

# ILLINOIS AG POLICY BRIEFS



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## FREQUENTLY ASKED QUESTIONS ABOUT THE WTO

### 1. In general, what is the WTO?

The World Trade Organization (WTO) is a voluntary association of 149 countries which meet periodically (in what are known as “rounds” of negotiations) for the purpose of setting the rules of the road of international trade by which all of its members agree to behave. The purpose of each round of negotiations is to review the existing rules and revise them if there is perceived to be need for change. All decisions in the WTO are taken by consensus of all members (not by majority vote as occurs in many of the other international organizations to which the United States belongs).

The WTO, which has its headquarters in Geneva, Switzerland, has three basic functions:

1. It organizes and staffs the periodic rounds of international trade negotiations.
2. It organizes a dispute settlement process when one member country accuses another of violating one or more of the rules of international trade that all had agreed to abide by in the most recent round of negotiations.
3. It organizes periodic reviews of every member country's trade policies to be sure they are consistent with the existing international trade rules.

### 2. Why is it important for the U.S. to follow the WTO trade rules? How does the WTO relate to Illinois?

Having a rules-based international trading system benefits all countries by keeping trade flowing as smoothly as possible without unfair impediments or facilitation by government interventions. It is also important to have an international trade dispute settlement procedure with real teeth when some member country is violating the rules of the game.

Having a fair and well-functioning international trading system is extremely important to the economic well-being of Illinois agriculture, which sold \$3.4 billion worth of its production overseas in 2005. Corn and soybeans led the way. Exports provided the market for 44 percent of everything Illinois farmers grew in 2005. Exports are also important to the state's entire economy, having provided the market for \$35.9 billion worth of goods and services produced in Illinois in 2005.

### 3. Who started the organization and why? How was the United States involved?

The World Trade Organization, which came into being in its present incarnation in 1995 was created by the Uruguay Round of international trade negotiations, which was carried out under the auspices of the WTO's predecessor organization, the General Agreement on Tariffs and Trade (GATT). The United States played a leading role in that round of trade negotiations and was a principal author of the Uruguay Round Agreement, which defines the current rules of international trade.

In the waning days of World War II in 1944, some leading economic thinkers from the Allied powers concluded that the world was in need of several new institutions to deal with problems that had prolonged and deepened the Great Depression and probably contributed to the outbreak of World War II, in particular the cycle of increasing protectionism that had put international trade into a downward spiral in the 1930s. At an international conference in Bretton Woods, New Hampshire, in 1944, the need for an "International Trade Organization" was identified, however that entity was stillborn. Nevertheless, the basic need for a rules-based international trading system remained, and, at a meeting in Geneva in 1947, the principal post-war economic powers, including the United States, agreed upon a set of basic rules for international trade, which came to be known as the General Agreement on Tariffs and Trade (GATT).

#### **4. Who wrote the WTO rules that we hear about? What authority do those rules have over the U.S.?**

The present rules of international trade are those agreed to in 1994 by consensus of all member countries in the Uruguay Round of international trade negotiations. This was the last round conducted under the auspices of the GATT. In the years between 1947 and the Uruguay Round, there were six rounds of GATT negotiations, each of which updated and further refined the existing rules of international trade. During this period significant liberalization of trade in manufactured products occurred as the provision of export subsidies was banned and import tariffs on most manufactured goods were gradually lowered to today's relatively insignificant levels.

It is noteworthy that agricultural products were given an exemption from many of the early international trade rules in the GATT. It was first in the Uruguay Round during 1986 to 1994, with strong leadership from the United States, that trade in agricultural products started to be brought under many of the trading rules to which other sectors had been subjected for decades. For the first time, agricultural export subsidies were disciplined, with each country accepting a cap (in both value and volume terms) which was reduced over time.

With strong US pressure, for the first time domestic agricultural supports which are linked to the volume of production of *specific* commodities were recognized as potentially trade distorting. Each country accepted a cap on the total amount it could spend on trade-distorting domestic subsidies ("amber box"), and this cap was reduced over time. (No limit was placed on government support provided to agriculture through measures that are unrelated to the production of any specific commodity ("green box"). Also, if a country was offsetting the output-inducing effect of supports linked to the production of specific commodities by means of a mandatory set-aside or marketing quota, then those measures did not have to be counted against the cap ("blue box").)

The Uruguay Round Agreement on Agriculture also included several other new features. All quotas and other non-tariff barriers to imports of agricultural products were to be converted to tariffs and reduced over time. In addition, all restrictions on agricultural imports for the purpose of protecting plant or animal health now have to be based on sound scientific evidence.

The United States was a leader in the Uruguay Round of negotiations and was a principal author of a number of changes which were accepted by all members in the final agreement. It should be emphasized, however, that in the end, any trade agreement is a delicately politically balanced set of gives and takes from all the participants in the negotiations. This is why it is so important that each new trade agreement go to the Congress as a whole for one up-or-down vote on the entire package, as allowed under Trade Promotion ("fast-track" negotiating) Authority. If Congress were to start picking an agreement apart, the whole deal would come unraveled.

Once a trade agreement is approved by a majority of members of the Senate and of the House of Representatives and is signed by the President, it becomes part of U.S. trade law.

## **5. What are the benefits/consequences of complying or not? What happens if a country doesn't comply?**

When one WTO-member country accuses another of violating one or more of the existing WTO rules, the WTO first tries to resolve their differences through mediation. If that fails, the WTO appoints a "panel" of international trade experts and lawyers from countries which have no interest in either side of the case to hear the evidence brought by both the accused and the accusing countries. After weighing the evidence presented by both sides, the panel issues its findings in a report. If either side (or both) is unsatisfied with the outcome, the panel's decision can be appealed to the WTO's Appellate Body, comprised only of international trade lawyers, which in effect functions as the supreme court of international trade. Because trade agreements sometimes contain fuzzy language, the panels and the Appellate Body are building up a body of case law, just as any individual country's court system does.

If a country loses a case in the WTO, it is expected to bring its offending policy into alignment with the existing rules of international trade within a specified period of time. The WTO cannot force any country to change its policy. However, if a country refuses to change a policy found to be in violation of WTO rules, then the WTO can authorize the country which won the case to collect compensation for the losses it suffered as a result of the offending policy by imposing duties on goods it imports from the country found to be in violation of WTO rules. There is no presumption that the goods on which the duties are assessed have any relationship to the product in which the violation was found. Most countries act strategically by choosing products for taxation that are politically powerful in the country that lost the case, with the objective of bringing greater political pressure on that country's government to change the offending policy.

## **6. What is the Doha Round, and why do we hear it mentioned so often?**

The Doha Round of trade negotiations, which has been underway since 2001, is the most recent series of meetings in which the countries that belong to the WTO are reviewing the existing rules of international trade as set in the Uruguay Round Agreement and considering what, if any, changes are merited. (Rounds of trade negotiations are generally named after the place where the round is launched, in this case, Doha, Qatar.) Until the 149 member countries participating in this round reach consensus on changes to be made, the rules of international trade defined in the Uruguay Round Agreement will continue in effect. While the round is attempting to further liberalize trade in manufactured products, there is special emphasis in this round on reducing barriers to trade in agriculture and services.

Conceptually the Uruguay Round went a long way in bringing trade in agricultural products under the rules-based WTO system, however the agreement was riddled with loopholes, and in reality very little liberalization of agricultural trade occurred as a result of that agreement. We hear the Doha Round mentioned frequently now because the negotiations, which have languished for several years, are reaching a critical point. The target date for agreeing on the basic guidelines by which each WTO member country will be expected to change its trade and domestic agricultural policies is April 30, 2006. Most observers expect the negotiators to miss that target, but we should expect intense activity over the coming weeks or months.

## **7. Is there a link between the Doha Round and the 2007 Farm Bill?**

The United States has made it clear that its highest priority for agriculture in the Doha Round of trade negotiations is to gain greater market access into other countries' markets, whether by reductions in their import tariffs or increases in their import quotas. The U.S. has also pressed hard to have export subsidies banned in agricultural trade, just as they have been for other types of products for several decades. In exchange for such concessions from other countries, the U.S. has offered to significantly reduce the cap on its *trade-distorting* domestic agricultural supports, i.e. those in which the amount of support is linked to the volume of production of *specific*

commodities. Contrary to many media reports, the U.S. did *not* propose to completely eliminate all agricultural supports, just those linked to production of specific commodities. (Actually the U.S. offered to completely eliminate trade-distorting supports over 15 years if it can get big enough concessions from other countries in market access.)

If the Doha Round Agreement on Agriculture includes a significant reduction in (or even elimination of) trade-distorting domestic supports, there would be significant implications for writing the 2007 farm bill, because this would directly affect marketing loans, loan deficiency payments (LDPs), and counter-cyclical payments. Dollars now being paid out to farmers through these programs would need to be rechanneled via direct payments or via some other mechanism that could be counted as green box, e.g. conservation, rural infrastructure, research, or some form of farm revenue assurance.

### **8. Is there a link between the WTO cotton decision and future corn and soybean programs?**

In looking towards the 2007 farm bill, it is important to keep one other thing in mind related to the WTO. In 2003, Brazil took a case to the WTO against the U.S. cotton program, alleging among other things, that marketing loans, LDPs, and counter-cyclical payments had stimulated larger production of cotton in the U.S. than would otherwise have occurred, and that, when this cotton was pushed out into the world market, it had depressed the world price of cotton and in turn hurt Brazil's cotton producers, who get their entire income from the market. The U.S. lost this case, and the WTO agreed with Brazil on all of these points.

While the Midwest doesn't produce cotton, this case has very real implications for it because the corn and soybean programs have many of the same features as the cotton program that were found to be inconsistent with current agricultural trade rules as defined in the Uruguay Round Agreement of Agriculture. If the Doha Round should fail to come to closure, there is a significant possibility that other countries will take cases to the WTO against other U.S. commodity programs, including rice, corn and perhaps soybeans. One possible scenario is that the U.S. can either give these features up in the negotiations and receive concessions from other countries in exchange for them, or risk losing them through litigation and get nothing for giving them up.

The WTO decision on the Brazil cotton case has one other important implication for the 2007 Farm Bill. The WTO found that the United States' direct payments violate the definition of decoupled (green box) payments (of which, parenthetically, the U.S. was the principal author). For payments to come in under the definition of green box payments, there can be no relationship whatsoever between the payment and production of any *specific* commodity. Under current U.S. farm policy a farmer cannot receive direct payments if he/she grows fruits or vegetables on the land for which the payment is received. This exclusion will need to be eliminated in the next farm bill, or all the money American farmers receive in the form of direct payments will have to be counted under the U.S. amber box cap.

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