

# **Can Africa Achieve Millennium Development Growth Targets Through Effective Negotiations of the Doha Development Mandate?**

By

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## **Introduction**

The general consensus of opinion in international economic development circles is that Africa is lagging far behind in global efforts to meet the Millennium Development Goals (MDGs) by its target date of 2015. Africa is still far from reaching the targeted goal of an annual growth rate above 7 percent a year required to achieve economic convergence with other developing countries and to maintain similar quality of life. In particular, sub-Saharan Africa (SSA) has seen poverty rise and life expectancy decline in the five years since the Goals were declared in 2000 (United Nations Economic Commission for Africa, 2005). But achieving the MDGs would provide a unique opportunity for Africa and its development partners to seriously tackle the important issue of reducing endemic poverty for the continent.

African countries recognize the strong political will and bold and decisive actions necessary to establish the conditions for achieving sustained economic growth so as to eradicate poverty. For example, in anticipation of forthcoming high-level discussions, notably the African Union Summit in July 2006, the UN High-Level Dialogue on Financing for Development in June 2005, the G-8 Summit in Gleneagles, Scotland, in July 2005, and the UN General Assembly review summit in September 2005, African Ministers of Finance, Planning and Economic Development met at a conference in Abuja, Nigeria on May 14-15, 2005 on the theme, "Achieving the Millennium Development Goals in Africa." In its Draft Ministerial Statement, the conference affirmed the MDGs as a framework for reducing poverty and advancing development in Africa, and called for greater local ownership and more effective national poverty reduction and growth strategies by accelerating broadly-shared and sustained employment-generating economic growth. Additionally, among other things, the conference acknowledged trade as a vital engine of growth, and called for a fair, non-discriminatory, predictable, multilateral trading system. Whereas the conference recognized the importance of using African regional initiatives to open up and encourage trade in goods and services, it also called for substantial reductions and elimination of trade distorting domestic support with harmful effects on African exports, and appealed to all WTO members to work to ensure a successful 6<sup>th</sup> WTO Ministerial Conference in Hong Kong in December 2005, which will set the stage for the early conclusion of the Doha Development Round in 2006.

The most striking feature of Africa's performance in global trade since the early 1960s is the dramatic decline in the region's ability to compete in international markets (Ng and Yeats, 2000), which has led to a remarkable fall, particularly for SSA countries, in the continent's share of global exports. While developing countries as a whole increased their contribution to world trade, Africa's share of total developing country exports dropped from 15.5 percent in 1981 to 9.2 percent in 1997 (African Development Bank, 2000). Reasons given for the weak trade performance include relatively low growth in global demand for African goods, unstable export prices and earnings and the interrelated factors of domestic policy inadequacies, weak production capacities and supply constraints, fragmented and small national economies, inadequate trade-support services, continued marginalization in world trade governance processes, and diminished industrialization and growth prospects. In this regard, to effectively contribute to the

growth of African economies and improve living standards, capacity needs to be developed to mainstream trade policies and programmes in overall and sector-specific development strategies that focus on promoting pro-poor growth.

In the face of compelling evidence that openness to trade is associated with increased economic growth<sup>1</sup>, nations have been negotiating trade agreements at the multilateral and regional levels so as to enhance policy credibility and to accelerate trade and investment liberalization in the hopes of spurring supply response and export growth. In the past, Africa had not been a major part of this trend and had therefore not taken advantage of the trade opportunities opened up by the momentum of globalization and liberalization of the world economy. These concerns provided the backdrop for Africa's call that the post-Doha negotiating round focus more on broader development issues, beyond the narrow confines of international trade; such as the capacity needs to integrate trade strategies in overall development, overcome supply constraints and to effectively participate in international trade negotiations (United Nations Economic Commission for Africa, 2005).

The purpose of this paper is to analyze the issues stemming from the MDGs (especially elements of Goal number 8 aimed at developing a global partnership for development) and the WTO's Doha Development Agenda so as to reconcile how successful negotiations at the WTO will enhance Africa's ability to achieve shared economic growth. The first section discusses the nature of the economic development challenges facing Africa. The second section explains the Millennium Development Goals. The third section describes elements of the Doha Development Agenda in the context of development challenges facing developing countries and Africa in the multilateral trade negotiations process. The fourth section explains how rich countries' domestic subsidies impact poor countries trade. The fifth section provides an analytical case discussion of how domestic and export subsidies provided by rich countries to their farmers tend to impact African trade. It draws specific implications for the cotton subsidy case launched by certain West African countries against the U.S. at the WTO. The last section provides some suggestions of what needs to be done for the MDGs to be met in the context of the ongoing WTO trade negotiations. The paper purposefully focuses more on those external determinants that impact economic growth rather than domestic determinants of economic performance per se.

### **Africa's Economic Development Challenges**

Amponsah (2002) documents that research analyses usually highlight the following causes for Africa's economic problems: adverse geographic and demographic conditions, low rates of domestic savings, endemic poverty, excessive dependence on a few agricultural commodities, lack of institutional transparency, lack of market openness and liberalization, terms of trade and other external shocks, macroeconomic policy weaknesses, structural policy failures, weaknesses in governance, political instability and

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<sup>1</sup> Indeed, contemporary economic development literature tends to recognize that trade and investment policies have driven much global growth for the last three decades, and have served as a powerful locomotive for development (World Bank, 2002).

conflicts. Therefore, sub-Saharan Africa's average GDP per head is anywhere around \$509 (\$297 if we exclude South Africa) and it has hardly changed over the past three decades. The region has experienced declining shares in nearly all sub-sectors of world trade, and there is a tendency for its exports to be concentrated in primary products whose share of world trade has been declining.

Therefore, compared to other regions of the world, Africa is generally characterized by low economic growth, although many more countries have achieved positive growth in the 1990s in particular. For example, Sharer (2001) documents that Africa's non-oil exports in 2000 came to about \$69 billion, and that if Africa had retained its share of non-oil exports at 1980 levels, exports in 2000 would have been \$161 billion, or \$92 billion more than their actual level. However, it is important to note that economic growth has been more robust in those countries with resources such as oil and minerals, although generally the benefits accruing from such economic growth have not been shared with the poor.

Recent imperatives caused by globalization of trade and investment, the formation of regional trade agreements (RTAs) so as to gain greater access to markets, and benefits in improving trade competitiveness, have driven African countries to form the African Union. Therefore, African countries are gradually embarking on the necessary "learning by doing" process used by more successful global reformers and existing RTAs about the process, sequencing and the efficacy of integration efforts. It is expected that the combined effects of identified factors resulting from RTAs<sup>2</sup> would provide opportunities to expand trade, pool resources for investment, enlarge local markets, and industrialize more efficiently by taking advantage of the scale of production that large markets afford.

Ajayi (2001) suggests that broader integration must be achieved through trade, capital flows, human migration, and advances in telecommunications and transportation. Therefore, African countries are learning the hard lessons from globalization, by increasing the productive investment of their available resources, enhancing efficiency of their uses, and facilitating transfer of appropriate technology to enhance production processes and to reduce poverty. African countries have heeded the call to integrate into global markets or risk further marginalization. Through its sub-regional trade agreements and the African Union, African countries are continuing to integrate regionally so as to facilitate wider integration into the global economy. They also are working toward gaining access to greater flows of trade, finance, technology, and ideas for economic growth and human welfare. In particular, through the 1980s, many African countries embarked on the painful process of rationalizing and liberalizing their trade regimes, finance, investment and other flows through structural adjustment programs, with the assistance of the World Bank and International Monetary Fund (IMF). Nevertheless, liberalization is often externally imposed by development partners, such as the World Bank and the IMF, as part of conditions for emergency credit during debt crises, in the wake of other economic crises or to qualify for external credit. Furthermore, African countries are learning to deal laterally with their neighbours and other developing

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<sup>2</sup> Development economists tend to support the notion that by forming regional economic alliances, African countries would be able to build the necessary blocks in negotiating more effectively at the WTO level.

countries in the South as partners in trade and development. However, there do not appear to have been effective protocols that would allow for the intra-regional flows of labor and people.

The agricultural sector is very important to the economic development of SSA. Agriculture has direct and indirect effects on employment and food security and provides the critical foundation for sustainable economic growth, through linkages with industrial and service sectors. But the importance of agricultural markets and trade impinge on the nature of the sector's domestic and external liberalization. Agriculture accounts for more than a third of most SSA countries' Gross Domestic Product (GDP), nearly 70 percent of employment, and 40 percent of export earnings, with the entire foreign exchange earnings of most African countries being based on one or two major agricultural commodities (United Nations Economic Commission for Africa, 2005). Therefore, the performance of SSA economies on global agricultural markets is very crucial for the continent's economic growth as well as its employment and incomes. Yet, the agricultural sector confronts a duality of problems, namely, the capacity to increase output and to gain access to global markets. It is important to note that SSA countries confront diverse challenges in building trade relationships and in participating effectively in global trading markets (especially in developed countries) and institutions (such as the WTO).

### **The Millennium Development Goals and Progress by African Countries**

The world decided in the year 2000 to launch a concerted attack on poverty and the problems of illiteracy, hunger, discrimination against women, unsafe drinking water and a degraded environment. Meeting at the United Nations at the dawn of the new Millennium, leaders from all over the world agreed to a set of eight ambitious goals, characterized as the Millennium Development Goals (MDGs). For the purposes of this paper, let us focus on MDG number eight; with the broad goal to develop a global partnership for development, by emphasizing the role of the international community in further developing an open trading and financial system that is rules-based, predictable and non-discriminatory. The MDGs also call for the need to address major global development concerns, such as trade barriers and agricultural subsidies of countries of the North, debt relief, creating work, providing access to essential drugs and sharing new information, communications and other technologies, and more access to development assistance for countries committed to poverty reduction, and the special needs of landlocked and small island developing countries. Targeted development goals are expected to be met by 2015, when poverty is expected to be reduced by half (UNCTAD, 2004).

Looking ahead to the 2005 five-year review of implementation of the Millennium Declaration, Secretary-General Kofi Annan reported to the UN General Assembly in September 2004 that "overcoming human poverty will require a quantum leap in scale and ambition: more nationally owned strategies and policies, stronger institutions, wider participatory processes, focused investments in economic and social infrastructure, and more resources, external and internal." According to the Secretary-General's report, there is the urgent need for renewed commitment by political leaders to open trade and

increase aid and debt relief, and to give developing countries a fair chance to reduce extreme poverty within their borders. Nevertheless, it appears that SSA faces a daunting task in meeting the MDGs.

A major concern is that developed country subsidies, tariffs and quotas continue to restrict market access for African products<sup>3</sup>; this being compounded by slow progress in attaining effective regional integration in SSA as well as inadequate Overseas Development Assistance (ODA). According to the United Nations Economic Commission for Africa (UNECA, 2005), ODA levels to Africa have increased from \$US15.3 billion in 2000 to a high amount of \$US26.3 in 2003. Indeed, the recovery of ODA flows was largely driven by debt relief stemming from the Highly Indebted Poor Countries (HIPC) Initiative, and emergency assistance. Yet, these amounts have fallen short of requirements while the quality of aid has not improved partly because they have not taken the needs of middle-income countries' heavy debt burdens into consideration. Stringent patent laws continue to block access to essential drugs needed to fight malaria, HIV/AIDS, tuberculosis, etc., and the information and communications technology divide continues to be so wide between Africa and the rest of the world.

Certainly, a range of domestic factors have also constrained Africa's growth and its ability to achieve the MDGs. For example, governance, the capacity and quality of government, is at the heart of poverty reduction. Although governance is improving in Africa, much remains to be done especially with regard to accountability, the rule of law, corruption, creating the enabling friendly environment conducive to domestic and foreign investment, social or ethnic exclusion, and investment priorities. Additionally, many countries are unable to make the necessary investments in education, health, water and sanitation, which are key ingredients for human capital formation (UNECA, 2005).

For some countries in SSA, the sheer resources required to manage interventions against HIV/AIDS have exacerbated already weak economic growth, by depleting human capital necessary for social development. Then also is the lack of equality and non-discrimination in the approach toward development. For some regions, such as Cote d'Ivoire, Liberia and Sierra Leone, wars and violent conflicts have disrupted livelihoods, destroyed infrastructure, reversed economic development gains, and weakened the environment for growth in investment.

Although it is generally recognized that trade is very important in realizing Africa's growth potential, reducing poverty and achieving the MDGs, many bottlenecks are apparent. First, it is clear that to date trade liberalization policies have had minimal effects in improving SSA's share of world trade and overall economic growth. At least in part, this condition can be explained by the fact that trade liberalization policies seem to have been limited to the import sector with only minimal measures to address supply constraints that would support exports. In addition, there is the tendency for African governments to ignore the informal trading sector (in which the bulk of participants are women) in designing trade policies. Not only is it crucial that this segment be given

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<sup>3</sup> Protectionist barriers to goods from SSA countries reduce their foreign exchange earning capacity and stunt their economic growth.

greater attention, but also trade policies must be mainstreamed more aggressively into national and regional development strategies and programs. Indeed, it is also important for African countries to develop the necessary capacity to enhance export promotion, assist exporters in increasing their productivity, engage in greater value-added activities especially in non-traditional sectors, and diversify enterprise development. Therefore to accomplish these, internal conditions must be improved through offering training in trade facilitation and diversification so as to harness existing comparative advantages. It is important for UNECA (through its African Trade Policy Centre) and the African Union to provide leadership in rationalizing and streamlining activities undertaken by African regional economic communities toward helping improve trade in the respective sub-regions and to optimize progress toward accomplishing the MDGs.

### **The Doha Development Agenda**

One of the rallying cries in development circles has been that trade liberalization – as much as increased aid – holds the key to helping low-income countries boost growth and eradicate poverty (Wallace, 2005). In November 2001, the WTO launched a “Development Agenda” in Doha, Qatar with the motivation to engage in comprehensive trade policy reforms so as to achieve poverty-reducing growth. Certainly, the justification for the Doha Development Round (DDR) is rooted in the economic development literature in that those developing countries that have increased integration in the global economy over the past two decades have achieved higher growth in incomes, longer life expectancy and better schooling (The World Bank, 2003). Often cited, the World Bank’s study suggested that the Doha trade talks, if successful, would lift 140 million people out of poverty. Yet, more than three years later, there is little to show for the DDR.

Among other things, the DDR articulated a development strategy based on reciprocal markets and trade liberalization, including reforms in agriculture. Whereas many developing countries have undertaken unilateral reforms and sector liberalization through the Uruguay Round (UR) of negotiations, the burden of trade liberalization mainly rested on the shoulders of their governments. According to Wallace (2005), developing countries are split into two camps; (i) middle-income developing countries (led by Brazil, India and South Africa), and (ii) poorer developing countries. The top priority of the first group is to gain greater access to rich country markets in agriculture, whereas that of the second group is special treatment and greater “policy space” to pursue national development priorities.

Malhotra (2002) also presents several common themes that can be gleaned from the trade and development nexus of the DDR. First, the current trading regime is based largely on negotiations over market access and mutual reciprocity, with outcomes that cover both trade and non-trade issues. The WTO regime is different from the predecessor General Agreement on Tariffs and Trade (GATT) in that it deals with more than cross-border trade issues, such as sovereign domestic regulatory and legislative matters not directly related to trade. Second, significant asymmetries exist in the development levels, capacities, resource endowments, and power of WTO member

countries that could not simply be overcome by the preeminent principle of reciprocity. Third, a mercantilist market access system is not necessarily consistent with development. In particular, any attempt to implement a market access paradigm among unequal players highlights the importance of special and differential (S&D) treatment and of translating the “best endeavor” provisions accepted by developed countries in the UR into more concrete and binding agreements. Indeed, SSA countries which had not developed national institutions and capacities necessary to compete in global markets must not view S&D treatment as concessions or favors but as logical, just, and essential to enable the countries to employ trade as an effective engine of economic development.

During the tenuous DDR negotiation period, agriculture was at the forefront because of developing countries’ disenchantment with the raw deal they got from the Uruguay Round Agreement on Agriculture (URAA), in particular with the rich countries’ massive domestic subsidies (Coleman and Meilke, 2000; *The Economist*, 1999). The DDR negotiations and, in particular, the Agreement on Agriculture (AoA) was set for completion by January 1, 2005. Negotiations on agriculture began in early 2000 under Article 20 of the WTO’s AoA. The three pillars of the URAA aimed at liberalizing agricultural trade barriers were market access, export subsidies, and domestic supports. For most agricultural and food-exporting developing countries, such as in SSA, the main negotiation objectives at Doha were to have the European Union (EU) agree to phase out all export subsidies; for Japan, the EU, and U.S. to dismantle their trade-distorting domestic support measures, tariff escalation, and tariff peaks; and for all rich countries to provide greater market access. Developing countries were concerned about domestic support measures, in particular, because developed countries’ high domestic subsidies and the resulting over production and exports unfairly affected the developing countries’ agriculture (Taulanand, 2001).

A major problem for multilateral trade negotiations to date (which has a major implication for achieving the MDG number 8) is that most observers tend to believe that barriers to trade and investment are still too high. In particular, developing countries believe that despite trade preference by Organization for Economic Cooperation and Development (OECD) member countries, their tariff structures are still characterized by escalating tariffs with high tariff peaks, especially for agricultural and labor-intensive products such as textiles and clothing.

Additionally, for developing countries heavily dependent on agriculture, food security was a crucial concern as well. Hence, a stronger S&D treatment provision, recognizing the right of all countries to have access to safe and nutritious food, became a major objective. SSA also supported poor developing countries in seeking agreement on a Development Box that would emphasize food security but would also allow developing countries to have flexibility and policy autonomy to pursue agricultural policies serving their broader development priorities. That is, the poor countries wanted to avoid implementing international rules that are costly or that restrict their ability to subsidize, protect their domestic industries, and impose restrictions, as needed, on foreign investment. In other words, they wanted the freedoms that the rich countries had in the old days, in a less globalized and integrated world (Lankes, 2005).

Nevertheless, different views on the draft agricultural text in Doha became almost intractable, making negotiations on agriculture quite pivotal to achieving the goal of overall agreement. Why? According to Malhotra (2002), the EU remained staunchly opposed to the phase-out of export subsidies, while the Cairns Group of 18 agricultural exporting countries insisted on significant movement on the issue. The U.S. attempted to justify its domestic income support to farmers (which the EU and many developing countries opposed as trade distorting), yet was supportive of the Cairns Group, whose members were adamant that EU subsidies be phased out. In the end, the EU agreed to “reductions (in export subsidies), with a view to phasing out all forms of subsidies.” Moreover, the EU made its concessions only in exchange for stronger language on the environment, investment, and competition policy.

Another concern is that the WTO’s September 10-14, 2003 Cancun Ministerial could not reach negotiated settlement over a wide range of sectors, most importantly in agriculture on which most developing countries (and especially Africa) depend for their economic growth. Therefore, developing countries, including Africa, continue to charge that production and export subsidies of developed countries have depressed global agricultural commodity prices and have contributed to closing off trade opportunities for the less developed countries.

### **How Rich Country Domestic Subsidies Impact Poor Countries’ Trade**

Indeed, the promise of the DDR of international trade negotiations must be fulfilled, including the reduction of agricultural subsidies, which disadvantage farmers of developing countries in the global market. Developed countries mostly use domestic support policies, which tend to cause low prices, and implicitly impose a tax on poor countries’ agriculture (Diao, Somwaru and Roe, 2001). In fact, all OECD countries subsidize their domestic agriculture in varying degrees (Meijl and Tongeren, 2001). The OECD countries spend \$1 billion a day on domestic agricultural subsidies (Moore, 2001), and the total payments exceed the entire Africa’s GDP (The Economist, 2001). Domestic supports in the U.S., Canada, Europe, and Japan account for about 80 percent of the world’s total. Certainly, more than half of the EU’s, Japan’s and U.S. domestic supports are trade distorting (The Economist, 2001).

The following is an explanation of the functional mechanism of domestic support policies. Developed countries’ farm policies keep the domestic price artificially high. For example, EU prices for lamb, butter, and sugar are all more than twice the world market price (The Economist, 2001). Such artificially high domestic price can turn the EU from a potential importer to exporter as shown by the trade reversal in Figure 1. If the free trade price were to prevail in the EU, then the EU may be importing at  $P_w$ . Instead, the domestic price support at  $P^*$  could cause the EU to produce more and dispose the surplus of  $cd$  amount in the world market using export subsidies (Houck, 1992; Devadoss, 2002). In fact, poor countries feel that rich countries want to have it both ways by providing high domestic support and then dump the excess supply in developing countries (Burfisher et al., 2001). Therefore, developed countries’ policies have gradually eroded poor

countries' trust in the global trading system. This has been at the heart of all the recently highly publicized collapse of WTO negotiations.

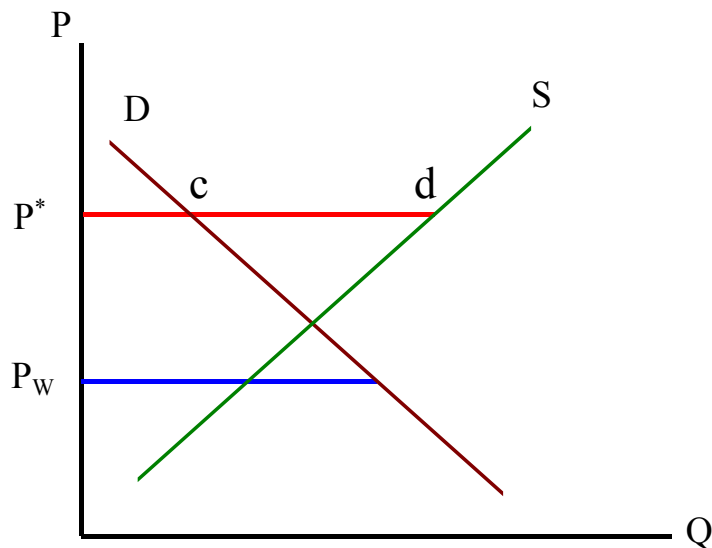


Figure 1. High Domestic Support Prices and Trade Reversal

The benefits of agricultural trade liberalization not only accrue to poor countries but also to rich countries. According to Burfisher et al., rich countries gain from efficient resource allocation among various sectors and from decrease in food prices. Elimination of agricultural distortions in the long-run will increase the world's welfare by \$56 billion annually. If rich countries were to remove farm subsidies, poor countries would benefit by more than three times the amount of all foreign aid they receive (The Economist 2001).

Therefore, although conventional economic thinking supports the notion that developing countries would gain more from comprehensive freer trade policies than developed countries (Stiglitz, 2000), most developing countries are more averse to trade reforms because of the perceived predatory practices of developed countries (McCalla, 2000). Stated differently, poor countries, such as those in SSA, want a free trade agreement that eliminates rich countries' distorted policies and questionable bail outs. Poor countries realize that prior URAA agreements have not delivered anticipated gains, even as rich countries continue to protect their domestic agriculture.

### **Case Example of How Rich Country Domestic Support Hurt African Cotton Trade**

Coming out of the Uruguay Round of trade negotiations, African countries expressed concern about the deleterious impacts of high domestic support and export subsidies on trade in agricultural commodities, and called for special and differential

treatment, as previously discussed. However, it was not until 30 April, 2003, that representatives of Benin, Burkina Faso, Chad and Mali presented the initial “Sectoral Initiative in Favor of Cotton” to WTO Director-General Supachai Panitchpakdi, and submitted the initial allegation that called for domestic cotton subsidies elimination by richer countries (citing the U.S. in particular) and compensation for economic losses from trade. On June 10, 2003 the case was presented to the Trade Negotiations Committee of the WTO by President Blaise Compaore of Burkina Faso. On June 24, 2003, the author (see Amponsah, 2003) provided written testimonial on the issue during a U.S. Congressional Hearing Before the Subcommittee on Africa, Committee on International Relations (108<sup>th</sup> Congress) with President Amadou Toure of Mali in attendance. The case was further discussed at the WTO Agricultural Committee’s special sessions from 1-18 July, 2003, prior to its presentation during the stalled Cancun Ministerial of September 2003 as a poverty reduction instrument. Since Cancun, the WTO’s “July Package” has set up a sub-committee on cotton, declaring that the cotton case will be addressed “ambitiously, expeditiously and specifically” within the WTO’s agricultural negotiations.

In the following, we highlight the analytical framework in support of the African cotton case in WTO negotiations and how U.S. cotton subsidies are hurting the CFA Franc Zone countries of West and Central Africa (WCA). Cotton production has increased fourfold in the last two decades, making the region the world’s second largest cotton exporter of 15% of world cotton production. Cotton is the main cash crop and the largest source of export receipts and government revenues in several countries of the region. Cotton cultivation employs more than 10 million people and hence is a key factor for poverty reduction through trade. U.S. share of world cotton production and exports have been 20% and 30%, respectively (U.S. Department of Agriculture, 2002). In 2001-02 the value of U.S. cotton production was \$3 billion but the value of outlays in the form of subsidies to 25,000 cotton farmers by the USDA’s Commodity Credit Corporation (CCC) amounted to \$3.9 billion – double the level in 1992 and a net cost to the U.S. economy. This amount was three times more than the entire U.S. Agency for International Development (USAID) budget for Africa. Therefore, U.S. subsidies exceeded market value of output by 30%, shouldering blame for driving down world cotton prices. China and the EU also use similar subsidies. Certainly, the more than 10 million cotton producers of WCA are more efficient producers of cotton at 21 cents per pound compared to the U.S. at 73 cents per pound (Oxfam). Indeed, a World Bank study by Badiane et al (2002) estimates that complete elimination of U.S. cotton subsidies would lead to increase in world prices of 20-30%, boosting export earnings of WCA.

We establish through an analytical framework how the U.S. protective farm policy contributes to stunting the African countries’ growth by reducing their welfare through trade (Edwards, 2000; Tyres and Anderson, 1992). We adopt a naïve Heckscher-Ohlin (H-O) specification, making assumptions inherent in the Jones’ specific factor model to account for labor immobility in African agriculture. Further, we analyze how the introduction of subsidies by the U.S. changes the pattern of relative prices and resource allocation to its agricultural producers and thereby reverses its trade pattern from agricultural commodity importer to exporter by transferring resources from its

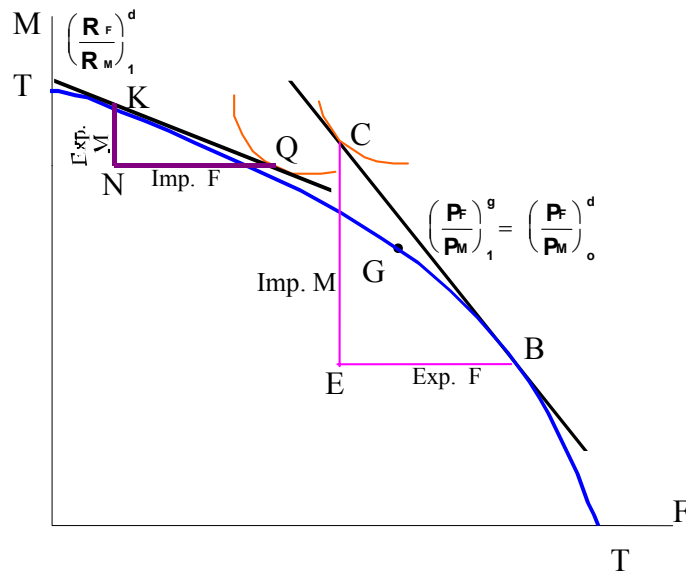


Figure 2a. Developing Country

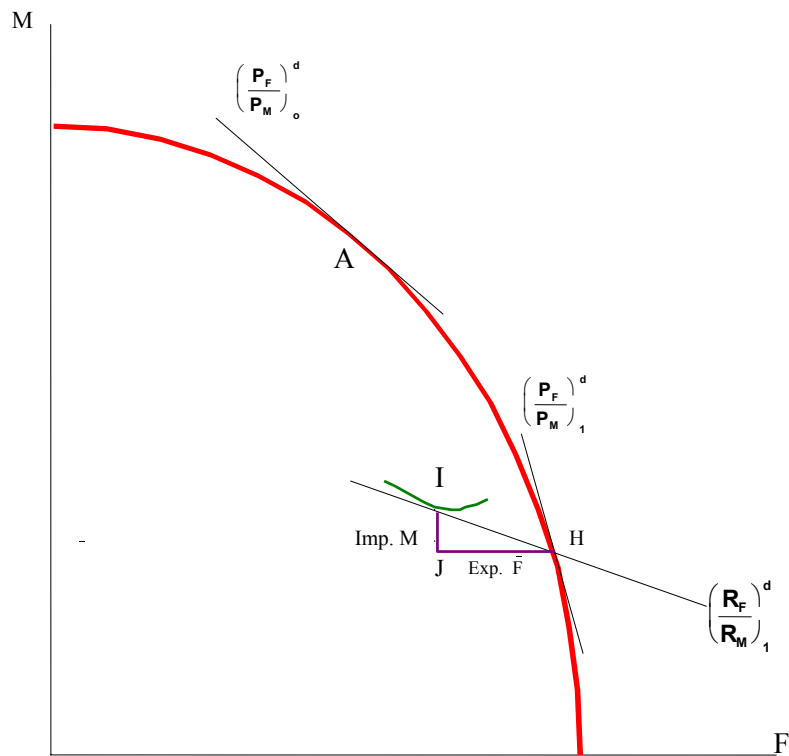


Figure 2b. Developed Country

manufacturing sector. The impact on the developing countries of Africa is captured as the reduction of consumer welfare following specialization in production of an agricultural commodity such as cotton and trade with the developed country. An extension of the model allows us to reach the conclusion that developed country subsidies generate trade that is not beneficial to both developed and developing countries (Bhagwati, 1971; Corden, 1974; Dixit and Norman, 1980; Markusen et al, 1995). We conclude that removal of subsidies would benefit WCA countries, while enabling them to better exploit their comparative advantage in cotton production (since they are cheaper producers) to catalyze growth and poverty reduction.

Let us consider two countries; one is large (say the U.S. and a composite of SSA or WAC countries), producing two goods (say food or cotton and a composite good consisting of non-agricultural products such as manufactures), using two factors (capital and labor) and trading the two goods between them. Let us assume that the developed country is a large country capable of influencing prices in the world market and the developing country is a small open economy acting as a price taker. From here on let us use the following notations: F for food, M for composite goods, K for capital and L for labor,  $P_F$  for food prices, and  $P_M$  for manufacture prices. Figures 2a and 2b represent the above descriptions diagrammatically. The developing country possesses a small production possibility frontier and the developed country contains a large production possibility frontier, consistent with the small and large country assumptions, respectively. Autarky equilibria for developing and developed countries are, respectively, G and A, where production equals consumption. In the interest of not cluttering the diagram, autarky indifference curves are not drawn for both countries. But in line with real world conditions, the developing country produces and consumes relatively more food than manufactures. In contrast, the developed country produces and consumes relatively more manufactures than food.

Let us now allow trade to take place between the two countries. Since the developing country is a price taker in the world market, its relative prices increase from the autarky level at G to a free trade level of  $\left(\frac{P_F}{P_M}\right)^s$  at B. Since trade with the small developing country does not affect the developed country's price, the free trade prices remain the same as autarky prices  $\left(\frac{P_F}{P_M}\right)^d$  in the developed country (Markusen et al.)

Under free trade, the developing country produces at B and consumes at C, and the trade triangle is BEC. Thus, under free trade, the developing country exports EB amount of food and imports CE amount of manufactures. It is quite clear that under free trade, the developing country's welfare improves from G to C. In contrast, for the developed country, because it is a large country, trade with the small developing country does not impact its price, and consequently, production and consumption points have not been altered. Alternatively, if we had treated the developing country as having relatively small impact on the world market, then the developed country would slightly alter its production and consumption points from autarky point A and would experience modest

gain by importing F and exporting M. The result is that the small developing country gains more from free trade (when there is no distortion such as a production subsidy) with the developed country are very well rooted in the trade literature (Markusen et al., 1995).

Now, let us introduce subsidies for food production in the developed country, which results in farm producers receiving a higher  $P_F$ . The domestic subsidy leads to resource reallocation in favor of food production and the production point moves from A to H in the developed country, where food production has increased and manufacture production has decreased. Once we introduce production subsidy, it is important to distinguish between consumer prices and producer prices. Let us use the notation P for producer prices and R for consumer prices. Then a production subsidy will lead to higher prices for producers, which result in larger supply and consequently lower food prices for consumers. This relationship between producer and consumer prices for food can be captured by the *ad valorem* subsidy of S% as  $R_F = P_F (1 - S)$ . Hence, the relative prices

under production subsidy in the developed country are 
$$\left( \frac{R_F}{R_M} \right) = \frac{P_F (1 - S)}{P_M} \leq \frac{P_F}{P_M} .$$

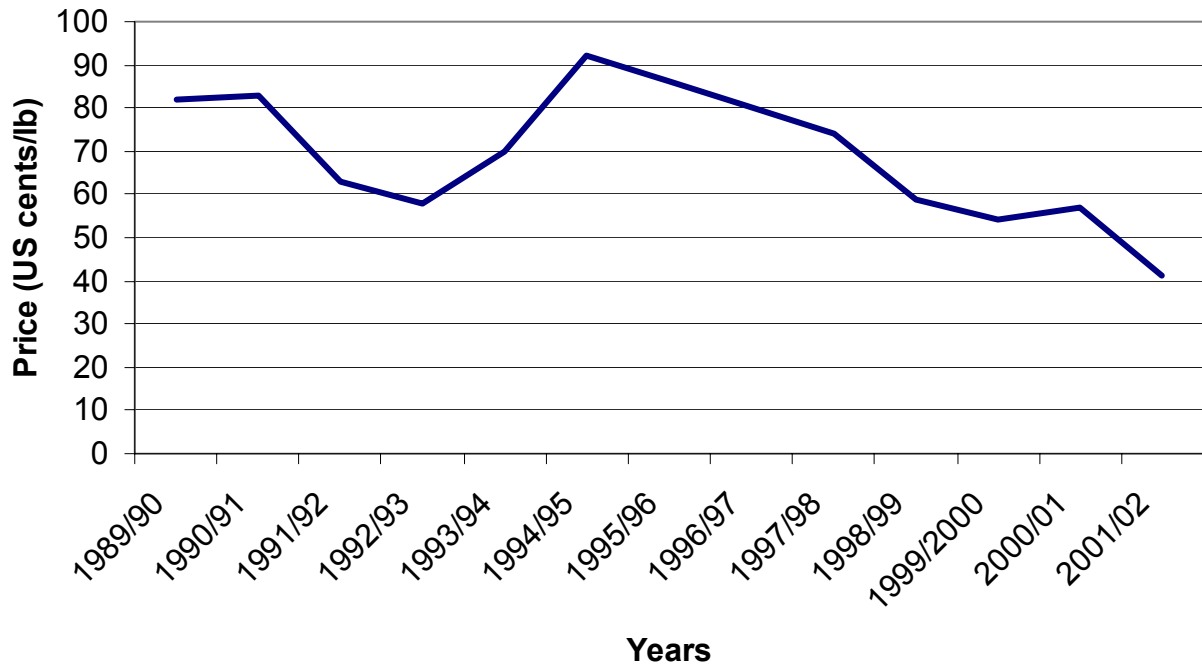
Thus the production subsidy has lowered the consumer price to  $\left( \frac{R_F}{R_M} \right)^d$  and increased

producer price to  $\left( \frac{P_F}{P_M} \right)^d$  as shown in the move from A to H in Figure 2b.

The developed country will produce at H, consume at I, export food (equal to HJ) and import manufactures (equal to IJ). Therefore, compared to the free trade scenario, the developed country's production subsidy has reversed the trade pattern from food importer (manufacture exporter) to food exporter (manufacture importer). Since food production has increased, the developed country will export more food and depress food prices in the world market. The small developing country, unable to influence world price, takes prices as given and move the production point from B to K and the consumption point from C to Q. Thus, the developing country, in response to production subsidy in the developed country and the resulting higher exports, is forced to reduce food production. The welfare of the developing country also decreases from C to Q). Additionally, price distortion in the developed country causes the developing country's terms of trade  $\left( \frac{P_F}{P_M} \right)$  to deteriorate. The result provides evidence to the conclusion by

Thompson (2001); and Diao, Somwaru, and Roe that developed countries' domestic supports distort world market prices and depress prices in the non-subsidizing countries. The terms of trade distortion is so adverse that the direction of trade has been altered. That is, the developing country now imports food and exports manufactures causing a trade reversal (see the trade triangle KNQ in Figure 2a).

**Figure 3. World Cotton Price (US cents/lb), 1998/90 – 2001/02**



*Source: International Cotton Advisory Committee*

It is also important to note that the developed country's subsidies not only hurt the developing country's economy but also reduces the developed country's welfare from A to I. The reason for this reduction in welfare is because resources are transferred from the manufacturing sector to the inefficient agricultural sector. Therefore, M production decreases and F production increases.<sup>4</sup> Although food consumption increases, manufacture consumption decreases more, and consequently the overall welfare decreases. This outcome exemplifies the underlying results of the flawed policies arising from governments, such as production subsidies can generate trade but it is not beneficial (Bhagwati; Corden; Dixit and Norman; Gardner; Markusen et al.; Schmitz and Chambers; Woodland). Stated differently, exports are not the measure of welfare per se, and higher exports of agricultural goods should not be viewed as an indication that the country's welfare has increased. This particular scenario is consistent with real world experience in that, but for production subsidies paid to cotton producers in the U.S., the U.S. would be importing instead of exporting cotton.

In fact, cotton is the key source of foreign exchange and government revenue for Benin, Burkina Faso, Chad and Mali. International Cotton Advisory Committee (ICAC) data and model reveal losses of up to \$301 million to SSA from U.S. cotton subsidies in

<sup>4</sup>Sayan, Tweeten and Hushak (1996) have used a CGE model to examine in detail such inefficient resource allocation.

2001; about a quarter of what it received in development aid (Oxfam). For example, Mali lost \$43 million in cotton export earnings and received \$37 million in aid from the U.S. The model also showed that withdrawal of U.S. cotton subsidies would raise cotton prices by 11 cents per pound or by 26 percent. Indeed, as can be gleaned from Figure 3, the African countries contention that the U.S. cotton subsidies tend to depress world prices may have some relevance. World cotton prices have experienced a steep downturn since the mid-1990s.

According to Oxfam, Africa's experience in cotton raises wider concerns about U.S. policy. Through its aid program, the Bush administration has sought to promote free-market reforms in Africa. Similarly, trade preferences under the Africa Growth and Opportunity Act (AGOA) are conditional on African governments liberalizing agricultural markets, including the cotton sector. Yet, when farmers from Mali or Burkina Faso enter the world markets they are forced to compete against heavily subsidized U.S. exports.

On April 26, 2005, the WTO ruled that subsidies paid by the U.S. government to its cotton producers were unfair (BBC News World Edition). Brazil had complained to the WTO that U.S. payments kept world cotton prices too low and gave its farmers an edge over less developed and less well-funded rivals. According to Brazil, the U.S. paid to its cotton farmers nearly \$4 billion in cotton subsidies between 2001 and 2002 for a crop worth \$3 billion; in essence the same argument presented by the Africans.

### **Concluding Comments**

In August 2004, the WTO General Council adopted the Framework Agreements on Agriculture and Non-Agricultural Market Access (NAMA), which are important steps towards successful conclusion of the DDR. On November 19, 2004 a sub-committee was set up to deliberate on cotton as required by the "July Package." This sub-committee is open to all WTO members, observer governments and international organizations. Additionally, on November 25-26, 2004 a high-level brainstorming meeting of African trade negotiators took place in Tunis, Tunisia to deliberate on key technical and strategic issues related to the "July Package." It also provided the opportunity to evaluate implications of the "July Package" for African countries. A communiqué issued following the meeting (UNECA, 2004) touted the need to judge the DDR by the extent of development gains that will result for African countries.

Progress made to date in the DDR negotiations sends a mixed message as to the willingness of all parties to reach meaningful negotiations. Negotiations on farm trade have been suspended over a technical dispute over how to convert tariffs to a common measure, although it is expected that agreement would be reached by early 2007 before George Bush's fast-track negotiating authority runs out in July 2007 (The Economist, 2005). If negotiations are held up, it would not bode very well for SSA, since protectionist elements in the U.S. Congress have recently been agitating for tighter reins on free trade. It is also important to note that whereas more work needs to be done in the "modalities stage" and in future trade negotiations, African negotiators have to be very

diligent in demanding that the “spirit and letter” of the Doha mandate be reflected in the final multilateral negotiations so as to realize poverty-reducing growth through trade. However, many of the key concerns raised by developing countries at Cancun following adoption of the Harbinson Text and in the negotiations of the “July Package” have not found expression in the final texts adopted by the WTO General Council. Even more glaring is the lack of clarity on the “development dimensions” of the DDA. Additionally, in the frameworks adopted for agriculture and NAMA most issues of concern to African countries have been postponed for subsequent negotiations, and there is no real commitment expressed as to how those issues would be handled were any further negotiations to take place. Judging by current realities, it is not clear how the DDR will serve as a catalyst for SSA countries to achieve MDGs through trade.

African negotiators in Geneva have articulated the need for the DDR to deal effectively with many of the imbalances currently existing in the WTO agreements, while providing the space and instruments to enable African countries to use trade as an engine of growth and pro-poor development. But to be successful, greater focus needs to be paid to (i) promoting growth and working to reduce the huge disparity separating developing (and African) countries from rich countries; (ii) providing special and differential (S&D) treatment for developing countries; (iii) addressing adjustment costs relative to trade liberalization; (iv) promoting pro-development priorities; and (v) addressing institutional capacity building and supply constraints relative to trade development. Moreover, given the recent victory by Brazil at the WTO on the cotton issue, there may be hope for the U.S. to provide some compensating mechanism to African producers of cotton. That will go a long way in strengthening gains from trade. In fact, in April 2005, Mr. Mendelson, the EU trade commissioner suggested in a speech that cotton, an area where the U.S. is an egregious subsidizer, should be dealt with more quickly than other areas of the farm talks (The Economist, 2005). Certainly, there is something inherently wrong with the World Bank using loan conditionality to drive cotton market liberalization in Africa while its key shareholder, the U.S., is using subsidies to destroy both local and international markets. Adam Smith’s law of comparative (economic) advantage favors the Africans.

On the other hand, poorer developing countries (that include many SSA countries) must overcome their fear of not understanding the issues at stake at DDR negotiations or of not possessing the negotiating skills and resources to effectively participate in negotiations. This palpable fear is currently being handled through technical assistance and capacity building programs provided through the WTO and other United Nations institutions, and supported by the World Bank, IMF and rich countries’ funds. It is also imperative that UNECA, through its African Trade Policy Centre, should provide backstopping in trade-related assistance to the WTO Geneva African Group. This fear is critical to unraveling the potential negative consequences of weak negotiations, namely, loss of jobs, food security, preference margins, the extra cost of implementing complex enforcement systems relative to trade, etc. Additionally, it is important for SSA countries to learn by doing in providing competitive goods of good quality and diversity to world markets so as to attract competitive prices.

Lastly, the promise of the DDR in lifting at least 140 million people out of poverty, while integrating many poor countries into the global economy, must be supported by financial assistance to undertake the necessary structural adjustments that would engender very strong supply response. Indeed, in a rare show of support for the concept of shared economic growth, The Wall Street Journal on June 13, 2005 reported that an international agreement on African debt relief has been reached as a lead-in to the G-8 meeting in July 2005. The G-8 initiative, pushed by Prime Minister Tony Blair of Great Britain, is consistent with the spirit and letter of MDG number 8 and is designed to turn around 38 highly indebted nations, ridding them of payments on \$56.5 billion in loans owed to the World Bank, African Development Bank and the IMF. In agreeing to the deal, G-8 countries hope to free capital in the poorer developing countries (many of them in SSA) for local investments in education, health care, the environment and infrastructure to boost supply response. Whereas some of these countries have already been graduated through the Highly Indebted Poor Countries (HIPC) Initiative and, therefore, qualify for assistance, the modalities for qualifying many countries will take some time. Therefore, the issue of how soon many poor countries would take to gain access to aid to spur economic growth is not clear.

Nevertheless, the U.S. and EU must show similar magnanimity in providing greater trade concessions to poor developing countries during the DDA negotiations. They cannot continue to dominate negotiations as they have done in the past because it is in their interests to grow those markets. Judging by current population growth patterns, poorer countries will form the next generation of growth markets for goods from developed countries. It is more than imperative, therefore, that the rich countries share their wealth today than later. These countries, which live on \$1 each day, cannot afford to buy. Moreover, the poor countries are the majority members of the WTO. There will simply be no agreement until they perceive something in it for them.

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