

REDEFINING AGRICULTURE IN THE WTO: CREATING ONE CLASS OF GOODS

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Abstract

A significant achievement at the start of the Uruguay Round of multilateral trade negotiations in 1986 was the commitment to include the agricultural sector within the mandate for negotiations. However, agriculture was treated differently from trade in most other goods, with a specific Agreement on Agriculture established which limited the liberalization that was to take place for agricultural products. The Cairns Group of countries has a broad objective for the forthcoming WTO negotiations to see the integration of rules applying to trade in agriculture into the more general framework applying to trade in other products - that is to have a single classification of trade in goods. The potential welfare gains from further liberalizing agricultural markets in this way are huge in absolute terms - estimated at around \$80 billion per year. Gains are also large relative to gains from liberalizing trade in textiles or other manufacturing - with liberalizing agricultural markets representing around one third of the gains from complete liberalization of all trade in goods. These gains will not be narrowly based, with most countries benefiting from reform in terms of increases in social welfare and in GDP. This paper explores these potential gains and presents the views of the Cairns Group of countries for achieving a freer market for agricultural products.

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The Uruguay Round Agreement on Agriculture represented a significant achievement in that, for the first time, a comprehensive set of disciplines was placed on trade distorting measures affecting agricultural products. The negotiations applied limits to and cuts in both export subsidies and market access barriers, while recognising that domestic support measures can also distort trade. The Agreement on Agriculture served to both define the problem as well as place some loose bounds around it. More than that, the Agreement on Agriculture altered the climate of farm policy making in both advanced and developing countries, and raised the consciousness of policy makers of the international implications of their actions.

However, although agriculture was included in the multilateral framework for trade, it was not fully integrated into that framework. The Agreement on Agriculture applies a set of rules and disciplines which are different from those applied to trade in other goods and has resulted in the continuation of much higher levels of assistance for agriculture (particularly for processed food products) than for other goods. Indeed, little reduction in agricultural protection will have occurred by the end of the implementation period (2000 for developed countries and 2004 for developing countries). It is notable that, in 1998, agricultural support by OECD countries totalled some U.S.\$362 billion -- U.S.\$36 billion higher than at the start of the Uruguay Round. Moreover, as shown in figure 1, market access barriers in the primary agricultural sector and the processed food sector tend to be higher than for other sectors. Such differences in protection between sectors result in severe distortions to the efficiency of resource allocation both within and between countries.

The significant gains to WTO member countries from further liberalization in agriculture to reduce or remove such distortions are discussed in the first part of this paper. The second part

of the paper outlines the objectives of the Cairns Group in the next round, based on the eventual integration of agriculture into the normal WTO rules and disciplines applying to trade in other goods. Some concluding remarks complete the paper.

The potential gains from further agricultural policy reform

The Uruguay Round is scheduled to be fully implemented in all sectors and regions by 2005. At that time, there will remain the potential for further significant gains from reforming agricultural markets. Roberts, Podbury, Freeman, et al. (1999) recently estimated that a further 36 per cent reduction in agricultural support beyond those achieved in the Uruguay Round would result gains in global welfare of around U.S.\$34 billion a year. In this paper, we present results of a study by Anderson, Hoekman and Strutt (1999) in which the gains from liberalization of the agricultural sector are placed in the broader context of gains from liberalization in all traded goods sectors. Some focus is also given to gains by developing countries relative to those achievable by OECD countries. The study makes use of a modification of the global economy-wide model known as GTAP (Global Trade Analysis Project), focusing only on "traditional" trade policy instruments: tariffs, quotas and subsidies. It examines the benefits that could be attained from complete liberalization of goods trade barriers after all the gains from the Uruguay Round have been achieved in 2005. The study does not include the benefits of reform to the services sector and so under-estimates the total gains which are achievable for a broader liberalization of trade in all goods and services. The projected extent of distortions to goods markets that will remain in 2005, assuming the Uruguay Round is fully implemented and China and Taiwan have joined the WTO by then, is highly skewed. Despite the UR agreements on farm

and textile products, their protection rates will still be high in 2005, especially for the agricultural and processed food sector. Globally, the farm and food sector will have twice the import tariff average of textiles and clothing and nearly four times that for other manufactures. Significant distortions to farm production and trade thus will still be in place if no further policy reforms occur. The cross-regional pattern of distortions will then continue, with OECD countries subsidizing, and developing countries taxing, farm production and exports.

In the recent study by Anderson, Hoekman and Strutt (1999), six alternative scenarios are compared with the base scenario of the GTAP model's projection of the world economy in 2005 post-Uruguay Round. In these scenarios, all OECD countries are assumed to remove all price and trade distortions to (1) agriculture and processed food, (2) textiles and clothing, (3) other manufacturing, and (4) all goods combined. Two subsequent scenarios are (5) all developing economies remove all price and trade distortions to their goods markets, and (6) OECD and developing economies together remove all price and trade distortions to their goods markets.

The welfare consequences of these alternative comparative static scenarios are summarized in Table 1. If both OECD and developing countries were to liberalize all their goods markets in 2005, the model results suggest global welfare would be greater by US\$260 billion per year. This is a gross underestimate of the aggregate gains from trade liberalization because services and government procurement policies are excluded; no account is taken of the benefits of increasing the degree of competition and the scope for scale economies; a high degree of regional and product aggregation is employed; and the dynamic effects of reform are not captured. Those omissions may not affect greatly the relative gains from reforming the various markets for goods, however, so that is what we focus on below.

Almost one-third (32 per cent) of the estimated global gains from goods trade liberalization would come from agricultural reform in OECD countries - even though farmers in those countries contribute only 4 per cent of global GDP and less than one-tenth of world trade (Table 2). This amounts to gains of over U.S.\$80 billion a year. Textiles and clothing reforms appear to pale by comparison with farm reform: their potential global welfare contribution is only one-eleventh that of agriculture's. This big difference reflects the fact that distortions to prices for agriculture are more than twice those for textiles and clothing and that the latter contributes only 1.5 per cent to the value of world production and 5.5 per cent to the value of world trade, half or less the shares for farm products (Table 2).

However, two assumptions made above also contribute to this result. One is that China and Taiwan are assumed to join the WTO before 2005 and enjoy the same accelerated access to OECD markets under the UR Agreement on Textiles and Clothing (ATC) as other developing countries that already are WTO members. The other crucial assumption is that OECD countries fully implement the ATC. The latter is far from certain to happen though, particularly if China were to join WTO soon and phase out its 'voluntary' export restraints (VERs) on textiles and clothing by 2005. Dropping either of those assumptions reduces very substantially the estimated gains from Uruguay Round implementation (Anderson et al. 1997), and therefore would raise the potential gains from textile and clothing reform in the next WTO round.

Even so, agricultural protection would remain hugely more costly to the world economy than barriers to textiles and clothing trade - and more costly even than protection to other manufactures, despite the latter having much bigger shares in the value of world production and trade than farm products. WTO members were right, therefore, to insist that agricultural reform must continue into the new century without a pause.

Developing countries in particular have a major stake in the process of farm policy reform continuing: according to these model results, the farm policies of OECD countries contribute 42 per cent of the cost of global trade distortions to developing economies, nearly as much as the contribution of their own trade-distortionary policies. OECD textiles and clothing policies also harm them greatly, but only half as much as OECD farm policies (middle row of Table 1). OECD barriers to imports of "Other Manufactures", by contrast, actually help developing economies. The reason is that those trade restrictions lower international prices of those products (which developing countries import), thereby improving the terms of trade of developing countries.

For the OECD economies, despite the fact that agriculture and food represent only about 5 per cent of their GDP, abolishing their remaining agricultural protection in 2005 would contribute one-quarter of their welfare gains from liberalizing all goods trade globally - and nearly two-fifths of the gains from liberalizing trade in all goods in the OECD alone.

Cairns Group priorities for the next set of WTO agricultural negotiations

While there has been a substantial body of research over a large number of years estimating the benefits of farm and other trade liberalization (see, e.g., Tyers and Anderson 1992), it has proven difficult to achieve the substantial reductions in agricultural support necessary to achieve these gains. In this section, we outline the objectives of the Cairns Group of countries for the agricultural sector for the Seattle Round of WTO negotiations. The Cairns Group of 15 agricultural exporting countries was formed in 1986 to influence agricultural negotiations within the World Trade Organisation (WTO). The present 15 members of the Cairns Group are:

Argentina, Australia, Brazil, Canada, Chile, Colombia, Fiji, Indonesia, Malaysia, New Zealand, Paraguay, the Philippines, South Africa, Thailand, and Uruguay. These countries account for around 20 per cent of world trade in agricultural products. The Group's efforts contributed substantially to the establishment of a framework for reform in agriculture in the Uruguay Round. By acting collectively, this disparate group has had more influence and impact on the agriculture negotiations than any individual members would have had independently.

Trade Ministers from Cairns Group countries have met in 1998 and 1999 with the objective of positioning the Group to play an important role in the new round of WTO agricultural negotiations. Most recently, from 27-29 August 1999 the Ministers met in Buenos Aires, Argentina where they produced a communique that reaffirmed their previously released "Vision Statement" for the next negotiations and highlighted Cairns Group views on other issues.

The Vision Statement conveys the Group's ambitious objectives for the 1999 agriculture negotiations, with the overarching principle being the integration of agriculture into the rules and disciplines which apply to other products - that is, to reduce the disparities that were highlighted as so costly in the previous section. As stated by the Cairns Group Ministers:

The Cairns Group of Agricultural Fair Traders reaffirms its commitment to achieving a fair and market-oriented agricultural trading system as sought by the Agreement on Agriculture. To this end, the Cairns Group is united in its resolve to ensure that the next WTO agriculture negotiations achieve fundamental reform which will put trade in agricultural goods on the same basis as trade in other goods. All trade distorting subsidies must be eliminated and market access must be substantially improved so that agricultural trade can proceed on the basis of market forces. (3 April 1998)

In addition, the Group indicated support for "clear and detailed decisions in Seattle to ensure agriculture negotiations begin on time, conclude before 2003, and have an explicit negotiating timetable to deliver required outcomes" (Communique, 29 August 1999). The Vision Statement outlined the Cairns Group's reform goals in three key reform areas within the Uruguay Round framework - export subsidies, market access and domestic supports.

On export subsidies, the fact that (often discriminatory) farm export subsidies are still tolerated continues to distinguish agricultural from industrial goods in the GATT - a distinction that stems from the 1950s when the United States insisted on a waiver for agriculture of the prohibition of export subsidies. The Cairns Group objective in this area is that all export subsidies be made illegal for agricultural products, as they are for other traded goods, and clear rules be established to prevent circumvention of export subsidy commitments. In this regard it is worth noting that only 25 of the 134 current WTO Members are entitled to use export subsidies and most of these are developed countries (with more than 80 per cent of export subsidies accounted for by the European Union). Under the Agreement on Agriculture from the Uruguay Round budgetary expenditure on export subsidies is to be lowered by 36 per cent from the base period, while the volume of subsidized exports is to be reduced by 21 per cent (and only 14 per cent for developing countries).

Moreover, subsidised export credits were not included within the reduction commitments, despite them having a similar effect to direct subsidies in improving the competitiveness of a country's exports. However, there was a requirement that further negotiations take place to develop disciplines on export credits - specifically that: "Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits,

export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith." (Article 10(2)). These negotiations have been taking place within the OECD, but have not reached a conclusion. The Cairns Group argue that agricultural export credits must be brought under effective international discipline with a view to ending government subsidisation of such credits.

The extent of reductions in tariffs by the end of the 1990s will be even more modest than for export subsidies: the unweighted average bound tariff cut must be 36 per cent (24 per cent for developing countries), but it could be less than one sixth as a weighted average, since each tariff item need be reduced by only 15 per cent of the claimed 1986-88 tariff equivalents (10 per cent for developing countries). Moreover, the claimed tariff equivalents for the base period 1986-88, and hence the initial tariff bindings, are in many cases far higher than the actual tariff equivalents of the time. The European Union, for example, set them on average at about 60 per cent above the actual tariff equivalents of the CAP in recent years, while the United States set theirs about 45 per cent above recent applied rates – and developing countries are even more involved in the practice. Thus, for most farm products and countries, actual tariffs will provide no less protection by the turn of the century than did the non-tariff import barriers of the late 1980s/early 1990s, according to Ingco (1996).

On market access barriers, the objective of the Cairns Group is to achieve deep cuts to all tariffs as well as the removal of tariff peaks and the redressing of tariff escalation. Again, the aim of the Group is to place market access for agricultural commodities and value added agricultural products on a similar footing as trade in other commercially traded products. The impact of tariff escalation is apparent, even at an aggregate level, when tariffs on processed food products are

compared with agriculture and other products (Figure 1). For example, the OECD calculate that the production weighted average tariff rate in 1996 on the food, beverage and tobacco sector in the European Union was 32.5 per cent, as compared to an average of 10.7 per cent for the agriculture, forestry and fisheries sector and 7.7 per cent across all products (OECD, 1999). For the U.S. the figures were 15.9 per cent for the food sector, 7.9 per cent for agriculture and 5.2 per cent for all products (OECD, 1999).

At least three options for reducing bound tariffs present themselves. One is a large across-the-board tariff cut. Even if as much as a 50 per cent cut by, say, 2005 is accepted, however, that would still leave some very high tariffs. A second option is the "Swiss formula" used for manufactures in the Tokyo Round, whereby the rate of reduction for each item is higher the greater the item's tariff level. This has the additional economic advantage of reducing the dispersion in rates that was introduced or exacerbated during the Uruguay Round. And a third option is the one used successfully in the information technology negotiations, namely, the "zero-for-zero" approach whereby, for selected products, tariffs are eliminated altogether. In contrast to the second option, this third option would increase the dispersion of tariffs across products, increasing the risk that resources will be wastefully diverted from low-cost to higher-cost activities. While that might appeal as a way of allowing attention to then focus on the politically difficult items such as dairy and sugar, the manufacturing sector experience with long-delayed reductions in protection of textiles and cars makes it difficult to view this option optimistically as a quick solution. The continued existence of non-tariff barriers for a number of products is also a target for the Cairns Group. The objective of the Group is to transform market access barriers to tariffs and remove non-tariff barriers to trade. In the interim, the Cairns Group

supports substantial increases in trade volumes under tariff rate quotas (TRQs) and administration of TRQs in a manner that does not diminish the size and value of market access.

On the third fundamental set of restrictions, domestic supports, the Cairns Group aims to achieve the elimination all trade-distorting domestic supports (including those in the so-called "blue-box") or the replacement of these with non-trade distorting (decoupled) methods of assistance. Under the Uruguay Round, the aggregate level of domestic support (AMS) for industrial-country farmers is to be reduced to four-fifths of its 1986-88 level by the turn of the century. As with other measures, that too will require only modest reform in most industrial countries because much of the decline in the AMS had already occurred by the mid-1990s. This has been possible because there are many forms of support that need not be included in the calculation of the AMS, the most important being direct payments under production-limiting programs of the sort adopted by the US and EU. However, as argued by Roberts, Podbury, Andrews and Fisher (1999), if decoupled support is to be effective as a means of replacing market distorting forms of support it is important that these supports are implemented in a way which are minimally distorting and are applied consistently. For example, the direct market support payments provided by the U.S. under the Federal Agricultural Improvement and Reform (FAIR) Act of 1996 have been made significantly more distortionary by the additional supplementary payments provided in 1998 and 1999 related to the low commodity prices which have prevailed over this period. If farmers believe that future payment levels will be influenced by future prices, such payments will not be minimally distorting. Consequently, the objective of the Cairns Group is that income aids or other domestic support measures should be targeted, transparent and fully decoupled so that they do not distort production and trade.

The Cairns Group also has positions on three other "non-traditional" issues of significance for the forthcoming negotiations. First, the Vision Statement reaffirms the Group's support for the principle of special and differential treatment for developing countries, including least developed countries and small states, remaining an integral part of the next WTO agriculture negotiations. The Cairns Group Ministers agreed that the framework for liberalization must continue to support the economic development needs, including technical assistance requirements, of these WTO Members. As has been stated by the Cairns Group:

Major challenges facing many developing countries are the persistence of rural poverty and the linkages between such poverty and serious environmental problems. Consequently, more sustainable agricultural development remains a central policy issue in many developing countries. An improved international trading environment, that is more conducive to supporting agricultural development, is needed as an essential ingredient in addressing these problems.

An improved international trading environment will not only improve the trading environment for agricultural exporting nations but will also have important implications for global food security. Food security will be enhanced through more diversified and reliable sources of supply, as more farmers, including poorer farmers in developing countries, are able to respond to market forces and new income generating opportunities, without the burden of competition from heavily subsidised products. To provide further assurance to net food importing countries, export restrictions must also not be allowed to disrupt the supply of food to world markets. U.S. moves toward reconsidering its use of unilateral trade sanctions on certain countries will be important in increasing confidence of other countries to rely on the world

market for achieving their food security objectives. However, while the prospect of imposition of such sanctions still remains, the full confidence of net food importing countries will be difficult to attain. Similarly, the use of export taxes by the European Union in 1996 when grain prices were already at high levels served to undermine the confidence of net food importing countries in reliance on the global trading system. A commitment to rescind this authority would also improve significantly the confidence of net food importing countries.

The second "non-traditional" issue on which the Cairns Group has a position, is a response to statements by the United States and Canada that they wish to see discussions or negotiations on trade in products of biotechnology in the forthcoming negotiations. The concerns on products of biotechnology relate mainly to the approval processes for these products and the extent to which they are already covered within existing WTO agreements. While it could be argued that the products of biotechnology - principally agricultural products and pharmaceuticals - clearly come within the ambit of various agreements within the WTO, a key concern is the attempt by some countries to delay approval of these products or seek to restrict trade in these products for non-science based reasons. Proposals being considered for including these products in the forthcoming negotiations range from a proposal by Canada to establish a working group to examine the applicability of existing agreements to these products through to re-opening of the Sanitary and Phytosanitary Agreement (or possibly attaching new understandings to the agreement). While there is still considerable debate as to how this issue should be addressed, the Cairns Group notes that they would be prepared to consider how issues affecting trade in these products might be addressed by the WTO.

The third "non-traditional" issue on which the Cairns Group has a position relates to the concept of "multifunctional" objectives of agriculture, which has been pursued, in particular, by

the European Union and Japan. The "multifunctional" objectives of agriculture go beyond the economic objectives of farm production to include such things as the rural amenity provided by farms, the social objectives of preserving regional populations, the advantages of agriculture in adding to biodiversity and the landscape (by preserving, for example, hedgerows in Europe), and for keeping farms in production for flood mitigation purposes (as argued by Japan). While the Cairns Group does not disagree that farms can achieve such wider social and environmental objectives, it does not believe that this should be used as a reason for maintaining trade-distorting support arrangements. Rather, these objectives would be more efficiently and effectively met by simply making payments which are directly targeted at the objective - for example, by paying some landowners not to destroy their hedgerows (Anderson 1998). Moreover, trade-distorting support arrangements can actually have a negative impact on the achievement of some of these objectives. For example, in many cases agricultural subsidies and access restrictions have stimulated farm practices that are harmful to the environment. Reform of these policies can contribute to the development of environmentally sustainable agriculture (Anderson 1992).

Concluding comments

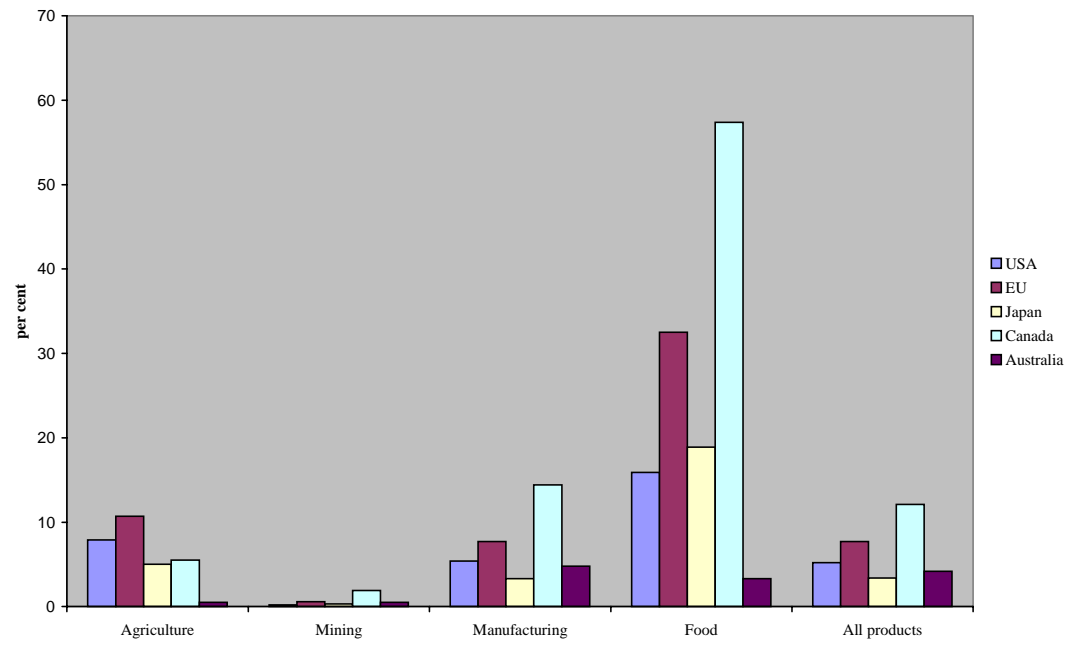
There are a number of other issues beyond agriculture that will be important in the WTO negotiations. While these extend to other sectors, such as industrials and services, they can have an important impact on agriculture - in terms of reducing input costs for agriculture (including farm material inputs, labour and investment funds), improving the purchasing power of net food importing countries, as well as providing gains in other sectors which will make countries more willing to accommodate reform in the agricultural sector. With a new round of WTO

negotiations on agriculture, services, probably manufactures and perhaps some new issues, the challenge for reform-minded policymakers is to identify potential agreements that are most useful in mobilizing the required domestic political support for reforms to farm policies. On the one hand, it might be argued that farm policies would get more attention if the next Round's agenda were to be restricted to just agriculture and services. On the other hand, however, the probability of sizeable agricultural protection cuts may well be greater if negotiations include policies of other sectors. With WTO's wider coverage than the GATT, multilateral trade negotiations now provide far greater scope for the pursuit of such linkage strategies.

On agriculture, traditional agricultural market access liberalization should continue to be a key priority issue in the next WTO round. The gains from such reform have been demonstrated to be substantial. As discussed in this paper, the Cairns Group has reaffirmed its commitment to achieving a fair and market oriented agricultural trading system as sought by the Agreement on Agriculture. Bringing agriculture more in line with trade in other goods will assist in removing the separate class structure of goods presently existing in the WTO, and so improve the efficiency of trade and resource allocation worldwide.

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Source: OECD (1999)

Table 1: Effects on economic welfare (equivalent variation in income) of removing distortions to various goods markets post-Uruguay Round, major economic regions, 2005^b

(per cent, and 1992US\$ billion p.a. difference from post-UR base case in 2005)

**Contribution from removing distortions
in OECD economies' markets for:**

<i>Region</i>	<i>Agriculture and food processing (per cent)</i>	<i>Textiles and clothing (per cent)</i>	<i>Other Manufactures (per cent)</i>	Contribution from removing distortions in all goods markets of OECD economies^c (sum of columns 1-3) (per cent)	Contribution from removing distortions in all goods markets of developing economies (per cent)	Net benefit from removing distortions in all goods markets of OECD and developing economies (\$ billion p.a.)
<i>All OECD economies</i>	26 (-50)	-3 (192)	38 (6)	68 (-17)	32 (98)	217 (20)
<i>All developing economies</i>	55 (97)	28 (84)	-29 (76)	42 (106)	58 (-249)	45 (-106)
ALL ECONOMIES^a	32	3	27	62	38	260

^a Includes 'Former Soviet Union and Central Europe' and 'Rest of the World', hence is a little more than the sum of OECD and developing economies.

^b Numbers in parentheses are the percentage of each result that is due to the change in the terms of trade, most of the rest being the change in allocative efficiency.

^c Not just the sum of columns 1-3 because distortions to minerals and fuels also are removed, and there are different interactions between sectors when all goods markets are liberalized simultaneously as compared with individually.

Source: Anderson, Hoekman and Strutt (1999).

Table 2: Sectoral shares of GDP, post-Uruguay Round in 2005, and of private household consumption and of trade in 1995
(per cent)

	<i>Agriculture+ food processing</i>	<i>Minerals and fuels</i>	<i>Textiles and clothing</i>	<i>Other Manufactures</i>	<i>Services</i>	ALL PRODUCTS
<u>SECTORAL SHARES OF REGIONAL GDP:</u>						
<i>All OECD economies</i>	5	3	0.8	19	72	100
<i>All developing economies</i>	19	9	4.4	16	52	100
<i>ALL ECONOMIES^a</i>	8	4	1.5	18	68	100
<u>REGIONAL & SECTORAL SHARES OF GLOBAL GDP:</u>						
<i>All OECD economies</i>	4	2	0.6	15	58	80
<i>All developing economies</i>	3	1	0.7	3	8	16
<i>ALL ECONOMIES^a</i>	8	4	1.5	18	68	100
<u>SECTORAL SHARES OF REGIONAL HOUSEHOLD CONSUMPTION</u>						
<i>All OECD economies</i>	12	0	2.6	11	74	100
<i>All developing economies</i>	30	2	5.7	14	48	100
<i>ALL ECONOMIES^a</i>	15	1	3.3	12	69	100
<u>SECTORAL SHARES OF REGIONAL EXPORTS:</u>						
<i>All OECD economies</i>	8	3	3.5	67	18	100
<i>All developing economies</i>	9	14	10.3	50	17	100
<i>ALL ECONOMIES^a</i>	9	6	5.5	62	18	100
<u>REGIONAL & SECTORAL SHARES OF GLOBAL EXPORTS:</u>						
<i>All OECD economies</i>	5.8	2.1	2.5	47.2	12.9	70.4
<i>All developing economies</i>	2.8	4.0	3.0	14.7	5.0	29.6
<i>ALL ECONOMIES^a</i>	8.6	6.1	5.5	61.9	17.9	100.0

^a Includes 'Former Soviet Union and Central Europe' and 'Rest of the World', hence is not just the weighted sum of rows 1 and 2.

Source: Anderson, Hoekman and Strutt (1999) and Hertel and Martin (1999), calculated using the GTAP data and model.