also arrives at three more general conclusions:

- The Doha Round has proven that market access is the most sensitive topic across countries. The Round is more likely to result in meaningful advances in domestic support and

¹Some observers would say that it is not necessarily true that Brazil has offensive positions in the Doha Round, based on the fact that some groups in the government and in society, and especially the representative organizations of family farmers and agrarian reform settlers, are in favour of defensive mechanisms such as special products and special safeguard mechanism. Although we cannot deny that those groups are capable of influencing government positions, we consider that their objective is to avoid losing policy space. Therefore, the decision making process in the government is able to recognize this objective and, in doing so, offensive interests will prevail over defensive interests.

- export subsidies rather than in tariff reduction and market opening. Improvements in market access will be limited to some products and specific situations, for example through tariff rate quota (TRQ) expansion.
- There is no consensus on what constitutes a “Development Agenda”. Developing countries with a competitive advantage in agriculture are of the view that trade liberalisation promotes development. However, other developing countries, notably G-33 members, argue that the development agenda necessitates the creation of new mechanisms to prevent negative impacts of trade. Their main argument is that domestic farmers cannot be exposed to external competition if food security, livelihood security and rural development are threatened by imports.
- Although the Doha Round is a multilateral process, only a few countries will make efforts. With the full or partial exclusion of various categories of countries - least developed countries (LDCs), small, vulnerable economies (SVEs), and recently acceded members (RAMs) - the negotiation is concentrated largely amongst 9 developed (the US, the EU, Japan, Switzerland, Norway, Australia, New Zealand, Canada and Iceland) and 15 or so developing countries/regions (in Mercosur, China, India, Indonesia, Malaysia, Thailand, South Africa, Mexico, Colombia, Chile, Korea and the Philippines).

2. IMPLICATIONS FOR BRAZILIAN POLICIES

2.1. Domestic Support

Like other developing countries, Brazil does not count on significant volumes of domestic support in the agricultural sector. This is not only because scarce funds are available for providing such support, in comparison with developed countries, but also because the country is in any case highly competitive. The great availability of natural resources is one of the most important factors. Other characteristics also contribute to this situation, such as the extent to which there is a good transportation infrastructure or low interest rates charged by rural credit programmes.

Because the Brazilian agricultural sector faces problems that are common to a variety of other sectors, and because there are no financial funds that would privilege certain groups of commodities, domestic support programmes are mainly non-specific. They are therefore reported in the Green Box, or as non-product-specific in the Amber Box (NPS). Because Brazil has programmes that focus on small farmers and rural development, it has also used the so-called “development box” in Article 6.2. Figure 1 shows the participation of domestic support programmes in Brazil and other countries.

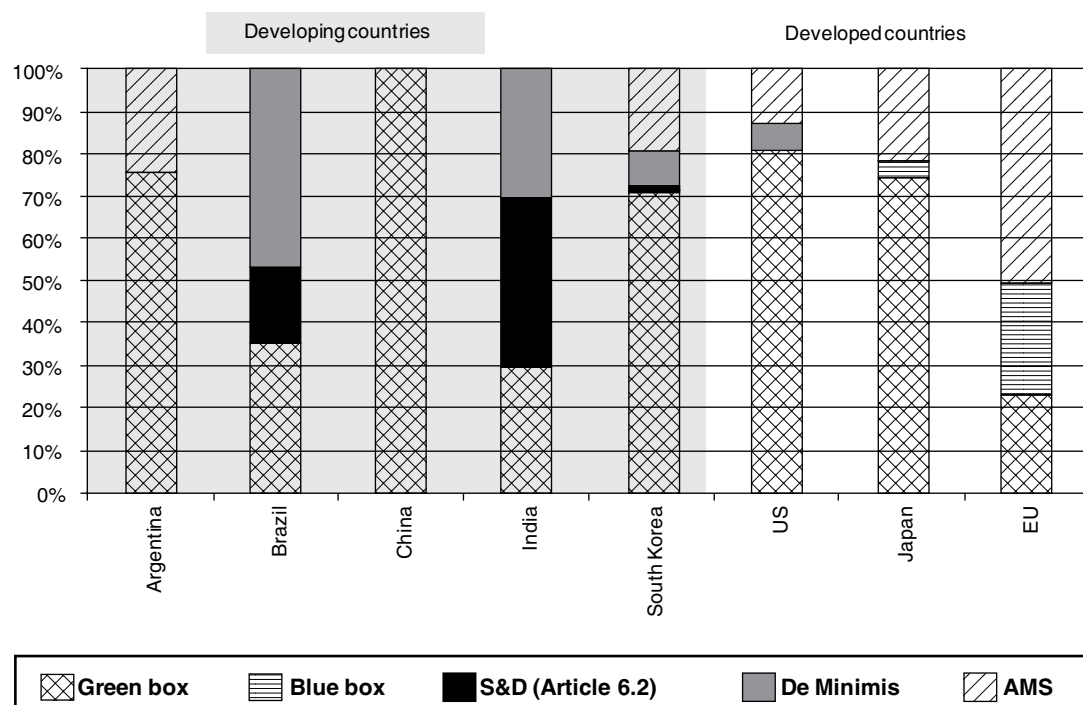
However, as there is no limit on the amount of Green Box subsidies a country can provide, and no negotiations are taking place to establish

new commitments of this sort. The changes proposed in the Doha Round relate only to the conditions under which other subsidies may be employed. This paper therefore focuses on how the Doha Round could affect Brazil’s Amber Box subsidies and its Overall Trade Distorting Support (OTDS).

Brazilian policies concerning the rural sector are organized in two general policy frameworks: agricultural and agrarian policies (Chaddad and Jank, 2006). The agrarian policy includes programmes related to agrarian reform and land settlement projects. Budgetary expenses for agrarian reform programmes are notified as general services in the green box. Agrarian policies will not be discussed in this paper, not only because they are notified in the green box, but also because commercial and family farmers do not derive benefits from them.

Agricultural policies target two beneficiary groups, commercial and family farmers. The classification and separation of the two groups was developed on the basis of the 1996 Agricultural Census. This division is also replicated in the government: the Ministry of Agriculture and Livestock (MAPA) manages the policies related to commercial farmers, and the Ministry of Agrarian Development manages agrarian reform programmes and policies

Figure 1. Composition of domestic support as percentage of total Green Box support



Source: Nassar et al, 2007.

related to family farming (Damico and Nassar, 2007). However, policies can be implemented by the same institution, as is the case with the income support programmes implemented by the National Food Supply Company (CONAB).

In the policy framework, the division between these two beneficiary groups is clear in the preferential credit policies: credit programmes for family farmers are established under the National Programme for the Strengthening of Family Farming (PRONAF), which offers more favourable conditions such as lower interest rates and more easily available credit than the programmes for commercial farmers.

The five main strategies of the Brazilian agricultural policy in place by the Federal Government are as follows (i) production, marketing and investment credit (commercial farmers), (ii) income support programmes (commercial or family farmers), (iii) rural development and family farming, (iv) debt rescheduling programmes (commercial and family farmers) and (v) rural insurance (commercial farmers) (Damico and Nassar, 2007).

With the exception of the rural insurance programme, it is possible to argue that Brazilian agricultural policy is broadly based on two pillars: rural credit generally available to all farmers at preferential interest rates, and income support programmes for specific commodities. Debt rescheduling programmes are, in essence, based on the preferential credit pillar. Rural insurance is a new strategy for the agricultural policy, and began in 2005. Currently, this programme is still very small in terms of production coverage and availability for producers.

The Draft Modalities document proposes the formula and the basis for new commitments related to the following domestic support elements: Overall Trade-Distorting Domestic Support (OTDS); total Aggregate Measure of Support (AMS); AMS product-specific caps; product-specific and non-product-specific de minimis support; and total and product-specific Blue Box support. In the Brazilian case, the government has not notified any use of Blue Box programmes, therefore the analyses focus on the Amber Box.

2.1.1. Analyzed scenario

The new OTDS limit for Brazil is the result of a 40 percent reduction of the estimated current OTDS (i.e. two thirds of the 60 percent cut otherwise required for developed countries). The estimate was calculated by summing the AMS of the Uruguay Round, 20 percent of the average value of production (VOP) in the period between 1995 and 2000 as the base period of *de minimis* and 5 percent of the VOP in the same period as the base value of the Blue Box. The new limit of the total AMS was reduced by 30 percent (two thirds of 45 percent cut) from Brazil's Uruguay Round commitment.

Regarding AMS product-specific caps, the draft

modalities point to three different alternatives for developing countries: they would be able to choose between the average of the AMS product-specific support applied in the period between 1994 and 2000 or 1994 to 2005; 20 percent (twice the value of the *de minimis* limit established in the Uruguay Round) of the value of production in the period between 1994 and 2000 or 1994 to 2005 or, as a third alternative, 20 percent of the annual bound total AMS.

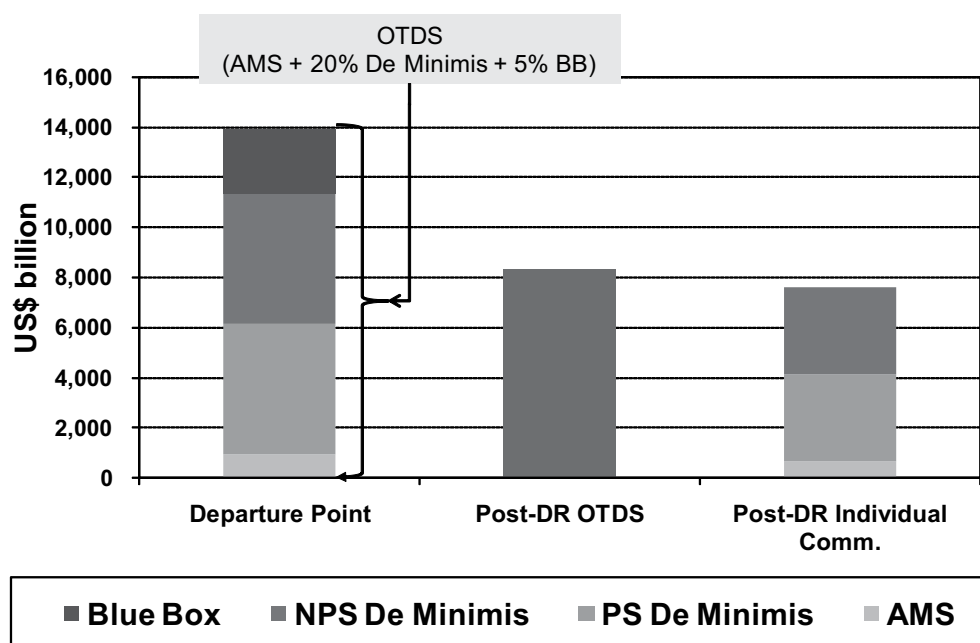
The draft modalities propose reducing product specific and non-product specific *de minimis* support by 33 percent. The current allowance is for 10 percent of the value of production.

2.1.2. Results obtained

Figure 2 shows the OTDS, total AMS, and product-specific and non product-specific *de minimis* limits for Brazil. Once the *de minimis* and AMS product-specific limits are determined in relation to a percentage of the VOP, the values of domestic support were calculated taking into consideration an average of the VOP in the period between 1994 and 2004. The post-

Doha commitment was also estimated using the same figure for VOP. In the case of Brazil, cuts to the components of OTDS are more constraining than the reduction in the total OTDS. This is due to the fact that Brazil does not have Blue Box policies and is not expected to establish them even following the creation of the new Blue Box. As can be seen in Figure 1, some

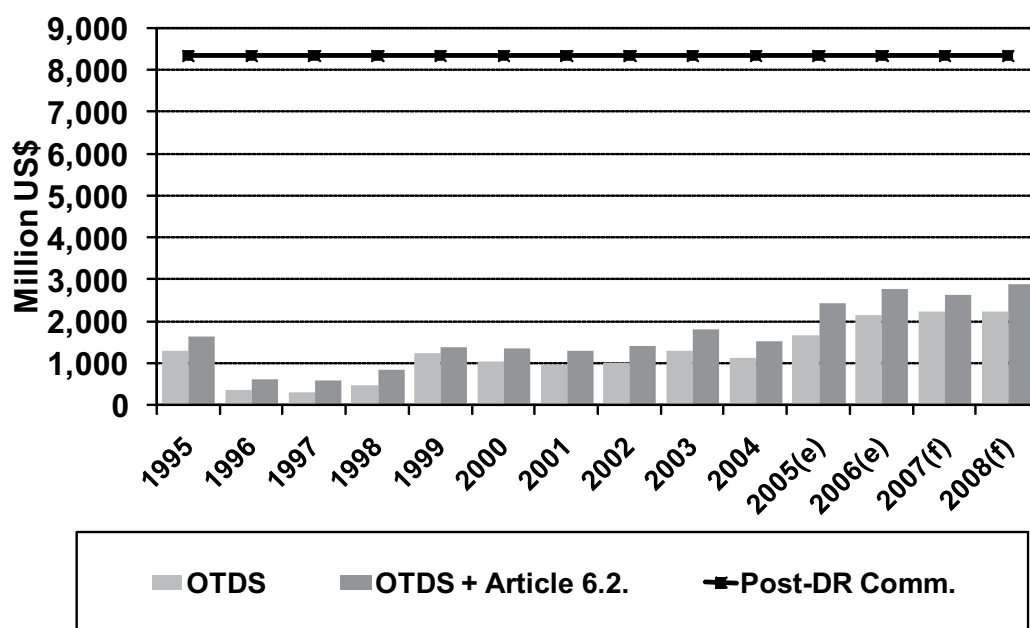
Figure 2. OTDS, AMS and De Minimis



Source: Brazilian notifications to the WTO.

Note: DR Final Commitment (higher): 40% cut in AMS and *de minimis* reduced to 6% VOP. DR Final Commitment (lower): 30% cut in AMS and *de minimis* reduced to 6.7%

Figure 3. Applied Overall Trade-Distorting Domestic Support (US\$ million)



Source: Nassar et al, 2007.

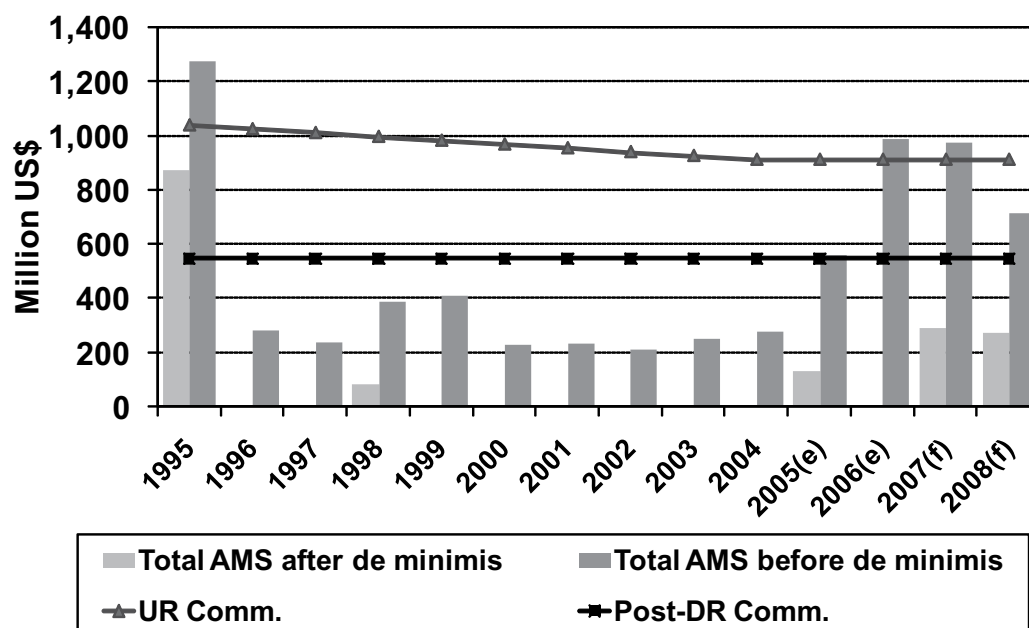
Brazilian subsidies are notified under in Article 6.2 of the Agreement on Agriculture, which will not be modified by the Doha Round.

Figures 3 and 4 compare the OTDS and AMS commitments post-Doha with the applied levels that prevailed from 1995 to 2008. They show that the proposed 40 percent OTDS reductions do not constrain historical levels of applied

support in Brazil. Applied AMS is presented after and before *de minimis*. Only in 1995 did the applied level of AMS after *de minimis* exceed the post-Doha commitment (US\$ 874.2 million). As with OTDS, Brazil has a fair degree of overhang for its AMS.

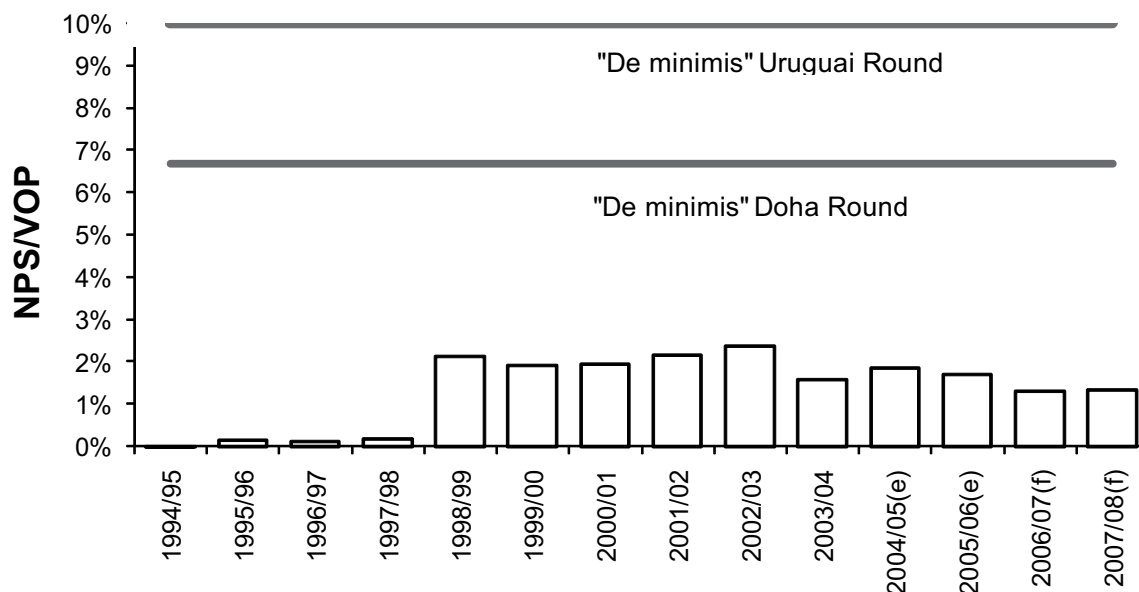
The reduction proposed for non-product-specific *de minimis* support (Figure 5)- from 10 percent

Figure 4. Total Applied AMS (US\$ million)



Source: Brazilian notifications to the WTO and Nassar and Ures, 2008. (e) Estimated. (f) Forecast.

Figure 5. Non Product-Specific Support as a Percentage of VOP

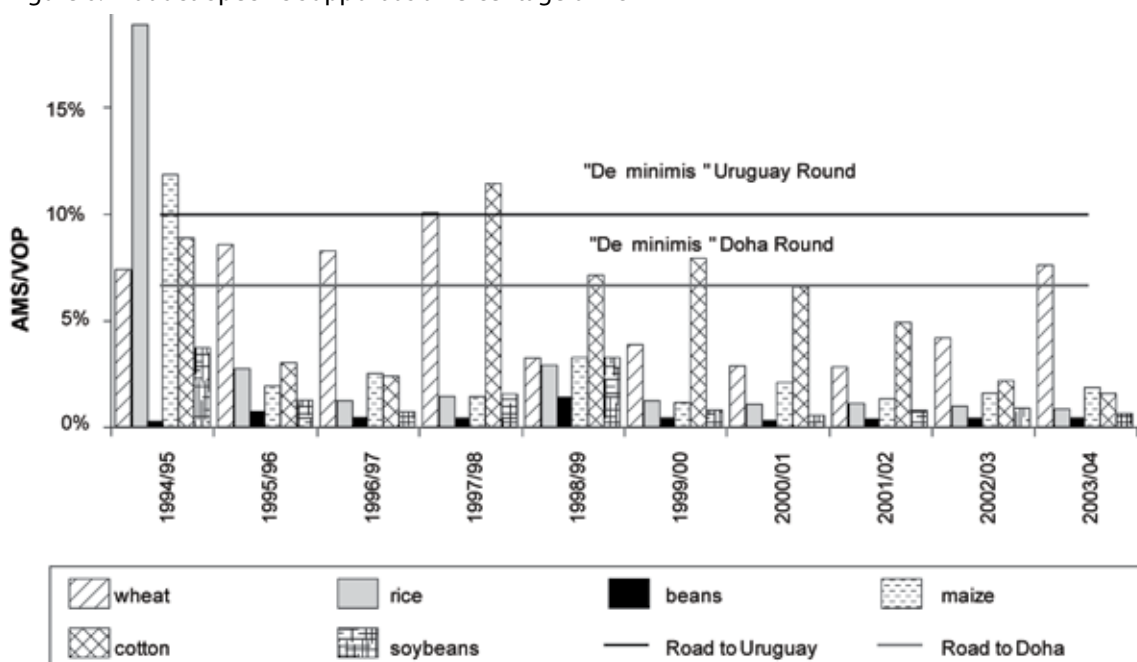


Source: Brazilian notifications to the WTO and Nassar and Ures, 2008. (e) Estimated. (f) Forecast.

to 6.67 percent - will be even less significant, as average applied subsidies from 1994 - 2004 were only 1.4 percent of the VOP. Even in 2003, when these subsidies amounted to US\$ 1.0691 million - approximately 90 percent above the average for that period - they represented only 2.4 percent of the total VOP in that year. Although the product-specific *de minimis* used in the period was well below the limit, specific

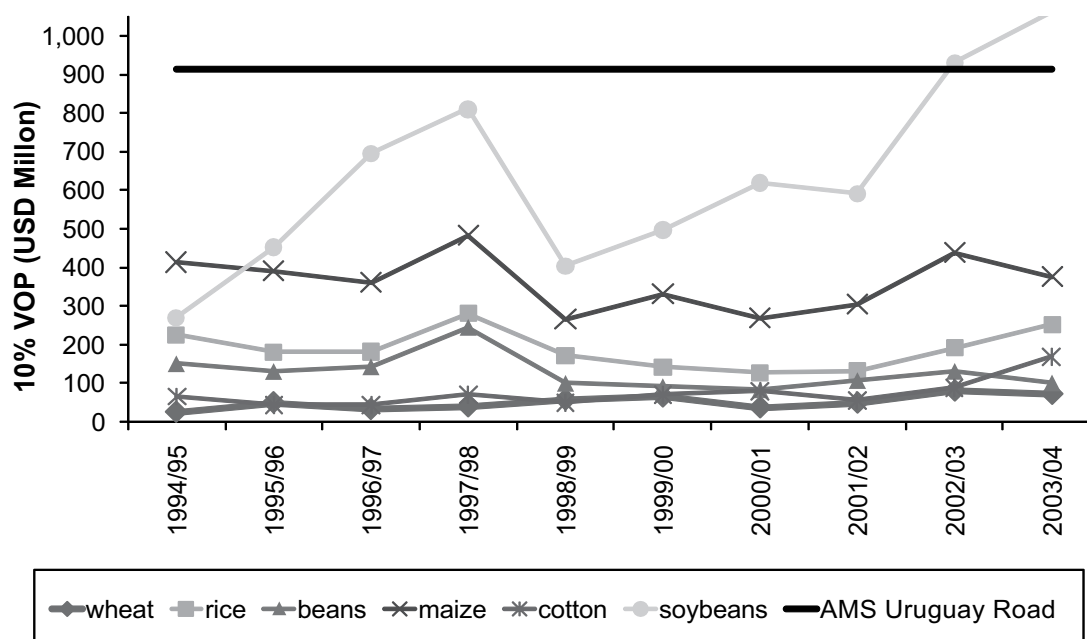
analysis of the main products subsidised by Brazil shows that the limit is sometimes constraining once the analysis focuses on products and not on the total value of production. Thus, the reduction of the product specific *de minimis* support commitment (Figure 6) could have some impact on the main Brazilian agricultural products.

Figure 6. Product-Specific Support as a Percentage of VOP



Source: Brazilian notifications to the WTO.

Figure 7. Relationship between UR Bound AMS and 10% VOP



Source: Brazilian notifications to the WTO.

Moreover, because of the high agricultural value of production in Brazil and the low AMS commitment in relation to the production value, product-specific *de minimis* support can already be the disciplinary element for Brazilian subsidies. In the case of soybeans (Figure 7), if the applied subsidies reached the product specific *de minimis* limits, the value would surpass Brazil's Final Bound Total AMS. For instance, the Final Bound Total AMS for Brazil is US\$ 912.105 million and the commitment for soybeans in 2004 was US\$ 1,067.207 million. If soybean subsidies granted that year exceeded the *de minimis* limit, they would, consequently, overtake the total AMS. Considering the new commitment - 6 percent of the value of production -, in 2004 the product-specific *de minimis* limit for soybeans would have been US\$ 636.124 million dollars, very near to the commitment proposed for the Final Bound Total AMS in the Doha Round - US\$ 928.8 million.

Table 1 shows that, of the results of the three alternatives proposed for product-specific AMS, the method that generates the highest limit for the majority of Brazilian products is setting subsidies to 20 percent of the value of production between 1994 and 2000 or 1994 and 2005 (twice the value of the Brazilian *de minimis* limit established in the Uruguay

Round). The average of the applied product-specific AMS between 1994 and 2000 or 1994 and 2005 provides less flexibility because there are zero AMS values for most products. Therefore, the products that have been subsidized would count on incentives to continue. Employing the other alternative - 20 percent of the Annual Bound Total AMS - would provide values below the limits previously described for most products.

In summary, Brazil is in a comfortable position in the Doha Round negotiations with respect to its domestic support. Doha Round outcomes that create or strengthen domestic support disciplines will not be a constraint for Brazilian agricultural policy. Even in a scenario in which Brazil is considered as a developed country, the government would still have enough room for manoeuvre by using non-product specific and product specific *de minimis* to support its programmes. Due to the high level of overhang, even for product specific *de minimis*, a 40 percent reduction would not oblige Brazil to make excessive changes to its programmes. In the case of total support (AMS and OTDS), the Brazilian government's margins for manoeuvre to implement agricultural policies will continue to be determined and constrained by the magnitude of the *de minimis* clause.

Table 1. Product-specific caps: comparison of alternatives

Products	Avg applied [1995 – 2000] or [1995 – 2004]	20% VOP	20% AMS total
soybeans	0	1,266,081	127,695
cotton	0	146,801	127,695
maize	46,756*	726,711	127,695
rice	40,659*	376,483	127,695
wheat	16,916*	101,064	127,695
beans	0	255,099	127,695

* The average of the 1995 - 2004 period was used.

Source: Brazilian notifications to the WTO.

Nevertheless, Brazil has to be careful with product-specific support programmes, as these have led to total product-specific support exceeding the product specific *de minimis* ceiling in some cases. Income support programmes, however, can be managed by the government in a way that allows them to fit within permitted levels of *de minimis*.

While debt rescheduling programmes do not lead to problems with notification, they are capable of influencing farmers' decisions in the medium to long term. These programmes reduce farmers' risk aversion and may lead them to over-invest in agricultural production.

2.2. Market Access

This section analyses the possible impacts that proposals in the Draft Modalities may have on Brazilian agricultural tariffs. The item that raises the most interest is the tariff reduction formula. The selection and treatment of sensitive and special products and the employment of the new special safeguard mechanism (SSM) are also items that could affect the results of the Round for Brazil.

The Draft Modalities defines thresholds for higher and lower tariffs, and presents cuts for each band of tariffs. Proposals referring to developing countries, which Brazil would

Although the debt rescheduling programme is not product specific and is decoupled from current production, successive debt rescheduling negotiations have indicated to farmers that they do not need to be risk averse in getting credit because debts will certainly be renegotiated at some point in the future. There are no empirical studies assessing this hypothesis but the release of 2006 Agricultural Census data can be expected to help us evaluate the consequences of the debt relief policy. One positive point is that the government has decided to be more transparent in releasing very detailed data on the Ministry of Finance website.

have to implement, open up the possibility of replacing the selection and treatment of sensitive products by the selection and treatment of special products. This seems to be the most likely scenario because it would be easier to implement. The percentage of tariff lines to be treated differently from the general tariff cut formula is around 5-8 percent for sensitive products and 10-18 percent for special products. Either 6 percent or none of the special tariff lines will be allowed to have no cut, but the average cut which has to be achieved by all the special product lines will be 10-14 percent.

2.2.1. Analyzed scenario

The results presented refer to the maximum and minimum proposed cuts for each tariff band. The

draft modalities propose a cut of between 32 and 35 percent for tariffs at 30 percent or lower

(first band); a cut of between 37 and 40 percent for tariffs between 30 and 80 percent (second band); a cut of between 41 and 43 percent in the third band (tariffs between 80 and 130 percent) and a cut of between 44 and 49 percent for tariffs above 130 percent (fourth band).

We have decided to assume that Brazil would replace sensitive products with special products, as the implementation of the treatment for special products is easier. We have therefore considered 15 percent of agricultural tariff lines as special products. We assume that half of these lines will have a 15 percent cut and the other half a 25 percent cut. Given that, as it will be shown later, Brazil has higher levels of tariff overhang, we assume that no special products will undertake zero cuts - even though it appears likely that this option will be available for developing countries.

2.2.2. Results obtained

Table 2 describes the expected results for Brazilian agricultural tariffs according to the four scenarios depicted in the previous section: scenario with minimum cut; scenario with minimum cut and 15 percent of tariff lines with more flexible treatment for special products; scenario with maximum cut; and scenario with maximum cut and more flexible treatment for special products. The results are described in terms of average tariffs and average tariff cuts. The table also shows the products that would have their bound tariffs reduced to levels that are below those of applied tariffs, that is, products that would have their applied tariffs reduced after the Round.

The results show that a limited number of products would have their applied tariffs reduced. Moreover, the products that would be subject to reduction are relatively unimportant for Brazilian imports, such as coconut for example, which represents only 0.01 percent of the total value of imports: tariffs for this product would undertake a reduction of 20.3 or 22 percent in bound rates. Products of significant import value - such as wheat, which

To determine which products will be designated as special, we have selected the tariff lines with the highest tariff protection level, those representing higher trade values and those with low “overhang” between bound and applied rates. In order to determine which tariff lines would be given priority, the following approach was used: first, tariff lines were ranked according to how high the applied tariff was; secondly they were ranked by the import value for a specific year (in this case, 2001); and finally, they were ranked in accordance with the degree of overhang between bound and applied tariffs. The first 7.5 percent of agricultural tariff lines selected in this way undertook cuts of 15 percent and the remaining 7.5 percent undertook cuts of 25 percent. All other tariff lines undertook the regular cuts required by the formula.

in 2006 accounted for 24 percent of total Brazilian agricultural imports - would not have to reduce bound tariffs to levels that are below the applied rate. Products that are important imports would therefore not have to undertake effective tariff reductions, especially when the exceptions to the general tariff cut formula are taken into consideration.

While both the maximum and minimum level cuts do lead to a slight reduction in applied tariffs for a few products, these remain insignificant given their relatively small share in total Brazilian imports - even where the exceptions for sensitive and special products are not taken into account.

Therefore, in both the minimum and maximum cut scenarios, the average cut that would result from the proposed the Doha Round modalities (35.6 - 38.5 percent) is far inferior to the average cut that would be required in order to reduce the applied tariff in Brazil (62.1 percent); that is, new tariff caps would have very little impact on Brazilian agricultural imports. Moreover, only 10.3 percent of the 946 total tariff lines would

Table 2. Results of Tariff Reduction Formula on Brazilian Agricultural Tariff Structure According to the Draft Modalities

		Minimum Cut	Maximum Cut	Minimum Cut	Maximum Cut
		no exception		with exception	
Considering cuts in tariff lines(TLs)	% of TLs which were cut in the applied tariff	10,3%	10,3%	2,9%	2,9%
	Average tariff cuts that were reduced	15%	19%	9%	9%
Total of agricultural tariff lines	Average cuts in the applied tariff	1,55%	1,94%	0,25%	0,27%
	Average cuts at Doha	35,6%	38,5%	29,8%	32,0%
	Average cuts necessary to achieve the applied tariff	62,1%	62,1%	62,1%	62,1%
	Average of proposed additional cuts to achieve the applied tariff	27,8%	25,2%	32,5%	30,3%
Products with reduction in the applied tariff > than 5% in the less aggressive scenario		Tariff cuts (%)			
Coconuts, cashew-nuts and nuts		20,35	22,0	8,3	8,3
Fruit-based preparations		20,35	22,0	8,3	8,3
Dye		12,95	14,0	5,3	5,3
Condiments and spices		5,54	6,2	1,8	1,8
Soups and broths		5,5	6,2	0,0	1,8
Candies		5,5	6,3	1,3	1,3
Chocolate		5,5	6,3	1,3	1,3

Source: Brazilian notifications to the WTO.

actually undertake a cut in applied tariff rates in both scenarios.

In the most likely scenario - the inclusion of special and sensitive product exceptions to the tariff cut formula - only 2.9 percent of tariff lines would undertake a reduction in applied rates. This represents 27 tariff lines as against 97 in the other, less realistic, scenario. Products such as coconut and fruit-based preparations undertook the highest tariff cuts: at 8.3

percent, these were much lower than the 22 percent first obtained.

When exceptions to the tariff cut formula are included, an additional cut of approximately 32.5 to 30.5 percent would have to be added to the cut proposed in the Doha Round in order to reduce actual applied tariff rates. In the previous scenario, the additional cut would need to be 27.8 to 25.2 percent.

3. IMPLICATIONS FOR BRAZILIAN OFFENSIVE INTERESTS

Although the Doha Round negotiations will generate results that seem to be meaningful at an aggregate level - a 54 percent average cut in developed countries' tariffs, or a 70 percent cut in U.S. OTDS - it is important also to analyse the results of the round for Brazil at a product level, and in terms of its implications for the country's export sectors. Aggregate

measurements of the results are important from a political perspective, but do not necessarily represent gains for Brazilian exporters, unless a given product is not selected as sensitive in the case of market access, or unless the OTDS and AMS reductions require reductions in product-specific support in the case of domestic support.

This section, therefore, focuses on the implications of the draft modalities from an industry-specific perspective. Most of the topics under negotiation can be assessed in this way. Two topics, special products and the SSM are discussed in this section from a cross industry perspective, both because they cover a very broad range of products and also because no negotiations have yet taken place on specific lists of products (as has been the case with tropical products, tariff escalation, and sensitive products, for example). It is difficult

to discuss both special products and the SSM on a product specific basis: the analysis therefore focuses on the obstacles that both mechanisms create to the reduction of trade distortions.

Brazilian interests in the Doha Round are concentrated in twelve agricultural sectors, as described in Table 3. These sectors accounted for 85 percent of total agricultural exports in 2007 (Table 4). The specific interests of each sector are summarized in the sections that follow.

Table 3. Brazilian Agrifood Exports

	Exports 2007 USD Million	Brasil / World (2005)		Annual Growth Rates (1996-2007)		
		Share	Ranking	Value	Volume	Price
Soy Complex	11,386	38%	2	9%	10%	1%
Sugar/Ethanol	6,770	29%	1	13%	14%	0%
Chicken	4,626	29%	1	19%	19%	-1%
Beef	4,232	20%	1	28%	25%	-2%
Coffee	3,887	29%	1	6%	2%	-3%
Tobacco	2,262	23%	1	6%	3%	-3%
Frozen Orange Juice	2,252	82%	1	5%	3%	-2%
Corn	1,943	2%	8	54%	42%	-8%
Pork	1,209	16%	4	27%	26%	-1%
Fruits	717	-	-	17%	19%	1%
Cotton	507	5%	4	91%	88%	-2%
Powder milk	225	1%	14	47%	44%	-2%
Other	7,061	-	-	-	-	-
Total Ag	47,078	4%	3	8%	13%	-4%

Table 4. Matrix of Industries' Interests on the DDR

Industry ¹	Issue of Interest and Defensive Country	Is the Draft Modalities Attending the Interests? ²
Soybean	Product-specific disciplines (U.S.).	Yes, if compared to past subsidies. No, if compared to forecasts.
	Tariff Escalation (EU, U.S. and China).	Partially. The general rule is it is undermined by exceptions to developing countries and for sensitive products.
	Differential Export Taxes (Argentina, Indonesia and Malaysia).	No. DET is part of the 2004 July Framework but the issue had been neglected on the Draft Modalities.
	Tariff reduction (45 percent soybean oil on India).	No. Special products will undermine any result of tariff reduction on developing countries.

Table 4. continued

Industry ¹	Issue of Interest and Defensive Country	Is the Draft Modalities Attending the Interests? ²
Sugar	Sensitive products (U.S. and EU).	No. Over-quota tariffs reduction will not eliminate water.
	TRQ expansion (U.S. and EU).	No. TRQ expansion will be very low compared to Brazilian exports.
	SSG (EU).	Yes, if it is eliminated.
	Export subsidies (EU).	Yes.
	Imports regime based on “mark-ups” or gate prices (Japan).	No, although some countries are pushing to include in future versions of the draft modalities.
Ethanol	Tariff reduction (U.S. and EU).	Yes, if it is not selected as sensitive and if U.S. reduces the temporary tariff.
	Sensitive product (U.S. and EU).	Yes, depending on the treatment that will be settled for sensitive products not subjected to current TRQs.
	Sectoral initiative on environmental goods	No.
Chicken	Sensitive products, TRQ expansion, TRQ administration and in-quota tariffs (EU).	Yes for TRQ expansion. No for administration and in-quota tariff.
	SSG (EU).	Yes, only if it is eliminated.
	Export subsidies (EU).	Yes.
Beef	Sensitive products, TRQ expansion, TRQ administration and in-quota tariffs (EU).	Yes for TRQ expansion. No for administration and in-quota tariff.
	Export subsidies (EU).	Yes.
	TRQ creation (Japan).	Yes, depending how new quotas will be treated.
Coffee	Tariff escalation (focus on roasted and instant coffee).	Yes.
	Tropical products.	Yes.
Frozen orange juice	Tariff reduction (U.S.).	Yes.
Corn	Product-specific disciplines (U.S.).	Yes.
Pork	Sensitive products, TRQ expansion, TRQ administration and in-quota tariffs (EU).	Yes for TRQ expansion. No for administration and in-quota tariff.
	Export subsidies (EU).	Yes.
	TRQ creation (Japan).	Yes, depending how the new quotas will be treated.
Cotton	Product-specific disciplines (U.S.).	Yes.
Powder milk	TRQ expansion (U.S. and EU).	Yes.
Fruits	Sensitive products (EU).	Yes, depending if TRQs will be created.

Source: Authors personal contacts with industries representatives.

Notes:

1. Tobacco has not been included because ICONE has no experience with the industry.

2. This column reflects Authors' opinions, which are based on the contacts and studies developed by ICONE for the industry's trade associations.

3.1. Export Competition

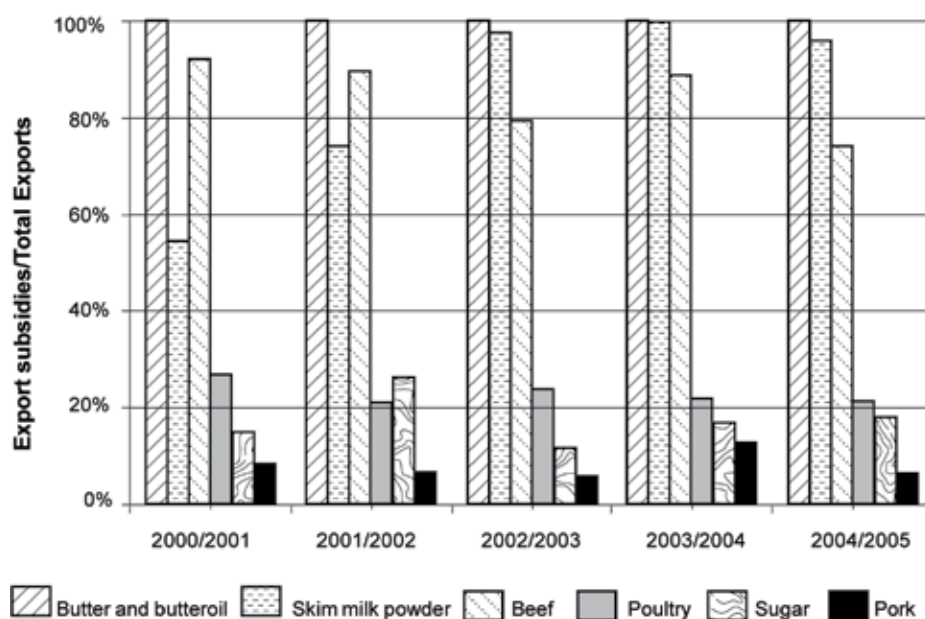
The issue of export has credit started to receive more attention in Brazil with the cotton case. There is a broad perception in Brazil that the Doha Round is able to strengthen disciplines on export credit guarantees and insurance programmes. Brazilian concerns are focused on U.S. programmes but the government has not been pro-active on this issue. Exporting state trading enterprises and international food aid have not also been given much attention by the Brazilian private sector, although the government has been working on both issues.

On export competition, the priority is the elimination of export subsidies. Brazilian interests are concentrated in poultry, pig meat, beef and sugar, with the EU's export refunds being the concern for the latter. Figure 8

shows the relationship between total exports and subsidized exports for certain products: it shows that butter and butter oil exports are fully subsidized in the European Union. Export subsidies are also high for pig meat, poultry and beef meat: almost 8, 20 and 90 percent of these products' exports, respectively, are subsidized.

Three issues are relevant for export subsidies: the elimination date, the elimination schedule and the exception for developing countries. Both the elimination date and elimination schedule for developed countries are in line with Brazilian interests. The main concern is related to developing countries. The recent experience with Indian subsidies on freight costs for exported sugar has shown that developing countries can use export subsidies, even if only

Figure 8. European Union: Evolution of Export Subsidies in Relation of Total Export



Source: EU notifications to the WTO and EUROSTAT.

in occasional situations, thus competing against other developing countries. The fact that the Draft Modalities indicates that developing

3.2. Domestic Support

Trade-distorting domestic subsidies for agricultural products are among the most contentious issues in the Doha Round. It would not be too much to affirm that disciplining domestic support has become the most important shared offensive interest amongst

countries would be allowed to keep export subsidies until 2021 is therefore a matter of concern for Brazil.

developing countries and has acted as the glue that keeps the G-20 an active coalition in the WTO negotiations. Although there is consensus that domestic support disciplines must be strengthened by the Doha Round, the concrete meaning in terms of cuts, caps,

commitments and allocation of subsidies in the boxes is controversial. The topic is even broader than the Doha Round because it also involves other spheres of the WTO, such as the Dispute Settlement Body and the functioning of the Committee on Agriculture. The topic is evolving and continues to incorporate new issues and perspectives, such as for example those concerning biofuel subsidies.

Brazil's domestic support priorities are as follows:

- (i) In the case of the EU, the priority is to eliminate all the water in the Amber and Blue Boxes that has been created by the 2003 Common Agricultural Policy Reform. OTDS and AMS cuts must be high enough to reduce Amber Box and Blue Box ceilings to the level that will be applied in 2013, the last year of the current CAP. Jean, Josling and Laborde (2008) have shown that OTDS and AMS cuts proposed in the Draft Modalities eliminate the water by 2013/14. The proposal, therefore, is in line with Brazilian objectives for the EU. Ideally, to avoid EU subsidies having any future trade-distorting effects, Green Box direct payments would also be subjected to quantitative disciplines. However, quantitative disciplines on Green Box are outside the Doha Mandate.
- (ii) In the case of the US, there are three priorities: to reduce OTDS and AMS to a level that will promote effective reductions in past applied levels; to reduce OTDS to a level that would be able to offset in the *de minimis* clause the creation of the new Blue Box; to impose product-specific disciplines that will minimize the trade-distorting effects of U.S. policies.

It is important to note that although from 2007 onwards U.S. domestic subsidies are projected to be substantially lower than they were in the years after 2000, OTDS and AMS cuts should nonetheless still promote effective reductions in past applied levels. In fact, if projections are taken into account, cuts for OTDS and AMS should be even higher than the numbers proposed in the Draft Modalities. U.S. OTDS should therefore be

reduced by the top cut, 73 percent. An AMS cut of 60 percent cut will merely eliminate water, and not promote effective cuts.

With the increasing prices of agricultural products and the noticeable reduction in future applied levels of subsidies (Blandford, Laborde and Martin (2008), a third priority can be identified, namely the elimination of water in the future use of AMS, Blue Box and *de minimis* subsidies. AMS and OTDS reduction, therefore, should be even higher than the proposed levels. However, this goal, which would impose higher constraints than a cut based on past applied levels of subsidy use, does not seem to be achievable in the current stage of the negotiations.

The aggregate reductions proposed in the Draft Modalities are therefore in line with the Brazilian objective of disciplining subsidies applied in the past, but should be more ambitious concerning future scenarios. A similar conclusion can be drawn with regard to product-specific disciplines. The WTO cotton panel clarified that two important considerations apply to product-specific support: first, farm subsidies that distort world markets are subject to the Agreement on Subsidies and Countervailing Measures, particularly when they cause serious prejudice; and secondly, that some domestic support can act as export subsidies and in such cases must be eliminated.

However, the jurisprudence does not specify how the adverse market effects of domestic support could be eliminated, or propose any criteria that would assist in determining whether the reform of a programme found to be WTO-inconsistent has effectively eliminated the trade-distorting element of the subsidy. The Doha Round negotiations provide a valuable opportunity to craft disciplines that will minimise the trade-distorting effects of product-specific domestic subsidies, as a step towards achieving the 'substantial reductions in trade-distorting domestic support' referred to in the negotiating mandate (Costa, Nassar and Jank, 2007).

Product-specific bindings are also an important tool to prevent support from being concentrated

on a few products, as governments shift subsidies between different WTO boxes and between different products. We have reached the conclusion that a 60 percent cut in U.S. AMS will, at least, eliminate water. In its 2008 farm bill the U.S. redesigned its dairy price support programme from all fluid milk to processed dairy products, which will allow it to reduce by half or more the dairy support reported in its AMS. With this reduction in the applied AMS, new space will be created for this support to be concentrated on other products. Strong AMS product-specific cap would minimize this possibility.

The rationale supporting the argument for product-specific disciplines is that the over-subsidisation of specific products cannot be avoided merely by establishing cuts or ceilings for AMS, Blue Box, *de minimis* and OTDS. Lower levels of ambition for the aggregate reduction can be compensated by precise product-specific disciplines, which are needed to minimize the distortions caused by domestic policies (mainly their adverse effects on world prices). The U.S. has been selected for the analysis for two reasons: it has subsidies that are inversely related to prices, and is a major exporter of products that benefit from trade-distorting support.

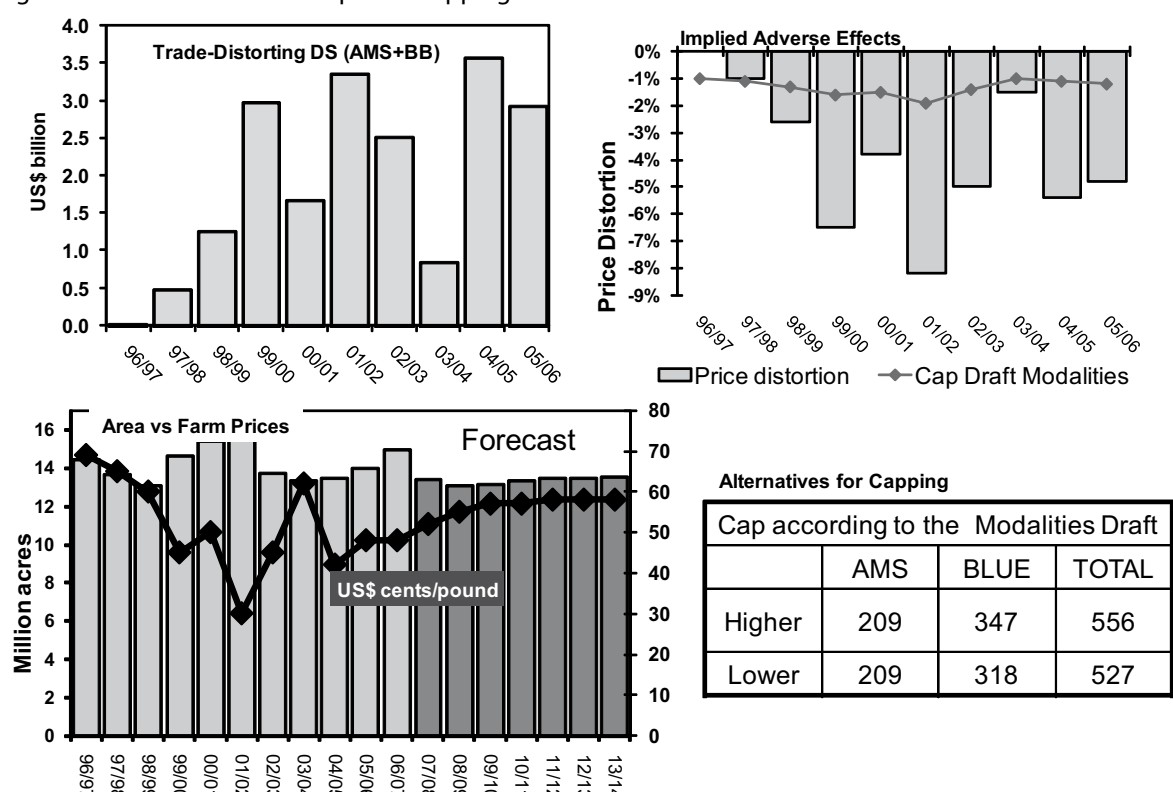
Following the methodology used by Costa, Nassar and Jank (2007), the product-specific caps proposed in the draft modalities have been evaluated according to their effects on world price, assuming that the cap represents the actual level of product support. The impacts of current levels of U.S. subsidies for some agricultural commodities on world prices have been described by Sumner (2005). The author showed that US subsidies might have depressed the world prices of maize, wheat and rice by 10 percent, 8 percent and 6 percent respectively. In this study, we estimated the depressive effect of subsidies on world prices by comparing the results from two scenarios: using the applied levels of subsidies from 1996 to 2005, and using the level defined as the product-specific cap. In both scenarios, data on prices, supply and demand, market share and parameters for elasticities were kept constant.

With the exception of cotton, the proposed product-specific caps will be an effective discipline only in market situations with very low prices. Strong disciplines are urgently needed precisely when prices are low and - at least in the US case - subsidies are consequently higher. However, the product cap will not act as a new discipline if prices remain higher than the levels observed when U.S. subsidies were at a historical high.

Figures 9 to 13 are divided into four groups of information. The first graph presents the amount of trade-distorting subsidies (AMS programmes such as marketing assistance loans, and Blue Box programmes, which basically cover the Counter Cyclical Program) granted from the period of 1996/97 to 2005/06 in US\$ billion. The second graph compares evolution of planted area (millions of acres along the principal Y axis) and US farm gate prices (US\$ /bushel, US\$ cents/pound or US\$/hundred weight along the secondary Y axis). We also included projections in order to show the position of projected prices in relation to the level of actual prices. The table presents the level of product capping according to the modalities paper. The third graph is the result of the calculations. The adverse effect is measured in terms of world average annual price percentage reduction compared to the actual average price. Data in columns show the adverse effect of the applied level of subsidies and data in lines show the adverse effect of the subsidies constrained by the caps.

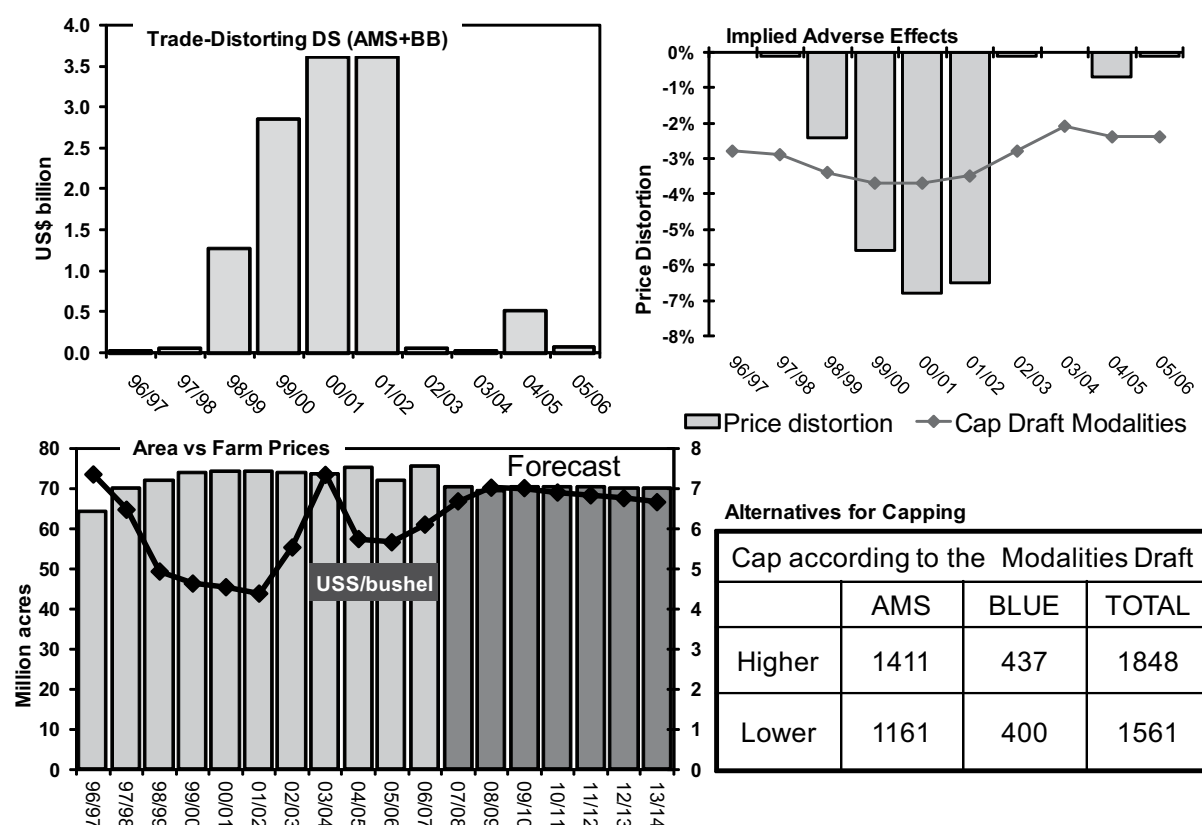
These figures show that establishing product-specific caps for some products, based on applied levels of AMS and Blue Box in the US case, does not by itself guarantee that these subsidies will be disciplined to the point of not affecting the price of these commodities. For example, in recent years, with the exception of maize and cotton, which have had higher subsidies from 2004 to 2006, the product cap proposed in the draft modalities text would have a price distortion that would be greater than the currently applied levels. Therefore, for some important products for world trade, like soybeans, wheat and rice, the price will be determined by market conditions.

Figure 9. U.S. Cotton: Product Specific Capping based on Adverse Effects on World Market



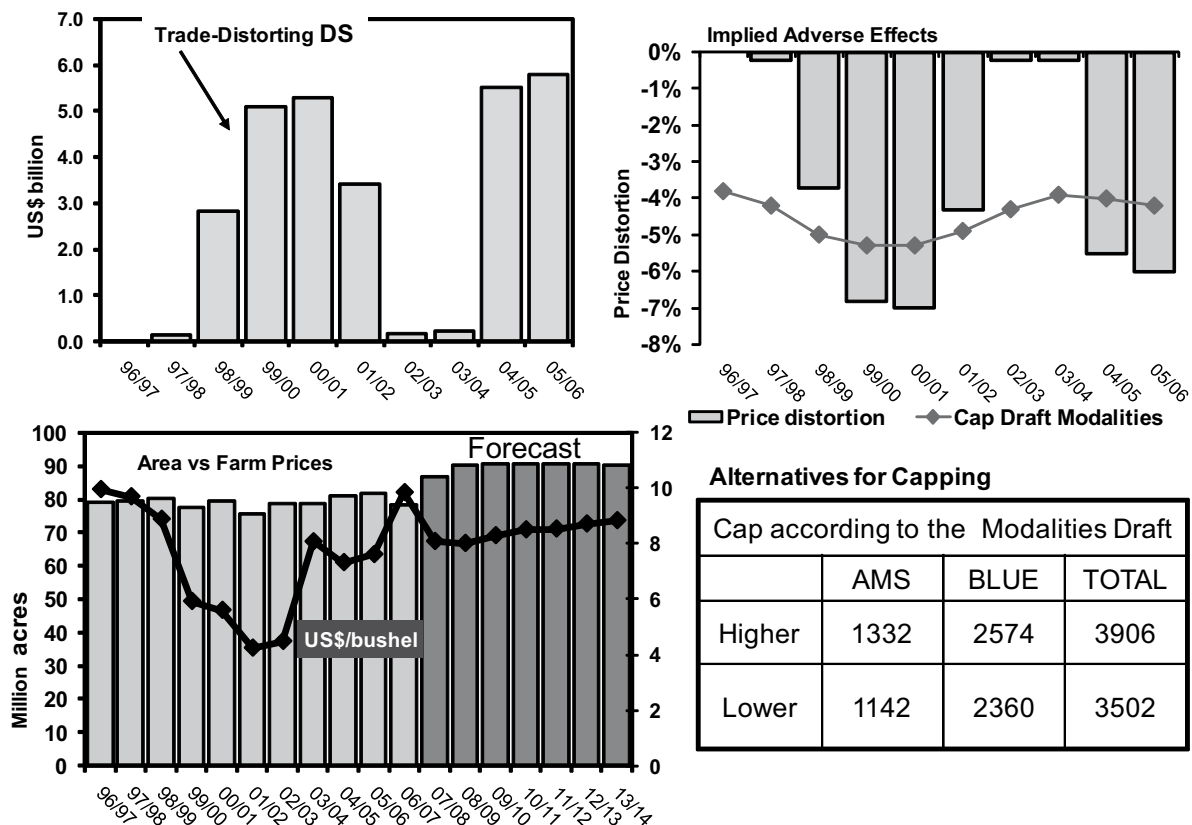
Source: USDA; WTO notifications; FAPRI/CARD. Elaboration: ICONE.

Figure 10. U.S. Soybean: Product Specific Capping based on Adverse Effects on World Market



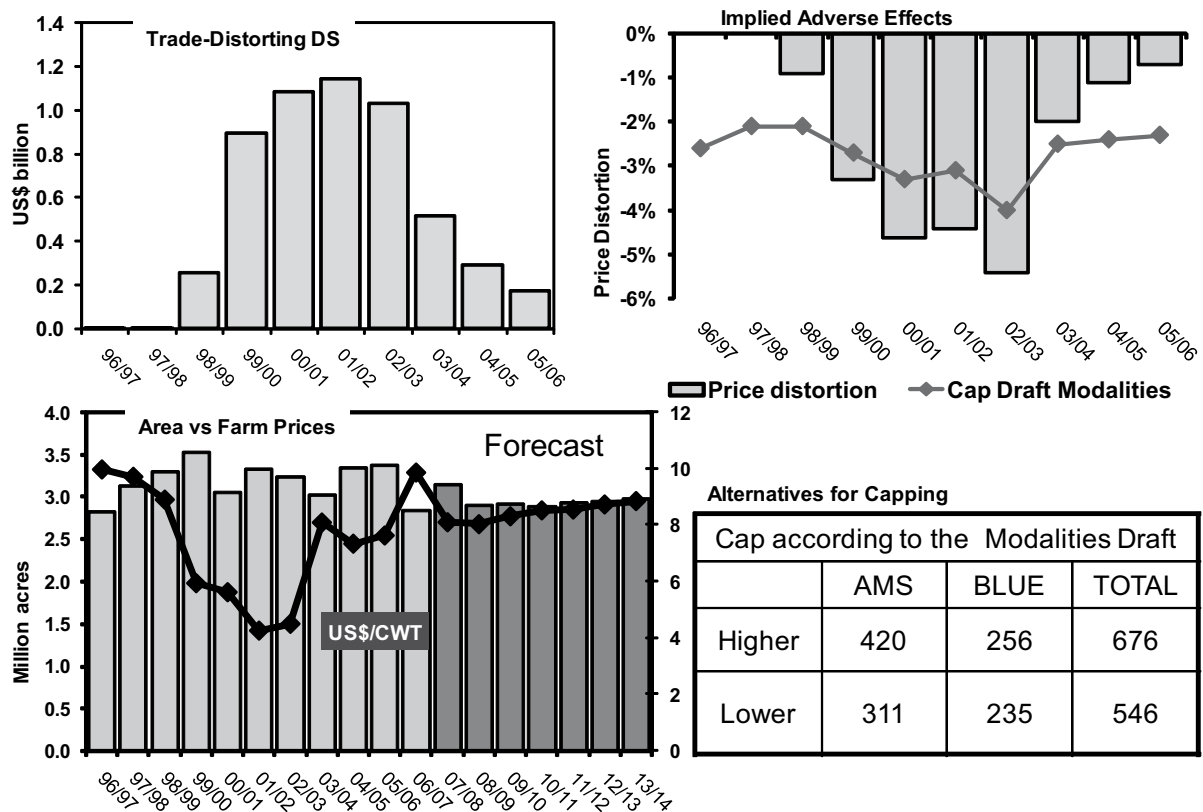
Source: USDA; WTO notifications; FAPRI/CARD. Elaboration: ICONE.

Figure 11. U.S. Corn: Product Specific Capping based on Adverse Effects on World Market



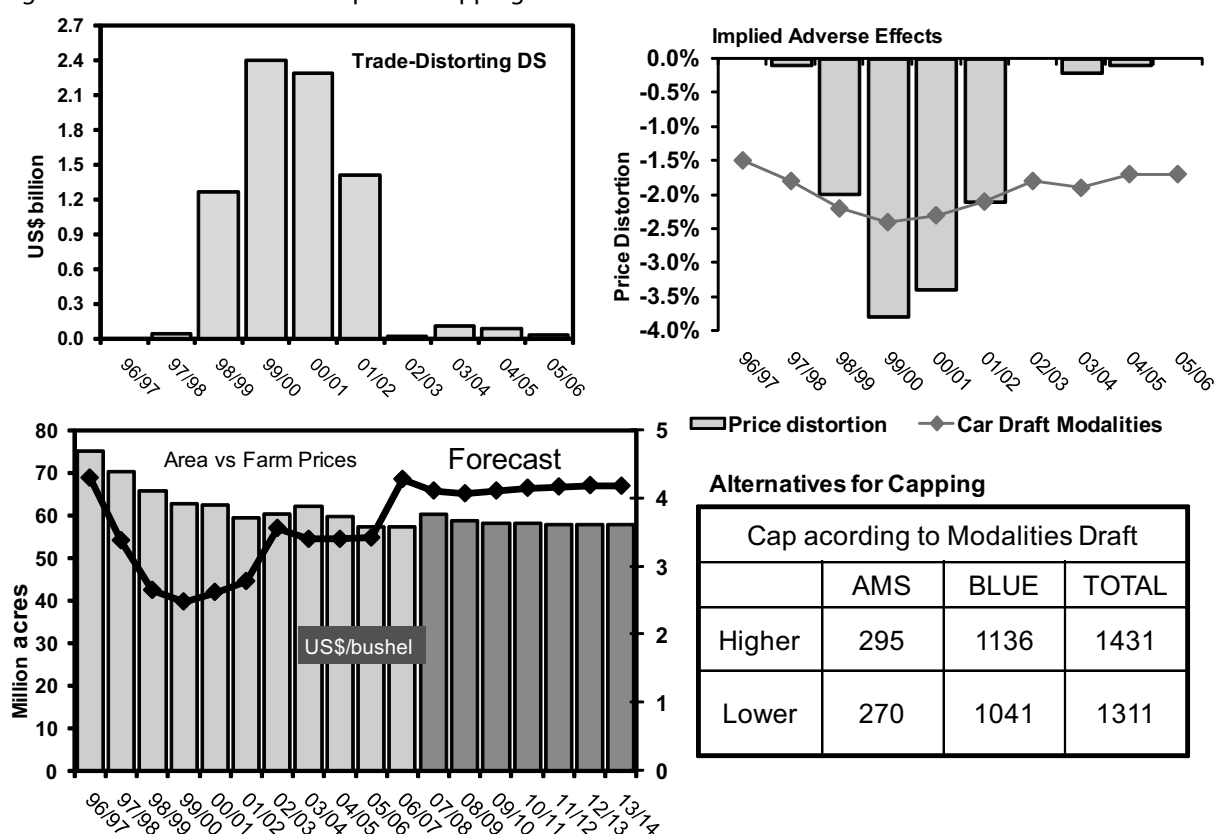
Source: USDA; WTO notifications; FAPRI/CARD. Elaboration: ICONE.

Figure 12. U.S. Rice: Product Specific Capping based on Adverse Effects on World Market



Source: USDA; WTO notifications; FAPRI/CARD. Elaboration: ICONE.

Figure 13. U.S. Wheat: Product Specific Capping based on Adverse Effects on World Market



Source: USDA; WTO notifications; FAPRI/CARD. Elaboration: ICONE.

3.3. Market Access

Market access is the most contentious issue in the Doha Round. Just a few countries, Brazil amongst them, have predominantly offensive interests. Even large exporters like the U.S. have defensive interests in some more 'sensitive' products, which lead them to seek some kind of flexibility to accommodate these. Some coalitions have only defensive interests in market access such as the G-10, the group of defensive developed countries and Korea, and the G-33, the group of developing countries that seeks substantial flexibility for SPs and SSM. Both groups have few offensive interests on market access.

When the Doha Round was launched, Brazilian objectives in the market access area focused primarily on tariff reduction. On TRQs, Brazil's sought mainly to reduce over and in-quota tariffs. TRQ expansion became a priority for

Brazil only after the establishment of sensitive products.

The SSM is also a topic that became a priority for Brazil only more recently. Until the G-33 tabled its proposals for the SSM, Brazil was of the view that an automatic safeguard for developing countries would be a legitimate mechanism. However, with the release of the G-33 proposals, it became clear that the SSM would lead to a reduction in market access achieved during the Uruguay Round. With the recognition that large importing developing countries were trying to take advantage of the SSM to increase levels of protection, the mechanism became a threat for Brazilian offensive interests. The SSM is thus a major concern for Brazil: depending on the parameters to be negotiated, Brazilian agribusiness is of the view that it could eliminate all the gains

of the Doha Round with respect to developing country markets. Brazilian exporters generally consider that a SSM that would jeopardize Uruguay Round tariff commitments is a deal breaker.

Overall, the topics that are top priority for Brazilian exporters are: the tariff reduction formula; sensitive products (number and deviation); TRQ expansion/creation (volumes, in-quota tariffs and administration); the Uruguay Round special safeguard (SSG); tariff escalation; special safeguard mechanism (SSM) and special products. Other defensive topics such as preference erosion could potentially

reduce gains for Brazil but are less important than the topics mentioned above.

Some offensive issues, which, although in line with Brazilian interests, are also not a priority: these include tropical products, tariff capping and tariff simplification. Our assessment is that they will not generate benefits for products of interest to Brazil because provisions for sensitive products, special products, special and differential treatment and the exception for recently acceded members will weaken the market access gains for many important products.

3.3.1. Tariff reduction formula

Brazil's objective on the tariff reduction formula has been to eliminate water in the tariffs and tariff binding overhang. However, there is no consensus among WTO members about eliminating overhang or water. There is no Doha Round mandate for the elimination of either element in the agricultural market access negotiations. The Doha Mandate calls for "substantial improvements in market access" but, following the approach used in the previous round, this expression can be interpreted in terms of the average cut. The minimum 54 percent average cut for developed countries and the maximum 36 percent average cut for developing countries average cuts does, at the limit, meet the requirements of the mandate in the sense that both represent 50 percent more than the average cuts undertaken in the Uruguay Round.

Developing countries have argued that applied tariffs are not under negotiation. However, the elimination of overhang and water is an underlying assumption of the objectives of export-oriented countries in the Doha Round. The G-20 tariff reduction formula proposal was designed to tackle the overhang and water in developed countries' tariff peaks (Jank et al, 2007).

Although many developing countries have refused to measure the efficacy of the tariff reduction formula in terms of its effectiveness

in eliminating overhang and water, the topic has nonetheless been raised in the non-agriculture market access negotiations (NAMA) by developed countries.

Still following the argumentation in Jank et al (2007), the difference in the level of ambition between the tariff reduction formula for developed countries and that for developing countries is due to the principle of special and differential (S&D) treatment. Since tariffs in these countries will be subject to smaller cuts, tariff reduction formulas will generally have a lower impact on binding overhang and water. The level of ambition is thus a function of two general factors: the magnitude of the cuts for developed countries' tariffs; and the application of the two-thirds rule to establish the S&D treatment that will be accorded to developing countries. By defining developing countries' tariff cuts in relation to those to be undertaken by developed countries, WTO members remove any possibility of eliminating water and overhang. If, in a few cases, the elimination takes place, it is by chance and not intentionally. Furthermore, once exceptions such as sensitive products and special products are taken into consideration, the likelihood of eliminating water and overhang is even smaller.

This conclusion is corroborated by Jank et al (2007). Evaluating water in tariffs and tariff binding overhang for 30 tariff lines in 14 countries

(7 developed and 7 developing), the authors show that many countries still maintain a large numbers of tariff lines with water and overhang after the application of the tariff formula. Although the paper bases its simulations on the G-20 tariff reduction formula proposal, the

cuts and thresholds proposed in this are similar to those in the last draft modalities text. Even without taking into account special products, the huge majority of tariff lines are not affected by the G-20 tariff formula. A summary of the results is reproduced below (Table 5).

Table 5. Summary of Tariff Lines with Binding Overhang and Water Before and After the Tariff Reduction (all in ad valorem)

Countries		[1]			[2]	[3]	[4]		[5]	
		Average Tariffs			Average Water	Average tariff with all overhang and water squeezed out	# of tariff lines with Overhang		# of tariff lines with water	
		(a) Bound	(b) Applied	(c) Bound after G-20 formula cut			before cut	after cut	before cut	after cut
Developed	Switzerland	227	116	42	16	100	12	2	4	2
	Norway	213	90	49	15	75	18	6	4	1
	Japan	156	110	35	6	104	13	3	4	1
	EU	58	58	18	14	43	0	0	14	6
	Canada	48	48	13	31	17	5	4	11	7
	USA	33	33	10	9	24	0	0	5	2
	Australia	2.3	0.6	1.3	0.2	0.4	13	10	1	1
	Total*	105	65	24	13	52	61	25	43	20
Developing	India	106	54	67	0	54	21	17	0	0
	South Africa	105	23	52	12	11	28	25	13	13
	Mexico	74	64	50	27	36	12	11	7	6
	Korea	72	62	42	1	61	10	8	2	0
	Brazil	44	15	31	7	7	30	30	16	16
	Phillipines	39	26	28	6	20	18	16	6	5
	China	25	25	19	13	12	0	0	10	10
	Total*	66	38	41	9	29	119	107	54	50

Note (1): A total of 30 tariff lines were evaluated for each country

Note (2): *Average = columns [1], [2] and [3] and Total number of tariff lines = columns [4] and [5].

Source: Jank et al., 2007.

3.3.2. Sensitive products and TRQ expansion

A number of considerations are likely to affect the market access gains that will be achieved in the negotiations on sensitive products and TRQ expansion: the number of sensitive products allowed, the deviation from the tariff reduction formula, TRQ creation, in-quota tariffs and tariff quota administration. Brazilian concerns on sensitive products are related to meat products (beef, poultry, pork), sugar and ethanol.

Brazilian negotiating positions were developed using the EU market as a reference. Brazil and the EU had discussed sensitive products extensively during the negotiation process.

Brazil-EU negotiations on sensitive products focused on beef, poultry and sugar. Brazil is the main supplier of both meats to the EU and the majority of Brazilian exports are MFN over-quota trade. For this reason, Brazil had focused on reducing over-quota tariffs rather than expanding TRQs. The EU, however, took the opposite position, seeking higher deviation from the formula for sensitive products and more emphasis on TRQ expansion.

The number of sensitive products is less important than other aspects of the sensitive product negotiations because the range defined

by the Draft Modalities (4 to 6 percent of total tariff lines) is large enough to allow developed countries to select the main products of interest to Brazil. In other words, the number would have to be much lower in order to be considered a constraint.

Once it had been established that countries would be allowed to deviate from the reduction formula, Brazilian priorities turned to the question of compensation: the TRQ volume expansion that should compensate for the trade that would now not be created due to the lower over-quota tariff reduction. The Brazilian private sector has explored with the government an economic approach to TRQ expansion. The central hypothesis is that TRQ expansion must fully compensate for the tariff cut not taken. The compensation would be the absolute difference between total trade creation from the full tariff cut and trade creation from less than the full tariff cut (depending on the deviation). The idea of working on an economic based approach was a reaction to the EU proposal to calculate TRQ expansion based on current imports, rather than using a percentage of domestic consumption as a basis for expansion, as was the case in the Uruguay Round (European Commission, 2005).

Although the economic approach is more accurate from a theoretical point of view, its main limitation is the definition of the price elasticity of import demand. While the EU was working with a standardized elasticity of -1, ICONE's calculations were based on -4. The price elasticity of import demand of -4 is based on the global top-level elasticities in the GTAP-AGR model. According to GTAP-AGR, the average import elasticity for agriculture products is -4.63. Intuitively, the price elasticity of import demand of -4 could be derived from domestic demand and supply elasticities. Assuming a domestic demand elasticity of -0.4, a supply elasticity of 0.8, and that 33 percent of agricultural output is traded worldwide, the derived import demand elasticity is calculated as -4.

The approach based on domestic consumption has prevailed in the course of the negotiations. Figures 14 and 15 compare the TRQ expansion resulting from the provisions of the Draft

Modalities with the current TRQ volumes and average EU imports for 2003-05 - the base period for calculating domestic consumption.

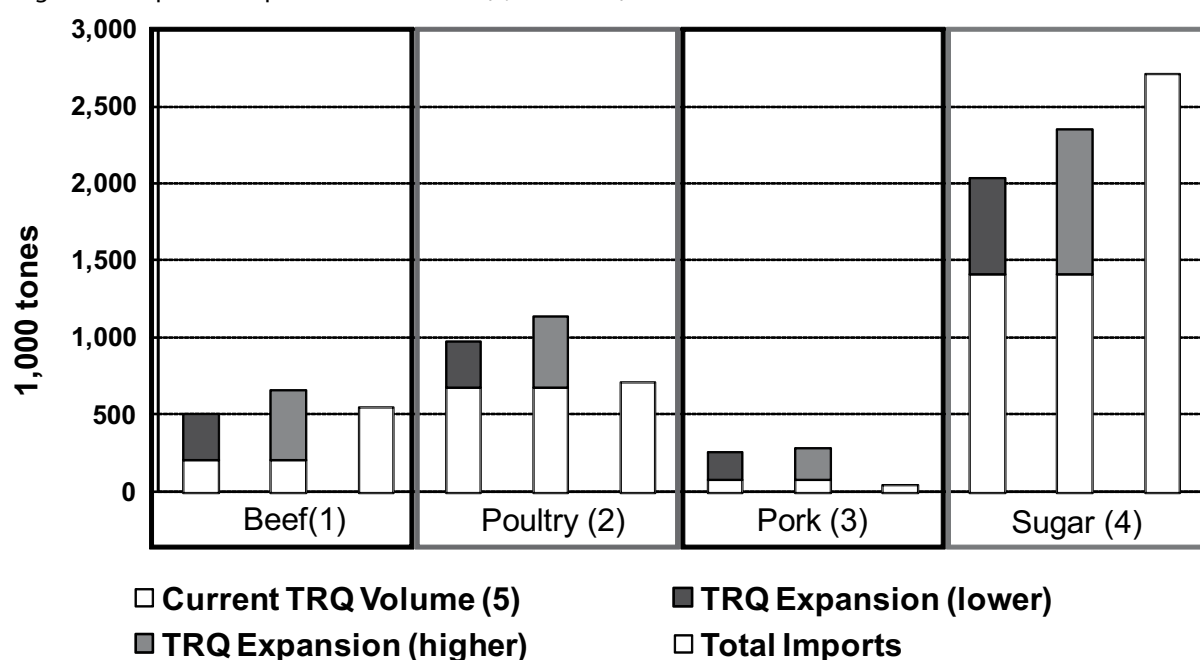
The general rule is expansion of [4-6] percent of domestic consumption when the 2/3 deviation is used, and [3-5] percent of domestic consumption when the 1/3 deviation is used. We expect that the EU will use the 2/3 deviation for beef, poultry and sugar and the 1/3 deviation for pork. It is clear that the quota expansion is determined by the percentage of consumption to be used as a base for expansion. Although the consumption allocation methodology sounds reasonable, the outcomes would not create satisfactory new trade flows, for example in poultry, beef and sugar to the European Union.

The partial allocation methodology results in some loss in the TRQ expansion volume. Effective expansion, in relation to domestic consumption, is 3.6, 2.7 and 3.6 percent for beef, poultry and sugar in the case of the lower base for expansion, and 5.3, 4.1 and 5.4 percent in the case of the higher. Poultry is the sector with the highest loss.

Pork is a special case because, in order to accommodate EU demands for flexibilities, a very casuistic provision has been established for the product. The provisions for pork are described in item "F" of Attachment Ai. Pork quotas will be expanded not by the [3-5] percent of domestic consumption required for other products, but instead by 1.75 percent of the domestic consumption allocated to pork sensitive tariff lines, or 1 per cent of the domestic consumption of the product category. It is clear that this provision has undermined the results for pork TRQ expansion.

If the total TRQ volume (Doha Round TRQ plus Uruguay Round TRQ volumes) is compared with average imports in the 2003 to 2005 period, it is evident that only pork will be provided with new market access opportunities. In the case of sugar, even if the higher base for expansion is chosen, imports would not reach current levels. In the case of beef, new market opportunities will be created only if the higher base for expansion is used.

Figure 14. Expected Expansion of EU TRQs (1,000 tones)



Source: Author's elaboration.

Notes:

(1) Chilled and frozen boneless cuts.

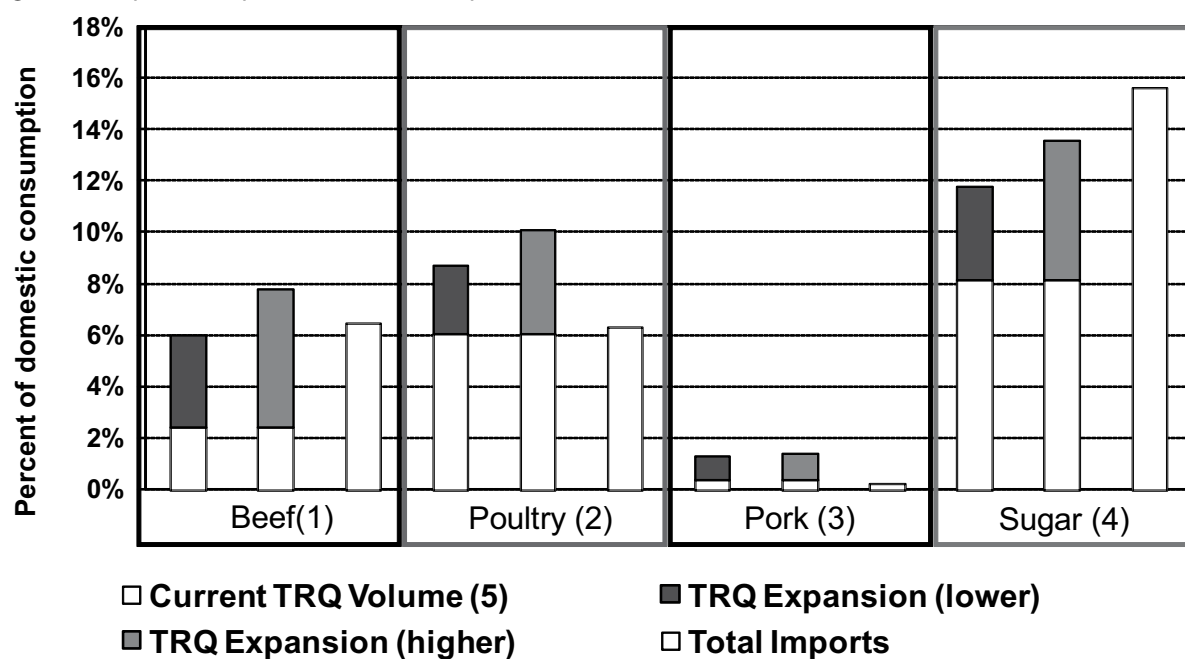
(2) Frozen poultry, salted chicken and processed meat. Current TRQ volume includes new TRQs created for salted and processed meat as a result of Article XXVIII negotiation between the EU, Brazil and Thailand.

(3) Fresh meat (frozen and chilled).

(4) Raw and white sugar.

(5) Although TRQ expansion is based on consumption data of 2003-05 period, the TRQ volume presented in the figure reflects the situation of 2007.

Figure 15. Expected Expansion of EU TRQs (percent)



Source: Author's elaboration.

Poultry is more complicated because current TRQs include new TRQs negotiated for salted and processed meat. Doha Round expansion will create new opportunities only for those products. The current TRQ for fresh meat represents only 0.3 percent of total domestic consumption and 8 percent of the current TRQ (57.2 out of 676.2 thousand tons). Imports of fresh meat, however, account for more than 50 percent of total imports. EU imports of fresh chicken are a typical case of over-quota trade.

The high over-quota volume also explains why the EU is resisting the elimination of the SSG: the bloc aims to maintain the poultry sector using the extra protection provided by the SSG. The main product imported by the EU is frozen boneless chicken breasts (HS 0207.14.10), which is subjected to a €1.024/ton tariff. The SSG has been continuously applied on this product since the first year of the implementation period of the Uruguay Round. The 2003-2005 average additional tariff, as a consequence of the activation of the price SSG, was € 360/ton.

In-quota tariff reduction is also a priority because the in-quota tariff can prevent TRQs from being fully filled. It is also important because with the sensitive products provision, more trade will flow at the in-quota level. As with previous versions of the draft modalities, the July 2008 version continued to reduce the level of ambition for in-quota tariff reduction. The Brazilian agricultural sector argues that in-quota tariffs should be reduced to levels below 10 percent, and all such tariffs should be expressed simply as *ad valorem* equivalents.

The arguments concerning in-quota tariffs are similar to those on the relevance of TRQ administration. There are many problems with TRQ administration methods that discriminate against exporters. Under filling, a topic that is addressed in the Draft Modalities, is just one of them. Brazil's strong experience with EU beef and chicken quotas nonetheless would suggest that under filling of quotas is not the most important market access issue in the case of the EU. Given that it will be hard to include further disciplines on TRQ administration in the modalities, the reduction of in-quota tariffs

becomes even more important as a mechanism to offset the limited progress achieved on TRQ administration.

The third revision of the Draft Modalities includes one fundamental choice on sensitive products: either countries will not be allowed to designate as 'sensitive' those tariffs lines that did not have TRQs before the Doha Round, which is the ideal situation for Brazil, or countries will be allowed to designate any tariff line as sensitive irrespective of whether it had a TRQ before the Doha Round. If the second option prevails, new TRQs must be created to compensate for the tariff cut not taken.

The way the Draft Modalities approaches this issue is a bit risky for exporters. Even if the idea that tariff lines which did not have TRQs pre-Doha can be selected as sensitive is implicit in previous drafts of the modalities, importing countries that may wish to create new quotas will be left in a very comfortable position if exporters accept the idea of TRQ creation in this way without negotiating additional disciplines for these new quotas. From a strategic point of view, the approval of new quotas must be negotiated in conjunction with their parameters. Moreover, exporting countries must argue that the creation of TRQs should be allowed only at very high costs to the countries that favour this. At minimum, TRQs volumes should be set taking into account Uruguay Round commitments. This means that 11 percent of domestic consumption (5 percent from the Uruguay Round and 6 percent from the Doha Round) is the bottom line. Also, TRQ volumes should be higher than current imports, in order to guarantee additional market access opportunities.

Brazilian ethanol exports could also be affected by the creation of new TRQs, as the EU has already indicated that it intends to select ethanol as a sensitive product. Consumption of ethanol in the EU and U.S. markets is growing. Using a fixed historical period as the basis for quota expansion would therefore lead to a relatively small quota increase in compensation for the lower tariff cut. Average ethanol consumption in the EU from 2003-05 was 2.8

billion litres. Current consumption is almost double this amount, and future consumption is expected to be higher than 10 billion litres (Jank et al, 2007). Projected increase in the US are even more dramatic: the Renewable Fuel Standard calls for 132 billion litres in 2017.

The U.S. is in a special situation regarding ethanol. The ordinary custom duty for ethanol (tariff lines 2207.10.60 and 2207.22.00) is 2.5 and 1.9 percent, respectively. However, the U.S. has also bound an additional tariff of US\$ 0.142 per litre for fuel ethanol as an “other duty and charge” (ODC) at the WTO. The U.S. will designate ethanol as sensitive only if is compelled to reduce the ODC as well as the ordinary tariff. The U.S., however, is indicating to Brazil that the ODC will not to be reduced by the tariff reduction formula.

The decision to reduce the additional tariff in the Doha Round belongs essentially to the U.S., given that it is uncertain if an ODC has

to be reduced. ODCs should be reduced if they are similar to ordinary custom duties (OCD). ODCs were bound for the first time with the creation of the WTO and, therefore, there is no jurisprudence with respect to how to treat them in a multilateral round. What is clear in the GATT 1994 is that ODCs and OCDs are border duties with different purposes and nature. The fact that the U.S. decided to bind the additional tariff as an ODC, however, does not remove the fact that the additional tariff is, *de facto*, an OCD and, therefore, is subject to any tariff reduction formula.

The Brazilian private sector, seeking to advance its interests in the U.S. ethanol market, is of the view that the country must calculate the *ad valorem* equivalent of the additional tariff and reduce it using the tariff reduction formula or select it as sensitive. Moreover, this issue is sufficiently important to justify the government bringing it as a dispute in the DSB.

3.3.3. Uruguay round special safeguard (SSG)

Amongst developed country market access issues, the question of the elimination of the SSG sometimes seems to be neglected. The way in which the SSG has been discussed in the negotiations is not in the interest of Brazil. G-33 countries have used the issue of the SSG as a way to reinforce their argument that the SSM should enable them to apply safeguard duties that exceed the Uruguay Round bound tariff. They have argued that if developed countries use the SSG remedy on top of the Uruguay Round bound tariff, developing countries should be able to do the same with the SSM.

Modalities on the SSG could affect Brazilian exports of two products, chicken and sugar, to the EU market. Reducing the number of scheduled tariff lines to 1.5 percent, as proposed in the Draft Modalities, does not therefore address Brazilian concerns. The SSG is a temporary measure that should have been eliminated at the end of the Uruguay Round implementation period. The only alternative that is in line with Brazilian interests is the elimination of the SSG in the Doha Round. It would be better to establish a phase-out period, but with an end date, than to maintain the SSG but limit it to a few tariff lines.

3.3.4. Tariff escalation

From the Brazilian perspective, three considerations limit the effectiveness of the priorities on tariff escalation:

- (i) Developing countries are not obliged to reduce escalation. However, China maintains complex tariffs on soybeans

which are a classic case of tariff escalation: 3 percent for soybean grain, 6 percent for soybean meal and 9 percent for soybean oil. The Draft Modalities, however, allow China to decide if it wants to reduce the escalation;

- (ii) Sensitive and special products are exempt

from the tariff escalation disciplines, undermining the effectiveness of these provisions;

- (iii) The absence of negotiations on differential export taxes (DET). DETs have been

created to offset or neutralize the distortions of tariff escalation. Reductions in tariff escalation, therefore, should be accompanied by similar reductions in DETs.

3.3.5. Flexibilities for developing countries: the special safeguard mechanism and special products

If on the one hand, projected market access gains in developed countries give rise to pessimism, on the other, likely market access gains in the developing world are even worse. This is not so much a matter of the lower tariff cut, but rather the high number of tariff lines that could be selected as special products, and the increasing number of products that may be considered sensitive. The creation of the SSM for this group of countries also reinforces the argument that the results of the negotiations will not lead to trade growth. The draft modalities indicates that countries will be allowed to designate [10-18] percent of their tariff lines as special, and that these will be subject to an average cut of [10-14] percent. The draft also proposes that countries be allowed to exempt from cuts up to 6 percent of their tariff lines. Besides, the percentage of tariff lines which developing countries will be allowed to select as special is enough to cover most agricultural trade.

The use of the SSM, which aims to protect developing countries from import surges and price depressions, may cause changes in current agricultural tariffs in developing countries. As the aim is protection from import surges, economic logic says that the safeguard should be applied when triggered by both price depressions and volume surges. However, this is not what prevails in current proposals. Furthermore, there is a possibility that tariffs may actually increase instead of decrease, consequently reducing agricultural trade. This could happen either at the level of the applied tariff, because countries would have available an automatic mechanism to increase applied tariffs when they are lower than bound tariffs, or at the level of the bound tariff if there is no overhang. As with the maintenance of the SSG in developed countries, this appears to be inconsistent with the objective of the Round to

reduce protection levels rather than increase them. It is therefore important to consider the safeguard as a temporary mechanism, with a deadline by which it should be eliminated: as in the case of the SSG, this should be the end of the implementation period of the Round for which it was negotiated. Otherwise, the SSM could be used as another protection barrier, in this case by developing countries, which will be able to use it to increase their tariffs whenever they wish.

For example, using the parameters proposed in the Draft Modalities, in 2001 and 2003, China could have applied additional safeguard duties of 15 percentage points to soybean imports on top of the current tariff of 3 percent. The modalities document, however, still kept an important provision that would discipline the use of the SSM: the maximum tariff, i.e. the applied rate plus the SSM remedy, cannot exceed the Uruguay Round bound tariff. If this provision is eliminated, the only way to limit the SSM's ability to increase protection levels is to renegotiate its parameters. Otherwise, situations like that described for Chinese soybeans could lead to an increase in protection levels, contradicting the overall aims of the Doha Round.

Considering the greater flexibility offered to small, vulnerable economies and recently acceded WTO members, the proposed changes seem to offer practically no opportunity to increase agricultural imports in developing country markets. While special conditions should clearly be provided to cater to the needs of more vulnerable countries, the exceptions to the tariff cut formula seem to encompass practically the totality of all agricultural trade, in both developing and developed countries.

4. CONCLUSIONS

This paper discussed the market access and domestic support pillars in the Doha Round negotiations. It analysed both the implications for Brazil of reducing its own tariffs and reforming domestic support for agriculture; and the likely benefits Brazilian exporters can be expected to gain. The analysis demonstrates that Brazil will not have to make major changes to its tariffs and subsidies. This is not only because the country has an adequate amount of overhang between bound and applied tariffs, and sufficient water in its *de minimis* support, but also because tariffs have not been used as income policy in Brazil, and trade-distorting domestic subsidies are few in comparison to the size of Brazilian agriculture.

The gains for Brazil, therefore, will come from the contribution of this round to the growth of Brazilian agricultural exports and to the reduction of the trade-distorting effects of domestic support. An undeniable achievement of the Doha Round will be the creation of product-specific caps for Amber and Blue Box subsidies. Product-specific disciplines are necessary to avoid the negative impacts of domestic support in the world market, as was the case with US subsidies for grain and oilseeds between 1999 and 2002. Product caps will serve to reduce world price suppression, especially if prices go back to 1999-2002 levels.

Product caps only make sense if they are capable of preventing the adverse effects of domestic subsidies on world prices. The effectiveness, therefore, depends on the level of the cap and the implied adverse effects on prices. This study has shown that the proposed caps, with

the exception of cotton, can constrain price suppression in situations of very low world prices. However, caps will not be effective if prices are at more normal levels.

Brazil's market access gains in developed countries are most likely to be constrained by the continuation of the SSG and the extent to which disciplines will achieve effective TRQ expansion. The continuation of the SSG will be an escape clause for countries seeking to maintain protection for specific sectors. The SSG will thus provide an additional layer of protection over and above the TRQ system, which itself is already a protectionist measure. Taking as an example the cases of beef, chicken and sugar in the EU, the compensation to be provided for selecting these products as sensitive will not be enough to create new trade. TRQ expansion will, at most, internalize over-quota trade: because there will not be any meaningful results in terms of import price reduction, imports will not increase. A reduction in over-quota tariffs would be the most effective way to create new trade.

In the case of developing countries, the SSM is the central concern. There is a potential risk of increasing levels of protection beyond the tariff levels that were bound in the Uruguay Round leading to deterioration in current market access opportunities.

Two topics now appear as "deal-breakers" for Brazil: the creation of new tariff rate quotas that will not be effective in creating new market access opportunities and an SSM that will lead to an increase in the level of protection consolidated before the Doha Round.

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