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Biofuel Policies as a Complement to and a Substitute for Agricultural Policies

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Introduction

Although some progress may be seen in WTO agricultural negotiations—though not in the short run—a group of measures having an important impact on the demand for agricultural products and on prices would fall out of the scope of these negotiations.

These measures are those related to biofuel (BF) promotion. Biofuels are currently using a growing proportion of oilseeds, corn and sugar as inputs. As the BF market is mainly driven by government measures, the supply of some agricultural products is affected by measures that do not correspond to agricultural policies.

This is an example of how measures of different policies may be interrelated, acting as complements or substitutes. When acting as a complement, the effects of one measure are reinforced by the effects of others; and when acting as a substitute, the changes made in one measure are compensated by those made in other measures. This will give some kind of immunity to some agricultural products with respect to changes in agricultural policies; changes which are decided either unilaterally or multilaterally, as a result of multilateral negotiations.

This explains why responses to this challenge call for a number of policy options and negotiations in the fields of trade, agriculture and energy. Options vary according to if the country is "large" or "small" in the international biofuel and agricultural commodity markets.

The Effects of Biofuel Policies on Agriculture And Agricultural Policies

Biofuels are no longer minor determinants of the demand for agricultural products. In 2008–10 on average, 11 per cent of corn, 11 per cent of vegetable oils and 21 per cent of sugar were used for BFs (OECD – FAO, 2011: chapter 3). OECD – FAO forecasts that, by 2020, 21%, 29% and 68% of growing corn, vegetable oil and sugar production respectively would be directed to BF production. Thus, since the development of BFs has been driven to a great extent by government policies, these policies indirectly influence agricultural production.

Measures to promote BFs combine a set of instruments from energy, agricultural, trade and environmental policies. The most usual measures are: minimum use mandates, production subsidies, consumption subsidies, subsidies on factors of production and inputs (e.g., agricultural feedstock), tariff and non-tariff barriers and environmental requirements. The development of new private standards could be added to this list.

The impact on resource allocation decisions is clear: i) minimum use mandates ensure a growing demand; ii) direct subsidies to production make it possible to reduce BF prices, thus making them competitive against fossil fuels; iii) support for agricultural commodities reduces the price of BF inputs; iv) market access barriers make imported BFs and raw materials more expensive, and buttress the demand for domestic production. The same is true for environmental requirements in case their application results in a disguised trade barrier.

The interrelationship among these measures shows how different policies involved in the development of BFs complement each other. In the first place, mandates would not ensure the demand for domestic production and domestic inputs if they were not supplemented by domestic subsidies and trade barriers. In the second place, consumption subsidies could be diverted to the demand for imported production if there were neither support for domestic producers nor tariffs or other trade barriers.

An indirect consequence of this is that the network of sectors that somehow benefit from policies that support agricultural production grows, and thus the future amendment of those policies becomes more and more politically difficult, because the network of sectors now involves not only farmers, input providers and landowners, but also agriculture-based BF producers and users.

In turn, an energy policy could also act—at least, partially—as a substitute for an agricultural policy, so as to meet the objective of sustaining farmers' income. Measures to promote BFs sustain the demand for agricultural commodities, thus increasing commodity prices. In this way, as farmers' income increases, the agricultural policy support they need decreases, since part of this is inversely related to price: the higher the price, the lower the support. Moreover, this price increase also affects other agricultural products which are not used for BF production, but which, in food production, can act as substitutes for those used in BF production—like wheat with corn—or compete with them for land use.

In the case of the European Union, trade barriers to biofuels are related to protection given to agricultural feedstock: protecting ethanol is an indirect way to continue protecting its raw material. For example, the most favoured nation (MFN) tariff on non-denatured ethanol is 0.192 euros/litre (ad valorem equivalent of 45%), while it is 0.102 euros/litre (ad valorem equivalent of 23%) on denatured ethanol. The tariff on biodiesel is 6.5 per cent. These differences are also evident in tariffs on raw material. In the case of crops suitable for ethanol production, tariffs are higher than those on biodiesel: while the tariff on wheat is 95 euros/tonne (ad valorem equivalent around 50%) and that on sugar is 3.39 euros/tonne (ad valorem equivalent around 100%), it does not exceed 9 per cent on vegetable oils, and oilseeds are duty free.

The link between agricultural and energy policies is also evident in what could be called the two-pronged channel of cross-subsidies for end products and raw materials. A good example is the case of ethanol in the United States, where, by reason of its energy policy, the blender—that is, the one who mixes gasoline with ethanol—is subsidized. Although this subsidy initially benefits blenders, it might then favour ethanol producers, and thirdly, producers of maize purchased by ethanol producers. At the other end of the chain, agricultural support to producers of maize favours its supply, but it can indirectly benefit the first demander (the producer of ethanol, in this case) and then also the second demander (the blender).

Therefore, energy policy subsidies might benefit farmers and thus add to or substitute the support given by agricultural policy measures. If the proportion of this subsidy transferred to the farmer is proved to be an agricultural subsidy, it will then be subject to the multilateral trade regulations that govern agricultural support. At the same time, if agricultural subsidies entail benefits for biofuel producers, their control at the multilateral level will imply reducing the amount of subsidies for the production of ethanol. These two aspects are detailed in the next section.

Policy Options for Large and Small Countries[1]

In the field of international relations, World Trade Organization (WTO) rules entail a limit to governments' room for manoeuvre. In any case, national commitment to international rules and willingness to comply with them or the need to resort to them depend, in many cases, on the size of the economy, the specific weight of the states within

1 This section is partially based on Galperín and Pérez Llana (2010).

the international community, and the ability of international agencies to ensure their enforcement.

By way of example, we will use "large country" to refer to a country which can influence the international market and multilateral trade negotiations, and "small country" to refer to a country which lacks said power.

In both cases, the decisions that should be revised are, on the one hand, those related to domestic production and support to industry—which imply deciding which BFs to produce and which inputs to use—and, on the other hand, those related to foreign trade. Our analysis assumes that a "large country" which, regardless of its relative efficiency as agricultural producer, depends on imports to supplement its own domestic production, and a "small country" that is an efficient agricultural producer and that can compete in the BF market.

"Large countries" do not usually take the international context as given in order to make decisions at the domestic level. On the other hand, although multilateral rules impose a limit on their domestic policies, these may also be a limit to multilateral negotiations. In contrast, small countries' options are to take the international context as given in order to decide their domestic policies accordingly, and to try to (not always successfully) modify the international scenario. Some of these options are unilateral, but others are bilateral and multilateral.

3.1. Options available to "Large Countries"

i. Large countries' policies do not depend so much on what happens in other markets or on other countries' policies and, at the same time, they have an impact on them.

Choosing which product and input will be subsidized can affect both the international price of the end product and of its inputs. An example is the United States BF policy that subsidizes corn-based ethanol and is one of the reasons for corn price increases (Babcock, 2011).

Also, a large importing country may have an influence on a large exporting country's BF policies. This has been the case with the US decision no to apply the BF tax benefit to foreign biodiesel that after a slight modification was re-exported to the European Union after the EU had decided to apply countervailing duties against US biodiesel exports—known as the "splash and dash" case.

ii. The size of its market enables a "large country" to choose its supply sources by granting trade preferences to certain countries and not to others, either based on raw material costs or geopolitical reasons.

BFs from efficient countries are usually considered a "sensitive" product that is either totally or partially excluded by the US and the EU from the trade preferences of the free trade agreements they negotiate and from their unilateral Generalized System of Preferences. In contrast, due to geopolitical considerations, preferences are given by the US to BFs imported from Central America and the Caribbean, and by the EU to BFs imported from least developed African, Caribbean and Pacific countries.

iii. WTO rules restrict what can be done in terms of granting subsidies and applying trade measures.

This is known as the national treatment principle, which is aimed at avoiding discrimination in the application of internal measures. But the small print in some BF technical standards and regulations relating to non-trade concerns may discriminate against imported products. For instance, there are two EU standards that discriminate against (imported) biodiesel produced from soybean oil and palm oil and benefit (local) biodiesel produced from rapeseed oil, namely, the iodine standard, thought to guarantee optimal engine performance; and the sustainability criteria according to which biofuels must show greenhouse gas emission savings of at least 35 per cent.[2]

iv. Domestic decisions are used as limits to what is being negotiated in the multilateral arena

The US and EU agricultural policies are presented by them as their limit to WTO agricultural negotiations, in order to avoid further reductions in their domestic support for BF feedstock such as corn, oilseeds and beet sugar.

v. To influence international forum decisions for one's own advantage

For example, the World Customs Organization is currently considering a change in the tariff classification of ethanol by which it could be excluded from the scope of application of the WTO Agreement on Agriculture (AoA), thus making it more difficult to challenge support for BFs in the WTO, as is commented in section 3.2.v.

Besides, in the G-20 group of developed and developing nations, the US and the EU, among others, have proposed to phase-out inefficient fossil fuel subsidies that encourage wasteful consumption; but support to biofuels was excluded from the group of subsidies to be phased out.

3.2. Options available to "Small Countries"

i. If they decide to export BFs, production decisions will largely depend on large countries' policies

If there is an intention to export part of their biofuel output, the decision as to which biofuel to produce (ethanol, biodiesel) and which input to use (maize, sugar, soybean, rapeseed or sunflower oil) should take into account—besides comparative advantages—the possibilities to access the main markets as well as those measures that have an impact on domestic and external demand, such as minimum mandatory targets for the use of BFs, domestic support, import duties, technical standards, trade agreements and the domestic needs of each country. That is why the US is a market for ethanol—mainly from Central America—and the EU, for biodiesel.

ii. Even when exporting is not a priority, large countries' policies influence small countries' production decisions anyway.

If there is no intention to export, large countries' decisions will inevitably have an impact on prices of raw materials used in production and on the relative profitability of alternative products. Moreover, it will be possible to take advantage of the gap left in the raw material market either because these countries export less—e.g., the case of maize in the US[3]—or less raw material is directed to food production—e.g., the case of oilseeds and vegetable oils in the EU.

iii. To seek or maintain preferences to access the main markets.

An example of this is the MERCOSUR request to the EU for BFs to have preferential market access within the framework of the MERCOSUR-EU free trade agreement negotiations.

2 According to the default values defined by the regulation, this standard is not met by soybean oil- and palm oil-based biodiesel. The sustainability criteria also ban the use of feedstock grown on land with high biodiversity value and high carbon stock. These criteria are applied both to local and imported biofuels.

3 Since the US is the main maize exporter, the void left in the international market would be very important. At the same time, the growth of areas sown with maize would reduce soybean production and exports.

iv. To take advantage of other countries' market access preferences in order to export to or invest in them, and thus sell BFs to large countries.

The US has negotiated preferential trade agreements with Central American and Caribbean countries. One of these agreements, the Caribbean Basin Initiative (CBI) establishes that the ethanol produced in the region can enter the US duty free as long as 50 per cent of its content is domestic. Hydrated ethanol produced in other countries—e.g., Brazil—could be sent to a dehydration plant in a CBI country to be reprocessed and then exported to the US market duty free, even if most of the production process took place in other countries. Moreover, some Brazilian companies are now investing in ethanol production plants located in CBI beneficiary countries.

v. To discuss the legality of measures used to encourage the development of BFs in the multilateral sphere, and to negotiate the reduction of support measures and the disciplines that rule them.

WTO rules and negotiations enable small countries to challenge and modify large countries' trade and agricultural policies. In this sense, it is worth noting that some of the measures applied by the US and the EU may not be compatible with WTO rules (Harmer, 2009). Regarding US measures, some authors (Pérez Llana et al., 2007; Orden, 2009; Earley, 2009) argue that US subsidies for ethanol are a support measure that is subject to the rules of the Agreement on Agriculture, and it thus has to be included in the Aggregated Measurement of Support (AMS). This issue has been called into question in the Committee on Agriculture Special Session and in the Dispute Settlement Body. The differential tariff on ethanol might also be challenged because it could be argued that it is above the bound rate (Harmer, 2009).

In relation to EU measures, Swinbank (2009) argues that it is not clear that EU subsidies might be considered as an agricultural support subject to the AoA, but the EU sustainability criteria may not comply with the GATT National Treatment provision. Likewise, the EU technical standard on iodine content may be incompatible with the WTO Agreement on Technical Barriers to Trade.

On the other hand, Doha Round negotiations may affect, through two simultaneous channels, the US and the EU biofuel promotion policies. In the first place, one of the questions under discussion is the level of reduction in agricultural domestic support. Depending on the magnitude of the cut, effective support for maize—in the US—and for sugar—in the EU—could be lowered and then to reduce an indirect subsidy for biofuel production. Furthermore, this reduction would affect some direct subsidies for BFs if they are included in the AMS. In the second place, negotiations on import duty reductions are underway for biofuels that may be considered either an agricultural good or an industrial good. Likewise, during the negotiations on environmental goods and services, Brazil proposed to reduce tariffs on ethanol.

Conclusions

The biofuel policies applied by the US and the EU—the two major BF markets—have an increasing direct and indirect impact on agricultural production and act both as a complement to and as a substitute for agricultural policies. Yet most of these measures still fall out of the scope of agricultural negotiations.

7 Ibid. at 14-15.

If developed countries continue to protect their BF sector through measures of this kind—some of which cannot be easily justified—the options available to developing countries will be either to export raw materials to be processed in developed countries or to resort to trade negotiations. Although this issue could be approached bilaterally, the WTO is the appropriate forum to ultimately discuss it, so that multilateral rules are effectively enforced.

The reason for this is that multilateral institutions, like the WTO, play a crucial role in enabling "small countries" to reach their objectives. Without them, it would be extremely difficult for "small countries" to alter the trade policies applied by "large countries" in order to offset international trade distortions.

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