Azerbaijan' WTO Accession Process: Non Agricultural Export Subsidies Aspects of Negotiations

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Received: 7 February 2015 Accepted: 2 March 2015 Published: 15 March 2015

Abstract

Azerbaijan has started to the unilateral and all-round negotiations with WTO namely from the time it has appealed for accession to this organization, i.e. 1997. The WTO membership of Azerbaijan is directly related to the improvement of legislation. Presently there are laws in the fields of regulation, intellectual property and investments that don?t meet any international standards and WTO very requirements. The WTO membership will enable the country to forecast the country?s trade policy, the level of transparency will be increased, the international trade partners? number will be increased and the economic disputes will be settled more effectively. It is to be noted that the main moments discussed within the agricultural agreement make important the determination of subsides upper limit and tariffs. Another important point is related to the export subsidies. For this purpose, the economic importance and the types of export subsidies, as well as the issues of export subsidy in WTO agreements were analyzed in the article and have been put forward the recommendations about export subsidies for Azerbaijan.

Index terms— export subsidy, WTO, GATT, agreement on Subsidies and countervailing measures, azerbaijan, export enhancement program (EEP).

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Abstract-Azerbaijan has started to the unilateral and all-round negotiations with WTO namely from the time it has appealed for accession to this organization, i.e. 1997. The WTO membership of Azerbaijan is directly related to the improvement of legislation. Presently there are laws in the fields of regulation, intellectual property and investments that don't meet any international standards and WTO very requirements. The WTO membership will enable the country to forecast the country's trade policy, the level of transparency will be increased, the international trade partners' number will be increased and the economic disputes will be settled more effectively. It is to be noted that the main moments discussed within the agricultural agreement make important the determination of subsides upper limit and tariffs. Another important point is related to the export subsidies. For this purpose, the economic importance and the types of export subsidies, as well as the issues of export subsidy in WTO agreements were analyzed in the article and have been put forward the recommendations about export subsidies for Azerbaijan.

2 I. Overview

orld Trade Organization (WTO) Members requested that Azerbaijan commit to binding its agricultural export subsidies at zero. Although Azerbaijan does not currently maintain agricultural export subsidies and does not have any plans to adopt them in the near future, the purpose of this paper is to provide a rationale for why Azerbaijan should make this zero export subsidy a life time commitment. We analyze the implications of having or not having such subsidies in the short and long run and point out that under any circumstances which such subsidies may ever be desired by Azerbaijan can be better achieved by other policies under the purview of the WTO. This paper shows the possible negative implications of Azerbaijan ever using agricultural export subsidies and that there are no circumstances in the future that would require the need for such subsidies.

This paper is outlined as follows. The next section provides background on the history and current state of export subsidies on agricultural products under the WTO. The key conclusion is that export subsidies for manufacturing products have been prohibited under the WTO for 40 years and WTO members have agreed to do the same for agriculture in the yet unfinished Doha trade negotiations. Furthermore, the European Union, which made up 90 percent of the total export subsidy commitments at the end of the Uruguay Round, has now reduced export subsidies to zero as of 2013. Section 3 explains the economics of export subsidies and shows why they are regarded as the most pernicious method of protection for agricultural products. Section 4 categorizes all of the different ways export subsidies can be delivered while Section 5 shows how ineffective export subsidies are in trying to achieve the various policy goals of governments using export subsidies in the past. Section 6 explains the countervailing duty provisions in the WTO which gives recourse to Azerbaijan in the event it faces export subsidies from other countries. The final section summarizes the reasons why Azerbaijan should commit to zero export subsidies in the WTO.

3 II. Background on Agricultural Export

Subsidies and the wto GATT Article XVI -subsidies -addresses the issue of subsidies in general as well as on exports. While it called upon contracting parties to cease to grant either directly or indirectly any form of subsidy on the export of non-primary products, an exception was made for primary products. An export subsidy was said to be subsidized when the export price is lower than the comparable price charged for the like product in the domestic market. GATT Article XVI recognizes the possibility of harmful effects as it states that ”contracting parties should seek to avoid the use of export subsidies on the export of primary products”. It is further stated that if a country grants directly or indirectly any form of subsidy which operates to increase the export of any primary product, such subsidy shall not be applied in a manner which results in:

”that contracting party having more than an equitable share of world export trade in that product, account being taken of the shares of the contracting parties in such trade in the product during a previous representative period, and any such special factors which may have affected or may be affecting such trade in the product”. Subject to this condition, therefore, export subsidies on agricultural products were permitted and it proved to be difficult to define the term ”equitable” in practice so agricultural export subsidies proliferated and the practice became a major source of international trade disputes. The remedy to subsidized exports is addressed by Article VI -anti-dumping and countervailing duties. Article VI did not make a distinction between a primary and a non-primary product, which meant countries were always allowed to take countervailing measures against subsidized exports of even the primary product where the above condition (i.e. ”equitable share in world trade”) is violated. In fact, several disputes related to agricultural subsidies were brought to the GATT over the years.

Export subsidies boost domestic production and lower domestic consumption, thereby causing a sharp increase in exports and depressing international prices. This hurts other exporters, and exacerbates the volatility of world prices by insulating domestic markets. As a result of the Uruguay Round Agreement on Agriculture, 25 members of the WTO, mostly rich countries, are still able to use such subsidies for the farm products. They specified export subsidies by product in 1995 which were capped and subject to annual reduction commitments throughout the implementation period. By the end of 2000, subsidized exports of developed countries were to reach expenditure levels and quantity levels that are 36 per cent and 21 per cent, respectively, below those of the base period .

Table **??** : Types of Export Subsidies Subject to Reduction Commitments a. The provision by governments or their agencies of direct payments-in-kind, to a firm, to an industry, to producers of an agricultural product, to a co-operative or other association of such producers, or to a marketing board, contingent on export performance;

b. The sale or disposal for export by governments or their agencies of non-commercial stocks of agricultural products at a price lower than the comparable price charged for a like product to buyers in the domestic market; c. Payments on the export of an agricultural product that are financed by virtue of governmental action, whether or not a charge on the public account is involved, including payments that are financed from the proceeds of a levy imposed on the agricultural product concerned, or on an agricultural product from which the exported product is derived;

d. The provision of subsidies to reduce the costs of marketing exports of agricultural products (other than widely available export promotions and advisory services) including handling, upgrading and other processing costs, and the costs of international transport and freight; e. Internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favorable than for domestic shipments;

f. Subsidies on agricultural products contingent on their incorporation in exported products.

Source: Article 9.1 of the Agreement on Agriculture.

The European Union accounted for 90 percent of the bound export subsidies (Hoekman and Messerlin, 2005). Article 8 of the Agreement on Agriculture -export competition commitments -provides the overall rule by requiring each Member to be in conformity with their export subsidy commitments as specified in that Member's Schedule. Article 9 of the Agreement on Agriculture or the ”Export Subsidy Commitments” Article identifies export subsidies subject to reduction commitments. Article 9.1(a) consists of three important provisions: the government agency provision, the in-kind provision, and the export contingency provision. The government agency provision indicates that support does not have to be provided directly by the government. Support can also be provided by a governmental agency, including marketing boards. Furthermore, the in-kind provision indicates that direct subsidies including payments-in-kinds are also subject to reduction commitments. In addition, the fact that export subsidies subject to reduction are those subsidies contingent upon export performance is reiterated in the export contingency provision. Article 9.1(c), or the governmental action provision, states that export subsidies do not require budgetary outlays to be subject to reduction commitments; payments financed by virtue of governmental action not involving a charge to the public account are also subject to reduction. Its Article 9.1 defines various types of export subsidies that are disciplined (Table **??**). Article 9.2(a) simply states that, subject to some flexibility provided for in 9.2 (b), the maximum quantity of the product in respect of which export subsidies may be granted and the maximum level of outlay for such subsidies are specified for each year in the Member's Schedule. These articles also imply that a Member that has no export subsidy commitment in the Schedule is not allowed to introduce them in the future. This applies to Azerbaijan.

Article 10 of the Agreement on Agriculture address issues associated with circumvention of a member's outlined reduction commitments. Article 10.1, or circumvention provision, states that export subsidies not explicitly stated in the export subsidy commitments article, which attempt to circumvent reduction commitments are also prohibited. Article 10.3 places the burden of proof on the defendant. The burden of proof provision states that any exports in excess of the reduction commitment amount are assumed to have been subsidized unless the defendant provides proof to the contrary.

Although the Uruguay Round Agreement on Agriculture permitted export subsidies on agricultural products, constraints were imposed. This outcome was considered to be one of the most important results of the agreement in view of the potentially disruptive effects that export subsidies can have on world markets. But countries reduced export subsidies faster than the caps and the European Union has reduced them to zero (see discussion of Figure 1 below).

To date, the Doha Round has been similar to the Uruguay Round in placing heavy emphasis on strengthening disciplines on export subsidies. Much effort has focused on obtaining agreement to ban export subsidies, and elimination of export subsidies was finally accepted by WTO members that are the most intensive users of such subsidies-most notably, the European Union-in the July 2004 Framework Agreement. That agreement spells out in some detail how liberalization is to occur: export subsidies are to be eliminated by a "credible" date, decreases are to be implemented in annual installments during the transition period, and an explicit link is to be made between the abolition of export subsidies and the negotiation of equivalent disciplines on other forms of export support, in particular the subsidy component of export credits, subsidies granted by state trading enterprises (STEs), and food aid. Special and differential treatment for export support granted by developing countries is to be limited to a longer transition period and "special consideration" for poorer countries' state trading enterprises. However, these commitments are conditional on an agreement on all the topics (agriculture, industry and services) currently negotiated in the Doha Round, a still distant goal.

The WTO's July 2004 Framework Agreement also call for elimination of so-called implicit export subsidies in many forms that are disbursed indirectly and non-transparently through food aid programs (that disrupt local markets and commercial trade flows), STEs (low-interest loans and government underwriting of losses), publicly underwritten export credits (long maturities and below-market interest rates), export promotion activities, 1

4 III. The Economics of Export Subsidies

and domestic policy levers that can, in combination, function as an export subsidy. Such nontransparent mechanisms were subject to few disciplines in the Uruguay Round Agreement on Agriculture and so are key issues for the discipline in the current Doha negotiations, despite the complexity of calculating their subsidizing effect. The elimination of export subsidies and their equivalents will finally put agriculture with manufacturing products.

Many countries have eliminated or suspended subsidies of some or even all commodity exports beyond the Uruguay Round Agreement requirements. This unilateral action may be in part due to high world prices in the early years of implementation that allowed more countries to export without subsidy. But much of the reduction can be attributed to policy changes, especially for the European Union which have reduced export subsidies significantly and are close to zero in 2012 (Figure 1). Changes to the language on export subsidies in the single Common Market Organization regulation go further than before in limiting the future use of export subsidies, without quite taking the final step of eliminating them altogether (Matthews, 2013). This new regulation setting export subsidies to zero in all circumstances except where there is a market disturbance or a market emergency does represent a very positive development and so one can expect that the EU Commission is adopting a strict approach in evaluating when a market disturbance or emergency occurs in the future.

Suppose a government offers a \$1 per bushel of wheat export subsidy. To profit from such a scheme, an exporter bids up the price of domestic wheat and sells it on the world market \$0.60/bushel below domestic prices and pockets a profit of \$0.40/bushel from the \$1/bushel government subsidy. But competing exporters see this excess profit being made and so participate in exporting more too by bidding up the domestic price even higher and so increases exports. This keeps going until there are no "excess profits" being made buying domestic wheat and selling it on world markets. The world price for wheat is in the end fully discounted by the \$1/bushel government export subsidy.

Several things happen in this process. First, domestic prices increase so domestic consumers are worse off but farmers are better off (provided the 1 The evidence suggests that the subsidy element of export credits is much less of a problem in terms of distorting world markets than are direct export subsidies (OECD 2012). Assessing the magnitude of the associated distortions and determining the subsidy equivalent is difficult, however, and much more work is required to understand better the prevailing situation and the possible benefits and costs of alternative types of multilateral disciplines. process of exporting is a perfectly competitive market, something not guaranteed always in some countries of the world, especially in countries where corruption is an issue).

Second, it costs taxpayer monies. Hence, domestic consumers and taxpayers both become worse off because of the export subsidy.

Third, world prices decline because of the double whammy of reduced domestic consumption and increased production. So the net increase to producers is less than $1/bushel in our example. Subsidies clearly hurt other agricultural exporters, especially small countries, by cutting their market shares and reducing export earnings. Furthermore, subsidies represent income transfers from the subsidizing country to consumers in the importing countries. So the effectiveness of export subsidies in reaching any domestic policy goal (discussed in the next section) is severely curtailed.

Fourth, an exporter has to also impose an import barrier to make the export subsidy effective. Otherwise, other exporters will undercut the effectiveness of the export subsidy in raising domestic prices. Imposing import barriers may not be possible, given Azerbaijan's market access commitments. This is especially true in regional free trade agreements. After the North America Free Trade Agreement (NAFTA) was signed, the U.S. wheat export subsidy became ineffective as Canada began to export wheat to the United States. Because of prior commitments in NAFTA, the United States was forced to eliminate export subsidies for wheat.

Fifth, if the WTO's Agreement on Agriculture agrees that all exporters eliminate export subsidies, then the self-defeating effects of each exporter's export subsidy in reducing world prices is eliminated and the world price can return to its free market levels, often higher than the domestic price for a small country exporter who is more adversely affected by large country export subsidies (e.g., the European Union) in this world trade war. Therefore, there is a special incentive for small countries to not have export subsidies because a $1/bushel export subsidy by the European Union can reduce world prices so much that a $1/bushel export subsidy by a small country cannot compensate for the price decline. It is better off for the small country to insist no country has an export subsidy. For all these reasons, export subsidies are regarded as one of the most pernicious subsidy schemes to exist and probably explains why the WTO has outlawed their use for industrial goods many decades ago and has now been agreed to now for agriculture in the Doha Round trade negotiations which still need to be completed. beneficial for the exporting country. One such literature is called "strategic trade policy" where it is possible but not certain, that a country can improve its welfare (at the expense of the rest of the world) provided it is a "large country" (can affect world prices), imperfect competition exists and products are differentiated (Panagariya, 2010). But Azerbaijan agriculture is perfectly competitive in world markets and is too small a country to affect world prices. Besides, the purpose of the WTO is not to improve one country's economic welfare at the expense of others but to maximize economic welfare of all countries together.

Another common argument for using export subsidies, made by the United States in the 1980s under the Export Enhancement Program, is to discipline other countries' trade policies (export subsidies and import barriers). But that invites retaliation by other countries and is not a constructive way to carry out trade relations with other countries. Besides, Azerbaijan is unable to retaliate against a trading partner's export subsidies or for neutralizing import tariffs because it is a "small" country. A country has to have a big share of the world market to discipline other countries and even then, it may not be beneficial yet be very costly in terms of higher domestic consumer prices and taxpayer expenditures.

Another argument put forward for export subsidies is to protect infant export industries in the presence of externalities (market failures like inadequate transportation facilities). But it is better to have nondistorting production subsidies or have policies that address the source of the market failures; in other words, correct the market failures by internalizing the externalities (e.g., provide public good investments that build infrastructure).

The thinning of the market for credit insurance because of adverse selection (exporter values the good more highly than the importer because of asymmetric information) and moral hazard (firm taking out insurance does not minimize risks) is another theoretical justification for export subsidies. But all WTO members have access to export credit facilities provided by their government so long as they abide by the OECD protocol on export credits (OECD 2012). Export credits can also help Azerbaijan penetrate foreign markets with a differentiated agricultural export product (e.g., natural tea).

Finally, maintaining a cultural heritage or a rural way of life may also be a justification for export subsidies only if the domestic market is too small to achieve the public goal.

5 Global Journal of Human Social Science

6 Arguments often made in favor of export subsidies

Some economists have argued that export subsidies may under special circumstances be IV. How Many Different Kinds of Policies Constitute an Export Subsidy?

Any policy that places a wedge between domestic and world prices constitutes an "export subsidy". The source of funding for a traditional export subsidy is domestic taxpayers and consumers. Export subsidies, even when not masquerading under other names, come in numerous forms. They may be specific, as fixed or ad valorem payments made on the volumes exported. Export subsidies can also be provided indirectly by marketing agencies or boards that buy on the domestic market and have monopoly rights to sell on international markets. Such agencies provide an export subsidy if they purchase a commodity at a higher price domestically than they sell it internationally. In this case, consumers only are the source of the subsidy where ”preferential exports” share is at a lower price than the pooled price as farmers ”forego revenue” and the price received is ”contingent on exports”. Consumer only financed export subsidies can therefore be derived from price discrimination and revenue pooling arrangements, and ”financed by virtue of governmental action” to allow these arrangements in the first place. An export subsidy can be achieved by any combination of domestic policy measures that tax consumption and subsidize production. There are many such complex and indirect ways for governments to subsidize exports including low-cost loans or tax relief for exporters, or government financed international advertising or R&D. Public expenditures for export promotion are often part of an expansionary trade philosophy. Indirect export subsidies not only are more difficult to measure than direct subsidies, but also involve programs that under some circumstances are beneficial or crucial, such as food aid. Hence, any rules to discipline their use must be carefully designed and will involve more disciplines on reporting and monitoring than will those on more explicit forms of subsidy.

7 a) Food aid

Although food aid can have market effects similar to those of export subsidies, it was not included in the WTO's Agreement on Agriculture schedule of reductions. Crucial in cases of national disaster, food aid has been used by developed countries to dispose of surpluses, provide budget support for the recipient government, and underpin foreign policy. Such uses have created serious problems. When given in kind, food aid may be detrimental to local producers by lowering prices and altering traditional dietary preferences. When distributed outside normal commercial distribution channels-as it usually is-inkind food aid also disrupts the development of those channels and interrupts the movement of food to the deficit areas from surplus regions in the country and from neighboring countries. Disruption increases the likelihood and severity of future famine. Hence, food aid should be purchased from other developing countries and from food surplus areas of the country assisted, as Year 2015

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a first priority. Also, food aid should never be used by industrial countries as a way of disposing of surpluses.

To avoid these risks, food aid in full grant form such as cash or vouchers should be directed to meet the needs of well-defined vulnerable groups or in response to an emergency as determined by the United Nations. This will also support local producers and traders. For these reasons, cash aid is often preferable to in-kind distribution. The exceptions are crisis situations where transportation is severely disrupted or markets are not functioning, or when there are good reasons to believe that in-kind food distribution can be better targeted to those with the greatest need.

9 b) Export credits

Officially supported export credit programs have averaged about $6.5 billion per annum, with the United States providing around 50 percent of the world total. The programs involve credit guarantees, public assumption of risk, and subsidization of interest and insurance. It is very difficult to measure the value of the export subsidy associated with these programs because the value of the risk reduction they provide is difficult to estimate. At the same time, export credit programs enhance food security for countries suffering from financial or food crisis, thereby expanding exports to everyone's benefit. However, only about 20 percent of agricultural export credit is extended to poor developing countries. Although the subsidy component of these credit programs is found to be small, disciplines are required for all such public expenditures (with exemptions for poor country importers in emergency situations).

10 c) State trading enterprises (STEs)

STEs and domestic policies that allow for market segmentation and protection of domestic markets can subsidize exports through price discrimination, that is, by using revenues from high domestic prices to subsidize fixed costs for the rest of production, which is then exported. STEs and domestic marketing arrangements can also be used to pool revenues to farmers, a practice that constitutes an export subsidy if domestic consumer prices are higher than world prices. Domestic production expands with pooling, and consumption declines, as in the case of a taxpayer-financed export subsidy. Pooling can occur over time and across markets and commodities. Some export STEs may counter the power of multinational trading firms and hence may improve competitive conditions in the market. But disciplines are needed to ensure that STEs are more transparent and subject to the same general rules as private firms. In particular, disciplines should be placed on price pooling and on taxpayer support to STEs (for credit guarantees or promotion, for example), with targets for their eventual phasing out. More stringent requirements for reporting acquisition costs and prices are required to ensure that any price discrimination by the STE is within normal business practices and that no product is sold on world markets consistently below domestic prices. There should be no discrimination against private firms' participation in the market; nondiscrimination discourages STEs from using discriminatory practices. Special financing privileges should be also disciplined, with exemptions for poor countries dealing with inadequate institutional infrastructure.

11 d) Price discrimination and pooling

Price discrimination and pooling can combine to create an export subsidy. Export subsidies based on price pooling and price discrimination are quite complex and can occur in different settings. Extra revenues derived from price discrimination are "pooled" and then "averaged" to farmers, thereby acting as a production subsidy, while higher prices to consumers act like a consumption tax. No tax revenues are involved, but the outcome is identical to that of a standard taxpayerfinanced export subsidy: supply is increased and demand is reduced at the same time. Such practices are often referred to as "consumer-financed" export subsidies.

Price discrimination with pooling can be carried out by an STE or through legislation fixing domestic prices. Non-traded domestic products (fluid milk, for example) can be used to support implicit export subsidies. Although the milk itself is not traded internationally, its high domestic price can be used to cross-subsidize exports of related products such as cheese or milk powder. If an STE practices price discrimination only in world market segments, without taxing domestic consumers, but pools the revenues, the resulting subsidy is not disciplined in the URAA.

The Dispute Settlement Body of the WTO ruled in 2003 and 2004 for the Canadian dairy and EU sugar sectors, respectively, that price discrimination alone with production quotas have the effect of cross-subsidizing exports and so violate commitments made under the URAA to reduce export subsidies. The WTO panel agreed with Brazil's argument that higher domestic prices for quota production have allowed farmers to expand output and sell the extra output at lower world prices below total average costs of production. The practice constitutes a subsidy because losses in one market (the export market) are offset by profits in another (the domestic quota market). Why would farmers accept a loss on exports? Because the unit-cost savings they realize from higher output are greater than the marginal losses they incur. Exploiting economies of scale under these circumstances constitutes cross-subsidization, according to the WTO panel. Output is also distorted because some farmers limit their production to the quota amount and would have exited the industry were it not for high domestic prices on the quota. This is output distortion due to "exit deterrence" as opposed to distortions that are due to cross-subsidization (where some farmers produce beyond the quota amount at lower world prices but are able to do so because of higher domestic prices).

12 Global Journal of Human Social Science

These rulings have implications for all production subsidies on limited output (known as "inframarginal" subsidies), whether financed by taxpayers or consumers. Subsidies on a limited amount of output have been increasing since the Agreement on Agriculture was adopted. It is therefore possible that other commodity sectors and countries are in contravention of their export subsidy reduction commitments.

13 V. How Effective are Export Subsidies

Relative to other forms of Policy Interventions?

Typically, there are several motivations for countries to use export subsidies. Historically, mercantilism has been a dominating economic doctrine where government control of foreign trade is of paramount importance for ensuring the military security of the country. In particular, it demands a positive balance of trade. But in the modern world of free trade and the WTO, along with military alliances, it is not necessary to be mercantilist although the most common notion amongst voters to this day is still that imports are bad and exports are good.

Furthermore, at the macroeconomic or general equilibrium scale, an export subsidy draws resources (e.g., land and labor) away from the import competing sector, causing the prices of these inputs to increase and so more imports result. The important thing to recognize is that export subsidies by themselves may not improve the country's balance of trade.

Another motivating factor for export subsidies is food self-sufficiency. But being self-sufficient in food is a poor indicator of food security which is best achieved by making sure the population has the resources to pay for food, regardless of the source. But export subsidies are counterproductive in that regard as domestic prices increase, curtailing consumption. Furthermore, more production is exported rather than maintained in the domestic economy. It is far better to use other policy instruments to achieve food self-sufficiency.

The most common political motivation for agricultural export subsidies in the past has been to support farm incomes and promote rural development. But an export subsidy is a very inefficient policy to achieve a farm income goal. There are economic efficiency losses due to a higher domestic price. There is inefficiency costs because overproduction of the agricultural product (resources could be better used for other agricultural products) and under consumption Year 2015 (E) (higher domestic prices cause consumers to under consume relative to what free markets would dictate).

The excess burden associated with taxpayerfinanced transfers induces two types of distortion. The first reflects the deadweight costs of raising revenues through income taxes; the second reflects the deadweight costs associated with disbursing taxpayer funds to farmers. Estimates of the size of these losses vary widely but can be quite high.

There are also distributive leakages (reallocations) to input suppliers, consumers, taxpayers and rest of the world through market price changes. Hence, for the cost to domestic consumers (in the form of higher prices) and taxpayers, only a fraction of the transfer ever reaches the farmer. Research by the OECD (2003) has established that output related support mechanisms (which an export subsidy is) are relatively inefficient, and that decoupled instruments such as direct income payments have the potential to deliver more efficient assistance to the farm sector. Not only are there upstream leakages to input suppliers who benefit from an export subsidy (the degree to which depends on the characteristics of the input supply curve and purchased input share of farm production costs), there are also downstream reallocations among processors, distributors and foreign consumers who now benefit from lower world prices.

A broader consideration of the transfer efficiency issue for export subsidies should also acknowledge that policy benefits may ”leak” not just to unintended recipients up and downstream from the farm gate, but also to unintended recipients within the farm sector (for example wealthier farmers). Price based polices designed to help farmers inevitably help larger farms and so are a poor instrument to target income to specific farmers that need it most.

According to OECD (2003), no support policy linked to agricultural activity succeeds in delivering more than half the monetary transfers from consumers and taxpayers as additional income to farm households. In the case of market price support such as export subsidies, the share is one fourth or less. Only 25 percent of producer support on average actually finds its way into the farmer’s pocket.

In the case of market price support (e.g., export subsidies), the stimulus to output, and hence to input demand, means that much of the increase in receipts is paid back out to input suppliers or capitalized into land values. This raises costs for farmers buying or leasing land. Farmers that own land do benefit, but this increase in wealth should not be interpreted as additional income, since it does not improve the long-term economic welfare of farm households as a whole. While there is a wealth gain for farmers that own land at the time such policies are introduced, farmers who subsequently rent or purchase land at these higher prices will face reduced profitability and lower incomes (OECD, 2003). The same applies, of course, to land costs for alternative, non-farm uses in rural areas.

Replacing domestic measures of support such as production subsidies by decoupled support is straightforward in the small country case and can be shown that it is a superior method to support agriculture. Instead of providing output-based subsidies, the government makes lump-sum payment to producers based on some historical criteria without any constraint or requirement on the current use of their resources. Under the lump-sum scheme, producers can receive higher payments as inefficiencies are no longer in place and they can be made better off. Taxpayers can also be better off if part of the efficiency gains is translated to lower taxes. Because both relevant groups (producers and taxpayers) can be made better off, decoupling in the production subsidy case is clearly a better way to achieve policy goals.

Decoupled payments have the advantage of being taxpayer financed so are transparent, allow for targeting to better achieve policy goals, allows the government to phase out all other programs so world prices rise (and reduce trade distortions), the efficiency of transferring income to farmers increases remarkably, and is politically acceptable and administratively feasible.

One of the more famous export subsidy programs in the United States was called the Export Enhancement Program (EEP). Its stated purpose was to help U.S. farmers compete with farm products from other subsidizing countries, especially the European Union, in other words, to challenge unfair trade practices, to expand U.S. agricultural exports, and to encourage other countries exporting agricultural commodities to undertake serious negotiations on agricultural trade problems. But this program was undermined by Canadian exports, being part of the free trade agreement, and so the United States had to dismantle the program. A small country like Azerbaijan could never undertake an export subsidy program with the same policy goals as the United States had with EEP.

Economic effects of export subsidies are to increase domestic prices and taxpayer costs, are inefficient, hurt other exporters, is non-transparent because it involves a higher domestic price and the domestic cost of helping foreign consumers is difficult to measure, has self-defeating aspects including reducing world prices and encouraging other exporters to subsidize exports as well, and involves the risk of retaliation by importers to impose import barriers on the affected product. We have shown above that using export subsidies to battle other country export subsidies will not work, especially if you are a small country trader (e.g., Azerbaijan) and the other country is a large country (e.g., the European Union). Unlike for import barriers, there are no safeguard clauses in the WTO legal code that would allow an exporter to use export subsidies if there were abrupt market changes. An exporter cannot claim that it can temporarily resume export subsidies because of domestic injury. The ”Safeguards Agreement” deals only with import restrictions. However the country can request a waiver or a renegotiation (two long-standing types of safeguards) but the political cost for an exporter to resort to such devices would be very high.

But Azerbaijan has access to the WTO Agreement on Subsidies and Countervailing Measures (hereafter ASCM) where remedies are available for an importing country that faces injurious subsidization by an exporter. The ASCM provides procedures and detailed rules on assessing the market impacts of these subsidies, as required to determine serious prejudice (measured by changes in market share, imports displaced or price suppression), material injury to domestic producers (a subsidy can therefore be countervailed) or nullification and impairment of agreed disciplines in the WTO. In other words, Azerbaijan has recourse to the Dispute Settlement mechanism in the WTO to guard against other country export subsidies, even if Azerbaijan is a competing exporter or importer of the subsidized product.

Article 6 of the ASCM provides more detail on when subsidies are considered to cause serious prejudice to the legitimate interests of other members. The following apply: (a) reduce imports into the home market of the subsidizer (b) reduce exports into third country markets; (c) undercut the price of other members or suppress or depress relevant market prices; or (d) increase the market share of the subsidizer.

As with anti-dumping and safeguards, these provisions apply within the context of the sales of a ”like” product. In determining whether a country has violated its obligations under the ASCM, a series of facts must be proven: First, there are prohibited subsidies, subsidies that are contingent on exports. But a country must first prove that a subsidy exists: the government is making a financial contribution (direct or indirect with revenue foregone). A subsidy is actionable if it meets the definition of a subsidy and be specific.

The complainant must also prove that ”a benefit is thereby conferred” and the requirement that the subsidy results in adverse effects to the complainant. The complainant must then show that serious prejudice or other adverse effects have occurred as a result of the subsidy. Three mechanisms are listed for determining whether or not adverse effects exist: ? First, the complainant’s domestic industry could be injured directly ? Second, the complainant’s benefits under GATT could be impaired or eliminated completely ? Finally, there could be ”serious prejudice to the interests of another Member.” If all three items are found in the affirmative by the WTO panel, then the complainant is highly likely to win the case.

14 Export credits are allowed under some circumstances

The SCM Agreement Article 3 says that ”subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance” –in other words, export subsidies –”shall be prohibited.”

Seemingly, export subsidies are prohibited for the most part but not entirely. Item (k) of the SCM Agreement’s Illustrative List of Export Subsidies says that the following are not export subsidies: ”Provided, however, that if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.”

In essence, this provision means that government export credit agencies can provide export subsidies as long as they comply with certain international agreements (in practice, the OECD Arrangement on Export Credits). If they comply with the terms set out there, then the practice ”shall not be considered an export subsidy prohibited by this Agreement.” Of course, that does not change the fact that it is still an export subsidy; it is just not prohibited.

15 VII. Concluding Remarks: What Alternatives to Export Subsidies does

Azerbaijan have?

Regardless of the political goal, be it an improved balance of trade, food self-sufficiency, food security, improved farm incomes and rural development, or protection from other countries subsidizing their exports and hurting Azerbaijan, Azerbaijan has far more effective tools available that are WTO compatible and in the interests of Azerbaijan to pursue.

We therefore recommend Azerbaijan forego the opportunity to ever be able to use export subsidies because:

? Export subsidies on manufacturing products have been prohibited for 40 years and the Doha Framework Agreement has specified zero export subsidies for agriculture as well ? The European Union, which held 90 percent of total export subsidies in the Uruguay Agreement on Agriculture, has allowed exports subsidies to expire in 2013 ? Export subsidies cause domestic consumer prices to rise, cost taxpayers money and income is being transferred to consumer in the rest of the world. Azerbaijan can ill afford higher consumer prices, tax payer costs and subsidizing foreign consumers ? Export subsidies can also cause world prices to go down, thereby being partly self-defeating ? Import barriers will also have to be imposed to make export subsidies effective, violating WTO or regional trade agreement rules ? There is no use for a small country like Azerbaijan to use export subsidies in retaliation of other countries export subsidies or trade barriers because the small country always loses; besides, Azerbaijan will have recourse to the countervailing duty provision in the ASCM of the WTO to protect itself ? Export subsidies will not necessarily improve Azerbaijan’s balance of trade because it draws resources away for the import competing sector ? Using for export subsidies for food self-sufficiency or food security is self-defeating as consumer prices increase and more food leaves the country ? Using agricultural export subsidies to support farm incomes and promote rural development is very inefficient and causes distributive reallocations to input suppliers, consumers, taxpayers and rest of the world through market price changes (decoupled payments are a far better policy) ? Azerbaijan still has access to export credits provided it conforms to the OECD protocol on such measures. [1]

Figure 1:

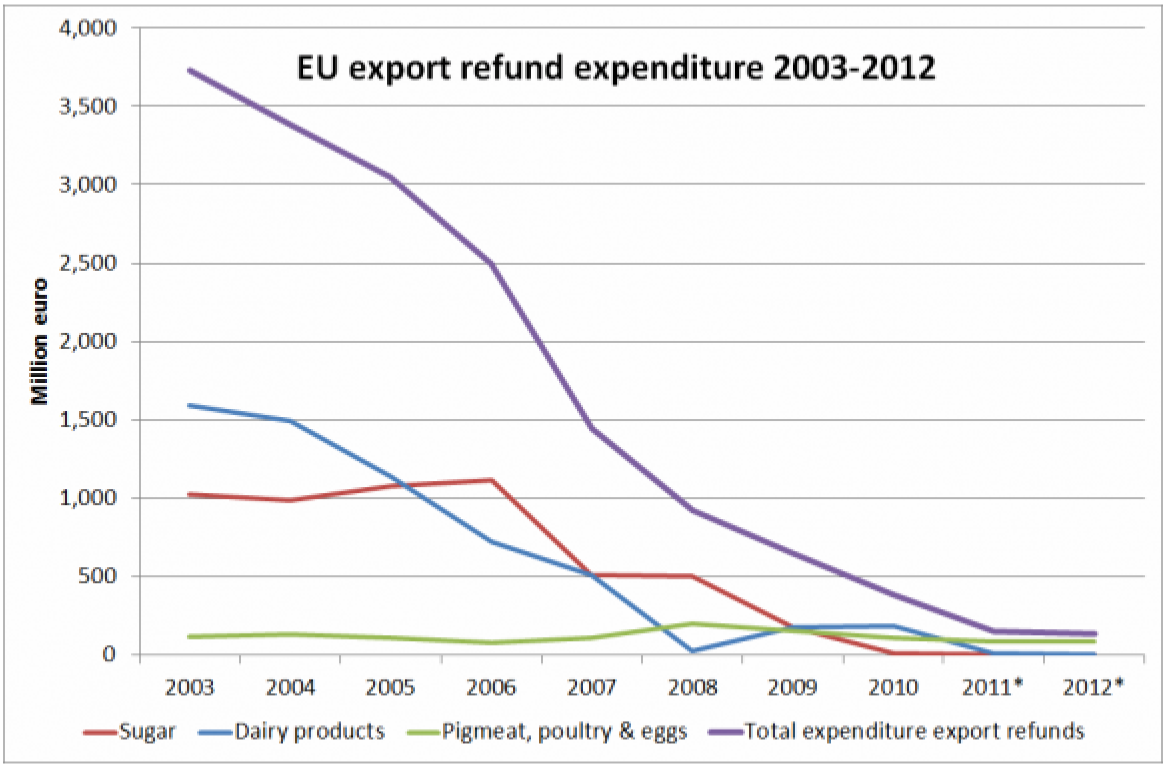

Figure 2:

1

Figure 3: Figure 1 :

Figure 4:

2

State trading enterprises	? Eliminate trade-distorting practices of state trading enterprises. ? Negotiate use of monopoly powers.
Special and differential treatment for developing countries	? Allow longer implementation periods for reductions and elimination. ? Permit developing countries to continue to benefit from Article 9.4 exceptions. ? Make appropriate provisions for export credits in line with Decision on Least Developed and Net Food-Importin Accord developing countries special consideration in negotiation of disciplines on STEs. ? Allow, in exceptional circumstances, ad hoc temporary financing arrangements relating to exports to developing countries.
Export restrictions	? Strengthen disciplines on export prohibitions and restrictions.

[Note: ? Agree on schedule and modalities of reductions.Export credits? Eliminate export credits, guarantees, and insurance programs with repayment period of more than 180 days.Food aid? Eliminate food aid that is not in conformity with disciplines to be agreed. Disciplines will be aimed at preventing commercial displacement. ? Negotiate other food aid issues (role of international organizations, humanitarian and development issues, aid in grant form).Source:Josling (2005).]

Figure 5: Table 2 :

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