

# The WTO, Agenda 2000 and the Next Steps in Agricultural Policy Reform

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## I. Introduction

The successful completion of the Uruguay Round of trade negotiations marked an historic turning point in the reform of the agricultural trade system. The Uruguay Round Agreement on Agriculture (URAA) puts in place a set of rules which will go some way toward improving the conditions under which agricultural goods are traded. Bound tariffs have

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replaced non-tariff import measures, export subsidies have been curbed and domestic programs have been codified on the basis of their potential to distort trade. The Agreement did little, however, to liberalize trade in agricultural products and improve market access. The larger part of export subsidies can still exist, and are in effect legitimized. The domestic farm policies of the major industrial countries have been required to make only relatively minor changes to bring them into conformity with the Agreement. The process of "tariffication" has produced a number of tariffs bound at such high levels that it is difficult to see any profitable trade developing in their shadow. Where tariff rate quotas were negotiated to prize open these markets a little, the prospect of quota rents has led governments to agree to a network of bilateral deals which guarantee continued state involvement in trade for years to come. This has in turn exacerbated the problem of competition between state trading enterprises and the private trade. Thus the time is ripe for initiating another set of multilateral talks to complete the job started by the Uruguay Round.

The Uruguay Round has not been the only forum for negotiation on agricultural trade in the past few years. Regional trade institutions have also begun to grapple with the issues of agricultural trade liberalization. Though there has in the past been a natural tendency to avoid the politically sensitive sectors such as agriculture when negotiating regional trade pacts, free-trade areas and customs unions have recently become more adventurous in dealing with agricultural protection. In the Americas, the North American Free Trade Area (NAFTA) agreement included agriculture as a central element, setting the scene for a relatively free market in farm products between the US and Mexico at the end of the transition period. Agriculture has been featured in the MERCOSUR agreement, opening up trade in particular between Argentina and Brazil, and is included somewhat cautiously in the new "Europe Agreements" between the European Union and the countries of Central and Eastern Europe and the Euro-Med Agreements with the countries of North Africa. Other trade groupings in Europe and the Americas also include agriculture,

such as the Baltic Free Trade Area and the Central European Free Trade Area in Europe as well as the Andean Pact, the Central American Common Market and CARICOM in the Americas. Plans for broad supra-regional trade structures, such as the Asia Pacific Economic Cooperation agreement (APEC) and the Free-Trade Area for the Americas (FTAA) have also explicitly faced up to the issue of the inclusion of agricultural trade. Set against the scenario of unfulfilled promise of liberalization at the multilateral level, these regional initiatives have begun to look like useful building blocks for the future of the agricultural trade system.

These agricultural trade policy developments have taken place against the backdrop of some remarkable changes in domestic agricultural policy. In developing and middle-income countries these agricultural policy reforms have been part of a package of economic policy changes induced by a combination of external pressures and long-term paradigmatic change. The remarkable fact is that politicians over the last decade did not shy away from the inclusion of agricultural markets in the overall reform of economic policy. In most cases, difficult decisions had to be made in the face of opposition from rural constituencies, and governments have often shown considerable fortitude in pursuing economic policy reform in agriculture. Domestic reforms then allowed countries to bring agriculture in to the trade policy reforms, generally involving the removal of non-tariff barriers and the setting of low fixed tariffs against imports.

In the industrial countries agricultural policy reform has come only reluctantly and with a great deal of domestic opposition. The farm policies in these countries had become so entrenched that they seemed almost to be immune from external pressures. However the reform of the EU's Common Agricultural Policy (CAP) in 1992 and the 1996 Farm Bill in the United States represent very significant changes in direction for farm policy and usher in a new era of relations between governments and the agricultural sector. Even in Japan the basic law which governs the role of the government in agricultural markets is being modified in the direction of

privatization, though the task of bringing down domestic prices has hardly begun. The industrial giants seem at last to be following the lead of the middle income countries in regard to adapting their agricultural policies to the new global realities, but still have some way to go.

This study takes as a starting point these changes in domestic, regional and multilateral policies in the agricultural area and looks at the task ahead as countries continue down the path toward comprehensive reform of the agricultural trade system. The next section discusses the case for further reform in the light of shifts in the global market for agricultural goods. This is followed by a description of the new Agreement on Agriculture negotiated in the Uruguay Round, the implementation of that agreement and the developments in domestic policies that have made it possible to contemplate further action on the trade side. A further section considers the context in which this reform must take place, and the new issues that have arisen since the time of the Uruguay Round which add urgency to the task. The fifth section discusses the alternative paths, domestic, regional and multilateral that would lead towards trade reform in the agricultural sector. This is followed by a final section which draws some conclusions about the needed action and points to ways in which some degree of coordination could be achieved between these alternative paths.

## II. The Case for Further Reform of Agricultural Trade

Why do we need further negotiations on agricultural trade so soon after the Uruguay Round? If agricultural policy reform is progressing satisfactorily, as countries modify their domestic farm programs to meet budget constraints and new notions of the limits to government activities, why contemplate further trade negotiations at this time and risk potential international conflicts? Why not leave well alone for a few years and revisit the issue of agricultural trade when domestic policies have finally changed? It is indeed tempting to allow these domestic forces to work towards a liberal trade regime for agricultural goods, and to postpone any further multilateral efforts to improve trade rules. Unfortunately such a strategy is unlikely to yield the desired outcome of a reformed trade regime. Domestic and international policy reform are mutually reinforcing, and are in fact two parts of the same process. Domestic reform was needed to get the changes in the trade system which were embodied in the Uruguay Round. The new trade rules in turn provide the constraints which channel domestic policy change in the right direction. If additional trade reform is not pursued in the next few years, the gains from domestic reform could well be lost. These linkages between the domestic and international reform processes are spelled out in some detail in this study. In essence they constitute the core of the case for further reform of the trade system for agricultural goods.

Five reasons can be distinguished to pursue agricultural trade reform, each of which would make a plausible justification. Together they make the case for further trade reform compelling. **First**, the Uruguay Round has exposed for the first time the extent of agricultural protection. The picture which has emerged is that of high tariff peaks towering above the more modest tariffs of non-agricultural goods. Such uneven protection carries a

high cost both to the countries with the trade barriers and to the trade system as a whole. **Secondly**, a further attempt at improving the international rules for trade could help considerably in the formulation of domestic agricultural policy in many developing countries, particularly in Asia. The dynamics of protection are such that countries often need the restraint and guidance of international agreements to assist with domestic policy choice. A **third** reason for more reform at the moment is to lock in and underpin the painful changes in agricultural policy which have been taking place in the advanced industrial countries and in a number of middle income economies. The reforms are a constructive response to the poor performance and high cost of those policies, but also need to be undertaken within the guidelines of international trade rules. A **fourth** reason for advancing further agricultural trade reform at the moment is to continue the process of reducing trade conflicts which have bedeviled trade relations among developed countries and between developed and developing countries for many years. Improving trade relations has a potentially large benefit at a time when the focus of the international system should be to foster non-aggressive solutions to global issues. A **fifth** reason for pursuing further reforms at this time is that agriculture has a significant role to play in the future development of the international trade system. It is a vital part of the political accord which is needed for continued global economic integration and growth. To omit it would be to weaken significantly that accord.<sup>1</sup>

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<sup>1</sup> These five reasons are not, of course, unrelated to each other. The high tariffs give exporting countries an excuse to continue protection in their own domestic agriculture, which in turn leads to aggressive export policies. This contributes to the tensions of the trade system and undermines the confidence of trading countries in the ability of the system to provide foodstuffs on a reliable basis. Removing both the high protection levels and the need for export subsidies improves the credibility of the trade system and hence is an important part of the multilateral bargain among countries.

## 1. Reducing Levels of Agricultural Import Protection

Around the world, agricultural markets are highly, if unevenly, protected from imports. The high tariff levels that were bound in the Uruguay Round for agricultural goods stand out as a major distorting feature of the trade landscape. As a result of the succession of GATT Rounds, manufacturing tariffs are now at modest levels in most of the industrial countries of the world and an increasing number of middle- and low-income nations. Many of these tariffs are of the order of 5-10 percent, and several countries have average manufactured product tariffs of considerably less than 10 percent. Agricultural tariffs by contrast average above 40 percent, with tariff peaks (“mega-tariffs”) of over 300 percent. Table 1 shows the broad picture by commodity, the ad-valorem tariff for a number of agricultural goods averaged over 20 major trading countries in North America, Asia, Europe and Latin America.<sup>2</sup> But the averages hide the tariff peaks which effectively

**Table 1: Average Unweighted Ad-valorem Bound Tariff Rates Post-Uruguay Round for Agricultural Goods, Twenty Countries**

Product	percent	Product	percent
Grains	46.7	Dairy Products	47.1
Oilseeds	41.7	Sugar	48.7
Fats and Oils	41.6	Fresh Fruits and Vegetables	35.5
Meats	39.3	Processed Fruit & Vegetables	35.3
Milk	40.7	Other Agriculture	24.4

<sup>2</sup> The table shows the unweighted average *ad valorem* tariff of the numerous individual tariff lines relating to the product groups identified. Two cautions should be noted. First, the unweighted average tariff does not distinguish between the importance of the individual items either in the current trade basket or in any potential pattern of trade; and secondly the average omits specific tariffs which cannot be averaged without assumptions about the level of world prices. An ambitious attempt to convert the specific tariffs often found in agricultural trade into *ad valorem* equivalents has been proceeding at the World Bank (Ingco and Hathaway, 1996). This indicates that specific tariffs are often higher than the *ad valorem* tariffs, though this is not always the case. More importantly the Japanese and Korean protection on rice imports is not yet in the form of a tariff, and is not included in the table. Nor is the EU protection on grains, as this is limited to a level below the bound tariff. The bound tariffs can overstate the level of protection actually applied: several Latin American countries apply tariffs which are well below their bound levels.

block trade. A well known example of such mega-tariffs is that of Canadian dairy imports: the tariff on butter is 351 percent and on cheese is a formidable 289 percent. Even by the year 2000 these will still be at the levels of 299 percent and 246 percent respectively (IATRC, 1994). Poultry tariffs are also above two-hundred percent in Canada.<sup>3</sup> The US has mega-tariffs for sugar and dairy products, as does Japan for grains, sugar and dairy products.

Source: WTO

There is little doubt that agricultural protection as evidenced by these high tariff levels remains one of the major distortions in the world economy

<sup>3</sup> Canada has, of course, lower tariffs on most other agricultural import items. An example of a country with consistently high tariffs is India, with an unweighted average bound tariff for unprocessed agricultural goods of 97 percent and for processed agricultural goods of 139 percent. Hong Kong, at the other end of the scale, has bound a zero tariff for agricultural goods, as one might expect in a country with no agricultural production.

today. As a result, domestic prices are pushed far above those on the international market. In such instances the allocation of resources among sectors is grossly distorted, and consumers of foodstuffs bear a heavy burden to support the high cost local production. The importing countries themselves have a strong interest in reducing the cost of foodstuffs to consumers and improving the efficiency of their own resource use. But in many cases the high tariffs contain considerable “water”, with imports unable to compete after having paid the tariff. Many of these high tariffs came as a result of the conversion of non-tariff barriers (often at levels above the “tariff equivalent”) and hence preserve the intent to exclude imports. In other cases the bound tariffs are above the levels actually in use. In these cases the distortion is potential rather than actual, but such tariffs should still be reduced so as to make market access more transparent. In fact, countries could use the reduction of such tariffs as bargaining chips in negotiations to gain better access to the markets of others.

Why does it matter if tariffs are high for agricultural goods relative to those in other sectors of the economy? In essence, by raising domestic price levels above the cost of imports the government is giving farmers the wrong incentives to produce and reducing the contribution that the sector makes to the national economy. In fact the cost of inputs into the production process can easily exceed the value of output.<sup>4</sup> Under these circumstances the contribution to the output of the economy is negative. Poor countries can ill afford to have a major part of their economy

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<sup>4</sup> A simple rule of thumb is to compare the value added in a sector (often called the “gross margin” in agricultural activities) with the nominal rate of protection (or more accurately the “adjusted” nominal rate netting out input tariffs). If, for instance, the value of output is 35 percent above the cost of inputs but the output is protected at a rate of 40 percent of the world market price, the cost of inputs exceeds by 5 percent the world market value of the output. The sector is yielding negative value added at “social” prices.

unproductive, especially when the distortion is financed by a tax on food. Moreover, the rest of the economy will feel the pull of resources toward the agricultural sector. Support to one sector puts a burden on others. In many countries agriculture is significant enough to have noticeable macroeconomic impacts, distorting in particular the wage rate and the exchange rate. In others, direct payments from the government treasury to agriculture raise taxes and curtail other desired spending. Even rich countries where agriculture is a small part of the economy can find such side-effects a drag on the economy.

All this might be tolerable if it was for some broader social goal. Few would push for freer trade if it compromised consumer access to food or devastated rural economies. Agricultural protection is indeed often justified on the grounds of food security and rural well-being. But these notions have been found to be a weak rationale for the perpetuation of gross distortion of agricultural incentives. Food can be purchased by any country with foreign exchange: absolute food shortages are rare and fleeting, and usually a result of administrative mismanagement of political turmoil. The best guarantee of food security for a country is to have a diversified export sector to provide the funds for needed imports, along with a sound macroeconomic policy to keep those exports competitive.<sup>5</sup> Neither is rural development helped in anything but the shortest of runs by encouraging high cost food production. Development is most successful when farmers and others in rural areas produce a mix of products for which consumers are prepared to pay. Dependence upon artificial markets, whether maintained through high import tariffs or direct intervention in the market by means of price supports, blocks the signals from the consumer and distorts production and investment decisions. Moreover, the cost of

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<sup>5</sup> There are of course many serious problems of internal food distribution and lack of access to food by the poor in developing (and even in developed) countries. But these concerns are also not well addressed by a policy of encouraging uneconomic production and wasteful national resources.

inefficient food production is borne disproportionately by the poor, who spend more of their income on food. Agricultural protection is a regressive policy which serves both developed and developing countries poorly.

The reason for the prevalence of high agricultural tariffs is much simpler. Agricultural protection, like that in other “sensitive” sectors of the economy, such as textiles, steel and shipbuilding, serves one purpose - to protect the profits of those at present in the industry from erosion due to competition. It is the fear of reduced incomes and asset values, including land prices, rather than food shortages or rural depopulation that often makes it so difficult to remove high levels of protection. Much of the rhetoric of agricultural policy debate is the attempt to build alliances to support the concept of agricultural protection. This serves to confuse the issues, but it also makes it easier to remove such policies once the politics are right and the decision is made. As experience over the last decade has demonstrated, when the average (i.e. urban) politician decides that it is no longer in the interest of the country to maintain such an unbalanced level of protection for the agricultural sector, the process of reform can be swift. The farm sector does not necessarily suffer a drastic cut in income when reform is introduced. Direct payments can be introduced to compensate for price reductions and more competition in agricultural markets. Several examples of such compensated policy reform now exist. Farm interests faced with reform know that others have learned to live with the opening of markets. The Uruguay Round gave this process a boost by distinguishing between payments tied to production, which have a direct distortionary impact on trade and those which are “decoupled”, where the effect on trade is considerably less or in any case so indirect as to be difficult to identify. The next round of trade talks can give the impetus for more and

more countries to make the decision to switch from price support to decoupled direct payments and hence move towards less distorted trade.<sup>6</sup>

## 2. Forestalling Agricultural Protection in Asia

We know from careful studies of agricultural protection in Asia that nations can fall prey to the temptation to increase agricultural price supports at particular stages of development, when the manufacturing sector is booming and agriculture seems to be struggling, and then have had difficulty removing such support at a later stage when the rural sector needs the pressure of market forces to become competitive (Anderson and Hayami, 1986). This has happened in Japan and Korea, as well as Taiwan. Table 2 shows the dramatic rise in domestic prices for basic farm commodities relative to border prices in the three countries in their “take-off” stages. In the mid-1950s Japan began to push up farm support prices in an attempt to keep farm incomes in step with the burgeoning non-farm sector. By the late 1960s the same process was repeating itself in Korea and Taiwan. Though protection was in all cases highest in rice, the other

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<sup>6</sup> There are other things that are worrying about the landscape of agricultural protection, in addition to the excessive height of the tariffs. In particular the proliferation of Tariff Rate Quotas (TRQs) has led directly to a number of trade disputes. Some of these have revolved around the allocation of the TRQs themselves: others concern the quantities involved and the growth of such market access. The problem that TRQs pose is that they generate profits for those that are allocated the quotas, setting up in turn a vested interest in their perpetuation. Those that don't have such quota allocations will tend to complain, thus ensuring both restricted access and trade frictions. This issue of quota allocation has become entangled with another issue, that of the prevalence of state trading in agricultural goods. Where the quotas have been allocated to para-statal trading firms the private sector has been quick to protest. In both cases further reform is needed to ensure a liberal and responsive agricultural trade system. These issues are discussed fully in later sections.

Japan, Korea and Taiwan, 1955-1982  
(percentage difference between domestic and border prices)

			1955-59	1960-64	1965-69	1970-74	1975-79	1980-82
grains, livestock products and even fruits and vegetables were heavily supported.	Rice	Japan	50	72	99	160	263	249
		Korea	-14	-9	6	55	138	154
		Taiwan	-31	-8	-13	4	58	144
As a result of the economic growth of the region, many other developing countries in Asia have been grappling with this problem over the last few years, including China, Indonesia, the Philippines, Malaysia and Thailand. The temptation to move towards a protective agricultural strategy has been growing beneath the surface. China already grants protection to its agricultural sector which is somewhat higher than that accorded most other sectors. Indonesia has recently reformed its industrial trade policy but has been hesitant to extend that to the agricultural sector. If growth resumes in India, another country with enormous potential to influence world trade will face the same dilemma. At present India has relatively closed markets but internal price levels not too different from those on world markets. Whether India will develop an open market for agricultural goods, and thus participate fully in world markets, or move to support its farm population with the proceeds of non-agricultural growth is a key question for the future.	Wheat	Japan	37	62	97	127	276	278
		Korea	-22	-8	18	16	47	128
		Taiwan	48	25	39	32	57	92
	Beef	Japan	113	142	165	146	284	181
		Korea	3	5	55	88	281	354
		Taiwan	-4	8	20	37	162	153
	Average*	Japan	44	68	87	110	147	151
		Korea	-15	-5	9	55	129	166
		Taiwan	-21	2	2	17	36	55

Source: Anderson and Hayami, 1986, p22

\* Average of 8 common agricultural commodities including barley, corn, soybeans, pigs and chicken as well as those in the table.

The recent financial troubles in many of these countries, and the possibility that it may be some time before rapid growth returns, does not remove the problem. Indeed, the need for economic reforms in the financial sector goes along with the maintenance of open markets and the removal of unnecessary government regulations on commerce. An open food and agricultural system would in fact complement the restructuring of the Asian economies, just

as the increased competitiveness of their own agricultural sectors which should follow from the currency devaluations will help the process of trade liberalization. In any case, the issue of the type of agricultural and food strategy to pursue in the region will certainly come to the fore in the next few years.

Further agricultural trade reform will obviously help these countries avoid the problems that Japan, Korea and Taiwan have experienced with high cost food industries. It will make increases in border protection difficult by reducing bound tariffs. Constraints on domestic support will avoid wasteful competition through subsidies on water and fertilizer. If the next round

deals with state trading, this will continue to put pressure on Asian countries to deregulate their internal food markets, to the advantage of consumers and entrepreneurial farmers.

Of these important issues perhaps the most significant is the path of agricultural policy in China. Will the agricultural sector of the world's most populous country become more protected as the manufacturing sector develops, along the lines of Japan if not to the same degree? Or will they bypass the stage of heavy protection and tight state control of the market for basic crops and head directly for a market-oriented agricultural system.<sup>7</sup> The signs at present are that China is prepared to try the road of modest protection and open markets. Levels of protection are relatively modest by international standards, though still high relative to other sectors in China. Clearly China cannot afford to burden itself with high cost foodstuffs. Unlike Japan and Korea, it has no structural food deficit. It has a choice between focussing on domestic needs or developing high value export industries based on imported raw materials. The latter would benefit rural development and enhance incomes. But China is also likely to be concerned about the security of food supplies from abroad and the possibility of food shortages and high prices. Thus it seems essential to complete the reform of the world trade system in agricultural products so that China can participate with confidence in international trade and be accepted as a reliable partner by other countries.

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<sup>7</sup> Jeffrey Garten raises the same question with respect to industrial policy. Will China try to repeat the experience of Japan in state encouragement of export firms and limit imports to those that bring in needed technology? (Garten, 1997). Others have suggested that the Chinese may opt for the Chaebol model of industrial organisation found in Korea.

For countries such as Indonesia, the Philippines, Thailand, Malaysia and India, the question is also one of alternative development paths. Most of these countries have moved from the stage of taxing their agricultural sectors. But industrialization is already putting a strain on agricultural incomes, and the temptation to increase protection is considerable. Is there a convincing alternative to the state-dominated food system, with the high price policies of Japan, Korea and Taiwan? Would an "open" food system built upon free trade, or at the least modest trade barriers, be a more secure basis for the growing Asian economies? The future of agricultural trade depends as much on the answer to this question as on any other. At present the constraints within the WTO are relatively ineffective in constraining this choice. A further step towards reform is needed, perhaps led by the APEC countries. An open food system in the Asia-Pacific region would set an example for other areas of the world and could lead rapidly to an open system at a global level. If countries could be persuaded to move down this path (and it is already explicit in the APEC target of free trade and investment for all countries in the region), then this could be the most important driving force behind global agricultural trade reform since the repeal of the Corn Laws by the English Parliament in the middle of the last century.<sup>8</sup>

### **3. Securing Agricultural Policy Reform in the West**

The slow but fundamental changes which are taking place in the agricultural policies of the major industrial countries also need the encouragement and underpinning of international agreements. The changes in these policies have generally been in the direction of improving the

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<sup>8</sup> The repeal of the protectionist Corn Laws, which themselves bore a resemblance to the EU's CAP for grain a century later, led after an interval to the expansion of agriculture in the "New World". Those European countries that did not take advantage of cheaper overseas grain fell behind in the process of industrialization. (See Tracy, 1964)

climate for agricultural trade, in contrast to the policy changes in the nineteen-sixties and nineteen-seventies which led to more trade conflicts. The Uruguay Round was able to take advantage of these changes, such as the 1992 Reform of the EU's Common Agricultural Policy (CAP) and to get firm commitments on future policy directions and support levels. But this process of reform is still at an early stage and needs to continue in order to avoid a swing back toward the costly and ineffective policies of earlier times.

The magnitude of the task ahead can be seen by examining the calculations made by the Organisation for Economic Cooperation and Development (OECD) in their 1997 "Monitoring" report (OECD, 1997a). The size of total "transfers" to the farm sector from taxpayers and consumers as a result of the mix of agricultural policies used by OECD members has changed little in the last decade, averaging \$280 billion in 1986-88, at the start of the Uruguay Round, and rising to an estimated \$300 billion in 1996 (See Table 3).<sup>9</sup> Agricultural policy transfers are greatest in the EU, with Japan and the US transferring income at just over one-half the European level. On a "per farmer" basis, corrected for part-time farming, transfers to Japanese farmers average about \$30,000 in 1996, well down from the previous year but still higher than in the late 1980s. US transfers per farmer have stayed rather constant over the period, at just over \$27,000. (Transfers per hectare are much larger in Japan, however, as a result of the much smaller farm size.) Inflation has reduced the value of those

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<sup>9</sup> The measure of total transfers includes benefits from price support policies and subsidies as well as all farm-related government spending. Not all the benefit goes to farmers, of course, with input suppliers and marketing agents also being supported. Moreover, new entrants to the sector may already have "paid for" these benefits in the price of land and other assets. Landlords also should be presumed to benefit from higher rental rates as a result of the transfers. These are additional reasons why the move toward targeting and decoupling of payments described below is likely to make transfers more effective in the future.

transfers (by 35 percent) and growth in income and population has reduced the burden on the rest of the economy from 2.2 percent to 1.3 percent of GDP. But the absolute size of the transfers to one small and declining part of the economy is still remarkable and vulnerable to both economic reform and straightforward budget-cutting pressures.

The transfers effected through specific policies for a more limited range of commodities have for a number of years been captured by the OECD in their calculation of the "Producer Subsidy Equivalent" (PSE), the payment that would have to be given to offset the income effect of a removal of those policies. The total value of this part of the transfer rose slightly from \$160 billion to \$166 billion over the decade (see Table 4). Relative to the value of output, the PSE for the products considered for the OECD member states was estimated at 36 percent in 1996, down from 40 percent in 1995 and 45 percent in the period 1986-88 (OECD, 1997a). Expressed with the border price as a base, the level of protection (called by the OECD the Nominal Assistance Coefficient) for producers fell from around 80 percent to about 50 percent over the decade. Calculated on the basis of consumer prices (i.e. not including direct payments) the level of protection fell over the period from 60 percent to 30 percent. However, this improvement is largely the result of firm world prices in 1996, and could easily be reversed if these prices collapse.<sup>10</sup>

The most direct case for "locking in" agricultural policy reforms by means of trade policy changes can be seen in Latin America. As history has demonstrated, economic reforms in the region can easily be reversed by a change in regime. In the past decade, country after country has liberalized agricultural markets by a combination of low border protection, deregulation of domestic markets and macroeconomic reforms which encourage trade and investment. To lock in these reforms governments

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<sup>10</sup> These numbers tend to confirm the impression from the unweighted *ad valorem* tariffs of a level of protection of about 40 percent for agriculture as a whole.

**Table 3: Agricultural Policy Transfers by Country, 1986-1996**

	1986-88	1993-95	1994	1995	1996
Total transfers by country					US\$ billion
EU	114.1	132.5	128.5	138.6	120.3
US	68.2	74.1	76.4	62.4	68.7
Japan	62.5	89.9	87.2	100.5	77.4
Canada	7.3	6.1	5.8	5.7	4.8
OECD	278.9	332.1	328.2	332.9	297.1
Transfers per farmer (Full Time Farmer Equivalent)					US\$
EU	12,785	18,657	18,336	19,478	17,474
US	27,892	29,384	30,285	24,742	27,240
Japan	17,280	31,647	29,402	38,440	30,091
Canada	15,742	14,085	13,750	13,318	11,225
OECD	11,100	15,651	15,440	15,955	14,493
Transfers per hectare					US\$
EU	851	953	944	951	825
US	159	174	179	146	161
Japan	11,705	17,553	17,013	19,618	15,107
Canada	99	84	80	78	66
OECD	236	284	280	284	254

Source: OECD, 1997a

have been actively seeking trade agreements with other countries, on a bilateral, regional or multilateral level. The signing of a trade agreement in effect constrains future governments by raising the cost of a reversion to protection. Export interests are developed which are likely to resist such a policy reversal. In this case the reforms can be cemented both by an expansion of access into the North American market or by further

multilateral reform. It is in the interests of countries outside the region to encourage the multilateral path. Conversely, failure to continue the process of policy reform at the international level makes it more difficult to continue the current economic policies. Domestic agricultural sectors will argue that they should not be alone in having little protection in an incompletely-reformed world market. Any breakdown of the regional trade accords is also likely to encourage a resurgence of protectionism within Latin America. Agricultural trade in the region will be among the first casualties.

In Europe the process of “locking in” domestic reform takes a somewhat different form. The WTO schedules are beginning to constrain domestic decisions in the EU. The 1992 CAP reform was essentially designed as a way for the CAP to live with both external and internal constraints and pressures. Tighter external constraints will translate directly into more reform, however much domestic interests may protest. But in the case of Europe the proliferation of regional trade pacts is also putting pressure on the CAP. Both the extension of regional trade liberalization (i.e.: the Europe Agreements with prospective members leading to their accession to the EU, as well as the negotiation of free trade areas with the countries of the Mediterranean littoral) and the WTO

commitments are acting as very firm constraints on the Common Agricultural Policy (CAP). Policy makers are well aware of these linkages. The recently announced plans of the European Commission for

the near-term development of the Union, known as Agenda 2000, include some suggestions on changes needed to the CAP which are clearly framed within the WTO constraints, and indeed anticipate the tightening of those restrictions in the next round of trade negotiations (EU Commission, 1997). To relax this pressure would be to send completely the wrong message. It does not take much imagination to guess what impact any decision to postpone or abandon further talks on multilateral trade liberalization would have on the internal debate on the reform of the CAP. Even in the apparently internal matter of EU enlargement the WTO constraints play an important part. In addition to the budget cost of expanding membership to such large agricultural countries as Poland and Hungary, the impact on the EU's export subsidy limits has to be taken into account.<sup>11</sup>

Multilateral reform has another specific role in agricultural policy change in this region of the world. The countries of Central and Eastern Europe emerged from their long period of central planning and embraced relatively open markets. In agriculture the tendency in the past few years has been, however, to drift toward more protection both in anticipation of joining the EU and as a reaction to pressure on markets from dumped commodities and restricted access to nearby markets (OECD, 1997b). Such a drift toward protection

Table 4: Producer Subsidy Equivalent (PSE) and Nominal Assistance Coefficients (NAC), OECD Countries, 1986-1996

	1986-88	1995	1996
PSE (US\$ billion)	159	180	166
PSE (percent)	45	40	36
NAC (Producer Prices)	1.8	1.6	1.5
NAC (Consumer Prices)	1.6	1.4	1.3

Source: OECD, 1997a

<sup>11</sup> It can be anticipated that the EU's export subsidy limits would be revised, presumably by adding the allowable subsidies of the new members (less the subsidies on trade between old and new members) to those of the EU. But these countries often did not claim subsidies in their schedules adequate to cover their expected surpluses, in which case the WTO constraints will become tighter with enlargement.

is not in the interest of these countries but is difficult to resist in the light of EU accession.<sup>12</sup> The advantage of further trade reform now is that it can help these countries maintain a strategy of reasonably liberal policies in the interim, as well as pushing the EU to more open markets by the time they join. A further round of trade talks would be a significant factor in this strategy. It would support those that argue that the future for agriculture in the region is as a supplier of processed goods for the markets of central Europe rather than unprocessed goods to add to the unsalable surpluses of the western part of the continent. Hence a new round may help them escape the trap of excessive resources in inefficient agricultural sectors in which Western Europe has been caught for some decades and from which they only now are slowly emerging.

In the case of Canada, both regional and multilateral trade reform processes are helping to improve and cement the domestic policy shifts of recent years. The NAFTA agreement avoided some of the most sensitive issues, such as the highly protectionist provincial marketing boards for dairy products and poultry, but did much to free up cereal, oilseed and beef trade. The Uruguay Round Agreement on Agriculture forced Canada to tackle the issue of the provincial marketing boards by converting the non-tariff barriers by which they

<sup>12</sup> This is one of the few clear-cut cases of a direct conflict between the regional and the multilateral trade paths with respect to agriculture. At a time when these countries would like to maintain a relatively open market for agricultural goods, they are under pressure to introduce CAP-like policy instruments in anticipation of membership. Sweden actually had to reintroduce some market intervention measures when it joined the EU in 1994.

controlled imports to tariffs, albeit at a high initial level. Both NAFTA and the WTO put pressure on Canada to remove its long standing transport subsidies for exported grain. Canada has now moved to income payments for much of its farm support policies, and reduced drastically the involvement of the (federal) government in agricultural markets. However, more pressure from the WTO will be needed to get better market access for the products still highly protected.

In the US the link between domestic reform and the regional and international trade liberalization processes is more subtle. Congress has made it clear that "Farm Bills are not made in Geneva". Yet US agriculture is more than ever integrated into the world economy, and decisions which the US takes in the area of agricultural policy are conditioned by external events. Moreover, the Uruguay Round Agreement on Agriculture, though not demanding major short run adjustments to US agricultural policy, does constrain future policy options. The Farm Bill of 1996 mandated the establishment of a Commission to look at the future role of the government in agricultural markets. At one level, the WTO schedules and rules will obviously be in the minds of the members of that Commission, though one would not expect their public statements to make much of this link. At a more fundamental level, the US needs the discipline of stronger trade rules to help open markets overseas: it follows that strengthening those same rules will constrain US policies and help prevent the US itself from slipping back into the expensive commodity-based policies of the past.

The case of Japan shows clearly the possibilities and limitations of attempting to influence domestic policy reform by multilateral negotiations. On the one hand the opposition to the inclusion of domestic policies as a subject for negotiation was in line with the desire to avoid pressure on the internal pricing and distribution system which held the internal price of rice and several other products at very high levels. On the other hand the external pressure, from the US, Australia and other exporting countries, as

well as successive GATT rounds, has succeeded in opening up much of Japanese agriculture to imports and appears almost to be an accepted way for the Japanese government to make changes which would be difficult to accomplish in purely domestic discussions. Now that the internal marketing system is opening still further, continued external pressure seems to be more useful than ever in promoting these changes which are healthy for the Japanese economy as well as for exporting countries.

#### **4. Reducing Damaging Trade Conflicts**

Agricultural trade conflicts undoubtedly have weakened the trade system as a whole and the market for agricultural goods in particular over the past thirty years. Hudec (1993) has calculated that 43 percent of the disputes which came before the GATT in the years 1948-1989 related to agricultural products (a total of 89 agricultural disputes). Tangermann (1997) reports that there were 18 agricultural disputes before the WTO (29 percent of the total) in the period from 1995 to mid-1997. Agricultural disputes in both periods were far out of proportion to the value of trade, though perhaps not out of line with the level of protection and trade interference. The visibility and intractability of the agricultural disputes, from the Chicken War to the Beef Hormone spat, has set them apart.

Three sets of conflicts in particular have soured trade relations. The first is that between temperate zone exporters and the EU. Led by the US, those countries that export grains, dairy products and oilseeds have complained repeatedly about the CAP and its impact on world markets (Josling, 1993a). At first the objection was to the shrinking market in Europe, as trade diversion took place encouraged by the high trade barriers. Then the issue changed to the use of export subsidies as the EU tried to keep surpluses from depressing the internal market - and the US retaliated with its Export Enhancement Program (EEP) expressly targeted at those markets where the EU was increasing its share. A decision to abandon the use of export subsidies in a further WTO round would be the most

significant factor in building a more constructive trade relationship between the US and other exporters and the EU.

More recently some of the most contentious EU-US agricultural trade issues have been in the area of Sanitary and Phytosanitary Standards (SPS) and other more technical trade issues. These include the dispute over the import of hormone-treated beef into Europe, the potential ban by Europe of imports of beef by-products (“specified risk materials”) that may harbor vectors of Bovine Spongiform Encephalopathy (BSE, or Mad Cow Disease) and that over the regulation of the use and labeling of genetically-modified organisms (GMOs). Progressive removal of these irritants from transatlantic relationships would also be a major accomplishment of a new round of multilateral talks or alternatively of a bilateral deal. As such it would contribute significantly to the restoration of harmonious transatlantic trade relationships, long an objective of politicians on both sides.

The second broad set of complaints have to do with access by exporters into the growing markets of Asia. In part this reflects the rapid growth in this area, which is bound to cause some friction. But the root cause of trade tensions in these cases has tended to be not the expansion of domestic production of these countries but the high cost of imported goods to domestic consumers caused in part by an internal distribution system which has been seen as unfair to outside suppliers. Examples are the wholesale and retail systems in Japan and the shelf-life regulations in Korea. A further set of trade talks would have to deal with some of these issues, at least in so far as they were rooted in agricultural or food legislation as opposed to general structural impediments to trade.

A third set of trade problems is that which has arisen between developed and developing countries over the years. These include the generally constrained access of goods into the developed markets that might compete with domestic farm production, such as sugar and beef. More recently there have been conflicts over the methods of providing preferential access for the agricultural commodities (such as bananas) of

developing countries; the need for adequate supplies of cereals as food aid when world prices are high; and the impact on domestic markets in developing countries of dumped surpluses of dairy goods from industrial country producers. Each of these issues is ripe for settlement, and each would improve trade relations disproportionately to the amount of trade involved.

It is clearly worth taking steps to avoid conflicts and thus contribute to the strength of the trade system. Trade conflicts have high economic costs as a result of profitable trade forgone, in particular where there is a succession of retaliation moves by the parties concerned. Perhaps as important, such conflicts sap the support for the system, polarizing interests and leading to the notion of trade as a struggle between countries rather than a mutually profitable exchange of goods among firms and an expansion of choice at the lowest cost to consumers.

## **5. Including Agriculture in Global Trade Liberalization**

Trade liberalization rests on an implicit agreement among countries that all will gain from more open exchange. Individual countries have to reconcile domestic sectors to changes that will leave some industries facing more intense competition. Such internal political reconciliation will be made more difficult, if not impossible, if the government cannot point to some overarching national benefit that will follow from trade liberalization. In some cases this may be the fear of being left behind in the general process of global integration, but this is not a very satisfactory basis for constructive policy making. More positive motivation is probably needed. Countries need to feel that they gain from participating in a global trade system which protects their rights as well as giving them new opportunities.

In general the tariff levels on manufactured goods imported into developed countries are now low. Access is, however, often restricted by administrative protection through product standards and contingent protection through anti-dumping duties. Protection on manufactured goods

is often much higher in the developing countries, and access to the local market for services is often highly restricted. Trade negotiations nowadays often take the form of developing countries gaining more secure access into the developed markets, by limiting the scope for import restrictions, in exchange for better access to their own expanding markets through lower tariffs on imports from the industrial countries. Bergsten (1997b) has called this the “grand bargain” which may be necessary to give the political momentum for the next round of trade talks. This bargain, however, has include more than just the conditions of access for manufactured goods. It has to include services and intellectual property rights, and also extend to investment and competition, and at least be supportive of parallel activities undertaken to correct global environmental problems and prevent labor abuse. Above all it has to offer something substantial for developing as well as industrial countries and not be seen to be an imposition of a set of trade rules that favors a few countries.

The role of agriculture in this bargain is crucial. Despite the impressive growth in the manufacturing sector in recent years, it remains the case that

the bulk of manufacturing activity still resides in the high income countries, as shown in Table 5. The same is not true for agriculture, where developing countries provide over 60 percent of the world’s value added. Although export patterns diversify with development, non-agricultural exports are still a much smaller share of total exports for most developing countries than is the case with high income countries. The way the world trade system for agriculture develops is of strong interest to relatively few in the rich countries: it is the lifeline to development for many in the poorer parts of the world. As they develop they will make even more use of agricultural markets, as exporters and importers. It would be quite unacceptable to these countries to continue a system where the domestic farm policies of industrial countries dictated what commodities could be traded and on what terms.

Many of the most egregious instances of high levels of protection in world agricultural markets are still to be found in the developed countries, particularly the European Union, Japan and the United States, as are most of the policies that cause disruption on world markets. It is clear that those countries that are still heavily engaged in exporting agricultural goods on world markets will require the prospect of better access to these markets and less market disruption from their policies to agree to further trade talks. New Zealand and Australia have been the champions of this view, which was associated with the Cairns Group of small and medium sized agricultural exporters in the Uruguay Round. The Latin American countries will clearly continue to take this position, both at the multilateral (WTO) and regional level (as in the FTAA talks). The incidence of high tariffs in the agricultural sector,

**Table 5: Share of World Value Added in Agriculture and Manufacturing (percent)**

	<b>Agriculture</b>	<b>Manufacturing</b>
<b>Low income</b>	<b>29.2</b>	<b>5.9</b>
<b>South Asia</b>	<b>10.2</b>	<b>1.2</b>
<b>less India and China</b>	<b>8.5</b>	<b>0.8</b>
<b>Lower-Middle Income</b>	<b>20.2</b>	<b>6.8</b>
<b>Upper Middle Income</b>	<b>15.3</b>	<b>6.9</b>
<b>High Income</b>	<b>36.2</b>	<b>81.4</b>

Source: World Bank, World Development Indicators, 1997

relative to manufacturing, is a serious concern for such exporting countries.

Other developing countries depend on imported foodstuffs and will in addition need assurances that supplies will not be arbitrarily restricted or taxed. This is likely to characterize the view of many Asian and African countries, though they too are becoming concerned with market access for their agricultural exports. The threat of export taxes and quantitative restrictions by the exporters of basic foodstuffs is a significant constraint to the wholehearted commitment of importing developing countries to the international system. The persistence of the use of export subsidies by the developed countries gives concern to both competitive exporters and those countries that are trying to develop domestic sectors that are competitive with imports. An important part of the agricultural component of the bargain will therefore have to deal with both supply assurance and export subsidies.

The bargain however will have to include more than market access and export taxes. As countries move away from special preference schemes as a part of post-colonial development policy, more emphasis may need to be placed on investment funds to take the place of commodity-linked transfers. Investment on developing country agriculture is in itself likely to play a role in growth and in the emergence of a strong, competitive sector. Improvement in the conditions for such investment benefit both developed and developing countries. And as the larger economies of the formerly centrally planned world join the WTO, other countries will need assurance that they will benefit from the significant increase in the size of “world” markets without undue disruption.

The terms of the agricultural part of the “grand bargain” might therefore be that exporters of agricultural goods will have improved access to industrial country markets; that importers will have firmer assurances on continuity of supplies; that preferential schemes be phased out with adequate facilities for diversification; that new members enter with relatively open markets to share the benefits with all countries; and that

market disruption by export subsidies be finally curbed. This would indeed make a worthwhile counterpart to the deal between developed and developing countries on manufacturing and service trade

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### **III. New Issues and Challenges for Trade Rules**

To add to the pressures for continued reform of the agricultural trade rules, other challenges faced by the trade system have been mounting. These challenges include the entry of China, Russia, the Ukraine and other countries into the WTO, the future of preferential commodity agreements such as those run by the EU for its former colonies, the issue of state trading which has reared its head in a number of agricultural disputes, and the emerging topic of trade in the products of bio-technology. Each of these has a strong agricultural component. The prospective new WTO members are major players, actual or potential, in agricultural markets. Under what terms they join will influence the nature of those markets. The preferential agreements are almost always related to agriculture, and the way in which the countries that benefit from the current preferences can substitute other products for the traditional exports will be crucial to their transition. State trading is more widespread in agricultural markets than in other sectors, and more controversial. And the fact that an increasing number of biotech products are coming on to the market ensures that this challenge will grow in importance over the next few years.

#### **1. Entry of China and Russia into the WTO**

The application of China for re-entry into the WTO (it withdrew from GATT membership in 1950) poses very significant problems and enormous possibilities for agricultural trade, as for many other aspects of the international trade system. The problems are caused in particular by China's internal political and economic structure, where state-owned firms still produce much of the output, and the ability to trade internationally is

still tightly controlled.<sup>13</sup> The opportunities are the result of the huge market potential as a result of strong economic growth. China could become a major player in agricultural markets: the issue is under what conditions and rules will such trade take place.

The negotiations have dragged on for nearly a decade, with alternate periods of optimism and pessimism. However, they now seem to have reached the point where the terms of accession could be agreed sometime in 1998. Some transition period will no doubt follow before full application of all rules to China's trade, and the schedule of tariffs for China may also be phased in over time. The main issues are the degree of import protection and the activities of China's state-owned sector. The height of the agricultural tariffs that China binds will help determine the attractiveness of the import market and have an indirect impact on the pressure for import liberalization in other Asian countries. In particular, a China with a relatively open market for agricultural goods could lead the way towards a more liberal regime in a number of other countries in the region. The treatment of the state trading firms for agriculture, such as Cofco, will also be an important part of the overall arrangements for dealing with state trading in the WTO.

Russia has also requested to join the WTO, along with the Ukraine and several other parts of the former Soviet Union. The problems that will emerge when these negotiations get underway will have some of the same features. Other countries will be concerned with the role of the state and the extent to which exports can be subsidized or imports restricted by non-transparent state action. However, these countries have made major political reforms which make them "open" and less likely to cause fundamental conflict with WTO rules. One might anticipate somewhat more speedy negotiations than have been the case with China. By the time

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<sup>13</sup> Some of the major issues in the debate on China's entry are discussed in Morici, 1997.

the next round of agricultural talks are coming to a conclusion, one might expect Russia and some other FSU countries to be members of the WTO.

## **2. Commodity Preferences for Developing Countries**

The world market for agricultural products is littered with commodity-specific preferential access schemes left over from the post-colonial period, where trade policy was designed to help the development of newly-independent countries. The system of non-reciprocal preferences has probably run its course. The preference systems tend to direct trade along particular channels which may have had an historic justification but which discourage innovation and diversification. The degree of preference itself will be reduced over time with liberalization, thus possibly leading to perverse arguments for maintaining high protection as a form of aid. Principles of non-discrimination are likely to be more rigorously enforced in future, requiring continuous applications for waivers for any schemes which favor particular groups of developing countries. Strengthening the application of Article XXIV, under which free trade areas and customs unions are allowed to violate the “most favored nation” principle of the WTO, will also put pressure on non-reciprocal preferences. Where the preference schemes are enshrined in TRQs in the WTO schedules, there will be a tendency to expand those TRQs as a part of trade reform, thus further diluting the benefits to the targeted countries.

The change from the present preferential system to one where the countries concerned grant and receive no preferences could be painful. The preferential quotas certainly have a value to the producing country which they can hardly pass up. The sale of bananas from the Windward Isles to the UK is facilitated by the elaborate licensing system which allows firms that participate in that trade also to sell more profitable bananas from Central America. Sugar from Jamaica and Trinidad would not be nearly as viable if it all had to be sold at world market prices. But on the other hand full access into the EU (and the US) markets without quota limitations could be even more lucrative, where domestic prices are kept high through

protection at the border. And compensation for loss of preference in the form of investment guarantees could be in the medium run as beneficial to the overseas banana and sugar supplier as compensation to the Mexican corn producer or the Japanese rice farmer as price supports are cut back.

What would help is a generally acceptable approach within the WTO to allow the winding-down of these preference schemes as a part of the general process of trade liberalization. To put it another way, one may need to devise rules similar to the concept of the “green box” for payments that would substitute for the transfers currently generated by preference schemes without the trade distortions. A solution to the “banana problem” and a long term reform of the world sugar market may both depend on such a scheme. This issue may not come up in the new round, but it will be under discussion at the same time and could influence the trade environment for some countries more than the multilateral talks themselves.

## **3. State Trading**

State trading poses another set of issues for the members of the WTO as they prepare for the new round of negotiations on agriculture. The tariffication of non-tariff barriers has highlighted the difference between import systems based on private trade, where tariffs directly influence trade decisions, and parastatal import arrangements, where the decisions are made on other grounds.<sup>14</sup> On the export side, the specification of export subsidies has made more apparent the difference between private trading and government sponsored export monopolies. This has surfaced in recent months in particular with regard to the Canadian Wheat Board, a state controlled single-desk selling agency for much of Canada’s grain, which is thought to have some commercial advantage over private traders

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<sup>14</sup> The introduction of TRQs has also increased the scope for state trading, as the lucrative quota rents can be distributed to parastatal organizations.

in world markets. The entry of China, Russia and the Ukraine to the WTO brings with it the fear that these countries have state control of imports (and in some cases exports) which will frustrate attempts to reform the trade rules. The issue of state trading will therefore be high on the agenda at the multilateral level. There will clearly be an attempt to regulate the use of market power in trade by parastatals. The question is what can one do and how can one do it?

That the state trading institutions are significant economic entities in trade is not in doubt. Table 6 gives the trading position of the top nine STE importers of agricultural products. With the exception of CONASUPO, which has lost most of its functions but still imports milk powder into Mexico to supply the domestic market for liquid milk, all the other large STEs are in Asia. Cereals and oilseeds dominate these large corporations, reflecting the trading patterns of the region. All have strong political support in their own country but are suspected by exporters of undersupplying the domestic market to boost prices. The value of trade of the major export agencies is shown in Table 7. The eight largest each has exports of over \$300 million. With the exception of China these are all in developed countries which pride themselves to be efficient exporters with an

interest in open markets.<sup>15</sup>

The first choice is whether to address the existence of state trading agencies or to regulate their behavior. Despite widespread adoption of neo-liberal trade policies, in particular in Latin America, it seems implausible that the members of the WTO would opt for an outright ban on managed trade. Too many countries would have to abandon too many powerful domestic agencies.<sup>16</sup> Currently WTO articles try the second approach, though without notable success. Article XVII of the GATT, clarified by but not essentially changed in the Uruguay Round, states that such state trading enterprises that exist should be notified to the WTO. These enterprises are expected to take decisions based on commercial considerations. Beside the ambiguity of what constitutes a “commercial”

consideration (after all, making use of market power is intrinsically commercial), the admonition is somewhat unrealistic. If a government establishes a state trading monopoly, one

**Table 6 : Major STE Importers**

Country	STE	Commodity	Annual Purchases \$ million
Pakistan		rice	1,437
China	Cofco	wheat	1,286
Japan	JFA	wheat	1,238
China	Cofco	oilseeds	1,140
China	Cofco	cotton	758
Indonesia	Bulog	wheat	608
Japan	JFA	rice	507
Mexico	CONASUPO	milk powder	442
Korea	LMPO	beef	412

Source: ERS, USDA

<sup>15</sup> With the exception of Pakistan, each of the largest importer and exporter STEs is in an APEC country, which suggests that this forum would be particularly appropriate for discussing the problem.

<sup>16</sup> The most one could hope for is an agreement, in principle, that such agencies should not be created anew without some form of compensation to affected parties.

can assume that it intends to use its monopoly power. Given that market advantage, a state trader is unlikely to conduct itself in the same way that a private firm would. As one might expect, little use has been made of this article to modify the behavior of parastatal agencies.

Just as tariffication has exposed the issue of state importing, it might also have clarified its solution. In particular, the abolition of non-tariff barriers has reduced the legitimate functions of the parastatals. A little-used article in the GATT/WTO states that no mark-up from a state trading importer should be larger than the bound tariff (Article II(4) of the GATT). In the past countries were able to circumvent this by claiming that the parastatal was administering a non-tariff barrier. In any case, relatively few agricultural tariffs were bound. In a regime of bound tariffs and no non-tariff barriers, this defense collapses. It should be fairly straightforward to

compare mark-ups with bound tariffs in the future and require state traders to sell imports on the domestic market at no more than the border prices plus the tariff.<sup>17</sup> Moreover, in this situation countries are obliged under GATT rules to abide by the language of the Havana Charter which mandated full disclosure of import costs and profit margins of state import firms and stated that the agencies themselves must import supplies adequate to meet “full domestic demand” for the product. A strict

<sup>17</sup> This approach highlights the importance of reducing the very high rates of tariff: there is little point in holding state traders to such disciplines if the tariffs are too high to allow any trade.

interpretation of this provision would make it very difficult for countries to use such agencies for substantive protection of the domestic market.<sup>18</sup> This approach may not require further negotiation, as it rests on the vigorous

application of current trade rules.

A third approach to reduce the incidence of managed trade by parastatals is to challenge the source of their power rather than their existence or behavior. For instance, one could agree to end the monopoly on imports by state trading agencies. They could

continue to exist but not have exclusive import rights. Countries could for

**Table 7: Major State Trading Exporting Agencies**

Country	STE	Commodity	Annual Sales \$ million
Canada	CWB	wheat	2,900
New Zealand	NZDB	dairy	1,800
Australia	AWB	wheat	1,400
Australia (Queensland)	QSB	sugar	925
China	Cofco	corn	704
China	Cofco	sugar	368
Australia (New South Wales)	NSW	rice	361
Canada	CWB	barley	301

Source: ERS, USDA

<sup>18</sup> This would move far beyond the binding of the mark-up as already incorporated for countries such as Japan and Korea in the Uruguay Round schedules. Indeed the process of tariffication should have already done this for most countries. So long as the quantities of imports do not respond to the reduction of the tariff or mark-up, the benefits are not felt by other countries. Only the size of the transfer between domestic consumers and taxpayers is affected. But by comparing import and domestic prices and requiring imports until the difference does not exceed the bound tariff means that the state importer will in effect be acting as if there was private trade over a fixed import tariff.

instance agree to allow private firms to compete with the state trading body as a component of the further liberalization of trade. This would incidentally improve the ability of other countries to monitor the performance of parastatals and generate some vested interest in liberal trade within the importing country.

Yet another way to reduce the market power of a state importer is to expand the quantity of imports until the monopoly power has no effect. Expanding the TRQs, for instance, could well prove an effective approach to the issue of state-controlled imports. The key is to expand the TRQs beyond the quantity which the state trader would choose to import. Expanding TRQs weakens the parastatals' ability to keep prices high; the lower tariff of the TRQ becomes the determinant of the quantity imported. Moreover the TRQs arising from tariffication and the minimum and current access provisions could be allocated to the private sector and not to the parastatals. Parallel imports would in this way erode the quantity control aspect of managed trade.

Despite the trade frictions which seem to surround exporting state traders, such as the marketing boards for wheat and dairy products, the application of current trade rules should be even more straightforward in this case. The concern about state trading exporters that is likely to be high on the agenda for the next round arises from the suspicion of covert subsidization of exports. The resolution should therefore be a straightforward matter of measuring and restricting export subsidies. The practice of financial assistance to exporter boards is explicitly included as an export subsidy in the Uruguay Round Agreement, and the sums involved in the past should have been entered into the Schedules. Countries can continue to subsidize up to this level with impunity. If the process of restricting such expenditures continues, then the issue of the subsidized marketing board will vanish. Some state export activity arises from the presence of state importers and some from the existence of export subsidies in other countries: removing the monopoly power of the importing parastatal and

curbing export subsidies may reduce the attractiveness of the export board as a marketing device. Somewhat more tricky is the situation where marketing boards define "domestic" and "export" grades as a way of charging a higher domestic price. Such two-price schemes, along with price pooling and other devices, were supposed to be included as export subsidies and therefore controlled. But some clarification may be needed either to the Agreement itself or in a subsequent code on parastatal exporter behavior.

#### **4. Agricultural Trade and Biotechnology**

Agricultural trade reform will have to proceed in the context of a set of other issues, related but not central to production agriculture. These include such topics as the differences between labor laws in different countries, divergences in environmental regulations and disparate standards and technical norms. Every now and then an issue emerges which cannot be so easily dismissed. The question of the public's acceptance of the products of biotechnology is one such issue. As more and more crops are planted which incorporate some form of genetic modification, the greater is the likelihood of a major confrontation between trading partners. The question seems at the moment to revolve around a simple but fundamental choice: should one take into account consumer sentiment (as opposed to hard scientific evidence) when setting import (and domestic) standards.

The two sides of the argument are clear. From the point of view of trade policy, any rule-based system has to guard against implementation which reacts to the headlines of the day and pressure from those groups looking to manipulate consumer opinion for other purposes. The SPS agreement appeared to put in place the principle that scientific evidence is required to justify a stricter standard than those in international use. From the point of view of politicians, however, consumer confidence and voter sentiment are not unconnected. It may not be wise to appear to be bowing to a ruling from a panel of trade policy experts (themselves possibly swayed by evidence from vested interests) in the face of adverse public opinion.

Politicians are the servants of the public and not answerable to trade dispute panels. A third interest is the business firm in the exporting country, which on the one hand prefers not to have to hurdle different barriers to each market, based on inconsistent standards, but on the other hand is not averse to differentiating the product to gain a higher price from the more discriminating part of the market. A fourth participant in the debate is the domestic firm who stands to gain from the trade restriction.

How might this clash be resolved? The trade system needs to maintain credibility and support from politicians and even the public. To attempt to go against public sentiment would be to risk this support. But national politicians should also explain to the public the benefits of a rule based trade system where some degree of objectivity is a small price to pay to avoid the chaos of each country attempting to impose seemingly arbitrary regulations on others. They would after all have no trouble explaining the same concept if it were suggested that each city have its own trade rules.

The circle can be squared in the case of the products of biotechnology by ensuring that each national regulatory body has the confidence of consumers and the public and is neither under the influence of self-interested local producers nor captured by political movements that have agendas broader than public safety and information. These national bodies should themselves be involved in the dissemination of information reflecting scientific consensus. They should also assist in the construction of international standards that they can recommend to governments to accept. They should work with the industry to devise appropriate labeling systems which would give consumers the choice when controversy surrounds the properties and consequences of particular foods. In other words, if the national regulatory agencies adopted a science-based approach, the problem would not show up as a trade friction. This is only likely to happen if those bodies themselves are free of direct influence from vested interests

(on both sides of the issue) and have their independence guaranteed by governments.<sup>19</sup>

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<sup>19</sup> Of course how the participants in these national “FDA-type” agencies are chosen will be important in determining whether they will really solve the dilemma.

## **IV. Next Steps in Agricultural Trade Policy Reform**

### **A. Further Steps in Domestic Reform**

Domestic policy reform clearly laid the way open for regional and multinational trade policy changes. The first question which one must ask of the recent policy changes in the industrial countries, in particular in the EU and the US, is therefore whether the farm policy reforms are “permanent” or just the latest twist in the endless saga of these programs. If a policy change is a short term expedient masquerading as reform, the tendency will be to revert to type as soon as conditions allow. Will these policies in, say, 10 years time look like an evolution of the reformed policies, or will they resemble the policies of the early and mid 1980s? Should they be thought of as the latest variant of the old entitlement approach to farm programs (not based on need but on participating in a program) or the first glimpse of a “new age” policy which takes the government out of making farming decisions, shifts payments to people rather than hectares, and “buys out” the political obligation to commodity and farm groups.

#### **1. The Permanence of Reform in Developed Countries**

In the case of the US there is still some doubt about the longevity of the reform engendered by the fact that the underlying legislation, the 1949 Agriculture Act, is still on the books. Failure to enact new legislation in the year 2003 will cause the policy to revert to the permanent legislation. This threat (since the 1949 Act would create an expensive chaos) has been the stimulus for the timely passage of the past many farm bills, but it is not clear how credible it is. It would surely be more likely that a compromise

bill could be put together whenever needed. The main reason why the failure to repeal the old legislation in 1996 was important was that it missed the opportunity to clear the political decks. The fact that there has to be new legislation is itself an important advantage to those that will argue for the revival of traditional farm programs. The Commission that is to recommend the appropriate role for government in agricultural markets at the end of the seven years will have to propose something: they will find it less easy to dodge the issue.

The issue can be put in a different way. Is it likely that the coalition that has kept farm programs in the US going long after general support in the urban areas had dwindled can stay together and bring back price supports? The coalition relies on the cohesion of commodity groups despite their widely differing interests, solid support from the (relatively few) Congressmen from overwhelmingly rural constituencies, and the unlikely alliance with those supporting the food stamp program. The coalition is beginning to look shaky. The commodity groups were not united on the occasion of the 1996 Farm Bill. Most of the pressure for the FFA came from Midwestern cereal and oilseed interests, whereas dairy, sugar, peanuts and other powerful sectors provided lukewarm support or outright opposition. In the end separate deals were cut to placate the sugar and dairy lobbies. Next time around it seems unlikely that the arable interests will come running to support these sectors from the reformers’ axe.

CAP reform is also likely to be permanent for rather different reasons. Both internal and external forces will act to keep the policy from backsliding. Internally, the benefits of a lower cereal price are clearly evident to the livestock sector, and the renewed use of domestic grain in animal feed has made market management easier. Externally the GATT agreement, and the schedules of export subsidies incorporated into the EU’s bindings, add up to an effective brake on any significant recidivism. And if the EU is to welcome new members in the first decade of the new century, the policy needs to be able to accommodate such changes. The

enlargement of the Union will leave no room for the type of policies that the EC6, the EC9 or the EC12 pursued for many years. A Union of 20 or more will neither be able to afford the expenditure nor be able to justify the economic costs of such a policy. Of course the CAP could be “rescued” by the device of a “green wall” around the existing member countries and using border taxes as a way of preserving a higher price level for those countries. But the political implications of this type of solution are worrisome. The message would be sent that agriculture is valued highly in the existing members but not in the new members. Any semblance of equity would be lost if the agricultural exports of Hungary and Poland cannot sell freely in Germany after accession. In other words political reality will require the CAP to change to allow for enlargement, which will in turn lock in the second round of reforms.

Another way of looking at the question of permanence concerns the instruments used in the reformed policies of the US and the EU. If the policy reforms are to become permanent there has to be an agreeable set of instruments which address the continued problems of the rural economy. Without such instruments the removal of price supports is essentially dependent upon favorable (i.e. firm) world market price levels. The armory of possible weapons for dealing with rural employment, farm income levels and social stability is extensive. Unfortunately most of it is untested or tried only on a small scale. The fate of decoupled payments over time is itself uncertain. Will they become truly portable, attached only to the individual that was first the recipient? That may have some implications for land prices and raise some interesting landlord-tenant problems. Will they become salable? If the payments are portable assets, there is no reason why they should not be sold to others, presumably at a discount reflecting the credibility of the commitment to future payments. If they did become portable and salable, the impact on the rural economy could be significant, as investment shifted from agriculture to other areas. Will they become truly green, being tied to environmental farming practices? This is certainly the way the EU is pointing, but it remains to be seen whether the farm

interests will object to the layer of supervision necessary to make significant payments in a fair and effective way. Will farm income stability be dealt with by other instruments? Crop insurance is likely to be one such instrument. But farmers in the US are experimenting with a variety of monetary instruments for offsetting risk, such as the use of options-based contracts. The terms of sale of farm products could over time evolve to include more such contracts. Income insurance and tax equalization schemes can prevent the major swings in income that often beset the farm sector.

A third way of phrasing the “permanence” question is to ask whether the new policies are compatible with the development of regional trade agreements and the process of market integration in the Americas and in Europe. If they are, then that reinforces their legitimacy and increases significantly their chances of permanently replacing the old price support policies. NAFTA has made a start in pointing the way to a single agricultural market in North America, and MERCOSUR is pursuing the same path in the South. The 1996 Farm Bill makes a significant contribution to this process by reducing the involvement of the government in supporting prices. One could imagine a free market in cereals and oilseeds and perhaps beef in the next few years. Nevertheless there will be frictions over sugar and over fruits and vegetables, as well as over dairy products. In these areas the Farm Bill makes only a hesitant step towards regional market integration.

In the case of the EU there is little doubt that the MacSharry reform made the economic integration of the European economies, west, central and east, markedly easier. By lowering the price level and compensating with direct payments, it is less likely that the market will have to be kept segmented between east and west. That is not to say that there will not be problems of further integration of agricultural markets. There will always be those in the existing EU that will object to the importation of goods from the new members. After all, French farmers still protest against agricultural

imports from Spain, Italy and the United Kingdom on the smallest pretext. But the political imperative to allow the Central European countries access to Western markets will over time allow the economic benefits of specialization and trade within the enlarged EU.

Another aspect of this question is whether the policies as reformed are compatible with the parallel reform of the multilateral agricultural trade system and the adoption of a new set of rules under the WTO. The MacSharry reform of the CAP qualifies clearly, as its enactment made a conclusion of the Uruguay Round possible. However, as emphasized before, the trade reform has so far only succeeded in the establishment of new rules (no non-tariff barriers, no new export subsidies and a definition of acceptable domestic subsidies) and hardly touched the level of protection. Access to markets is still more highly protected than in other traded goods. But there has been an important change in the ability of domestic policy to survive trade negotiations. When the major countries had to calculate the impact of trade agreements on their own ability to manage markets, the negotiations over substantive trade liberalization were difficult. But the reformed policies for cereals and oilseeds in the US and the EU have changed this situation. Management of the market through border intervention, at least for these commodities, is no longer so central in a policy of direct payments, income insurance, and rural development grants.

Is the FAIR Act, then, the policy change that makes a liberal global trade system possible for agriculture? It could be, if the US negotiating position in the 1999 Round of the WTO is strengthened and if it has not needed export subsidies in the meantime. The EU runs the risk of being isolated in the WTO if it does not respond by further modifications of the CAP. The “blue box” in which the US and the EU agreed to shelter their deficiency payments and compensation payments from reduction and challenge will now be occupied only by the EU. Hence the pressure to get rid of this anomaly will be irresistible. The new Round will include pressure to

continue export subsidy reduction, to improve market access, and to achieve further reduction in AMS. There are reasons to hope that on this occasion the necessary shift in EU policy to bring it into conformity and strengthen its bargaining position will take place without the six years of contention and confrontation that characterized the Uruguay Round negotiations.

## **2. Prospects for Further Reform in Asia**

It is central to one of the arguments for further agricultural trade reform that domestic policy in Asia is at a critical juncture. The developing countries in the region are at a stage in their own development where the taxation of the agricultural sector is being reduced, through macroeconomic and trade policy reforms. Marketing and distribution systems are in the process of being deregulated and privatized. But there is considerable pressure to protect agriculture against the success of the more dynamic sectors of the economy, rather than encouraging the rural sector itself to be among the leading sectors. To overturn the long history of exploiting the agricultural sector has taken a major shift in economic and political philosophy. The greater danger now is that the agricultural sector be given undue protection, distorting the economy in the other direction, taxing the non-agricultural economy through a regressive levy on foodstuffs and employing the countries’ natural resources in a way that does not add to national income.

The advanced industrial countries in Asia, Japan, Korea and Taiwan, who have already experienced a period of high price supports, have not yet undergone the same transformation in the agricultural policy paradigm as have the Americas. Direct payments are a much smaller part of farm support. The question is whether it is reasonable to expect these countries to follow suit or to take a different path. One key to this lies with the future of Japanese policy. Japan has a reputation, well deserved, for having one of the most protective agricultural policies in the world. Only Switzerland comes close to the degree of protection afforded by Japanese policies. And

yet these policies are of relatively recent origin, stemming from the 1960s, and are beginning already to be modified. A bold move toward decoupling of income payments from commodity output would send the signal that that country were prepared to allow imports to compete with domestic output, even if that meant that existing farmers were to be indemnified against income loss. The message that imports are a legitimate source of food for consumers and that a country best guarantees its food supply with a healthy economy and an integrated trade system, rather than with high cost staples, would have considerable impact on emerging countries in the region.

A decision by Japan to continue the deregulation of the wholesale and distribution channels and to allow private firms to import all agricultural goods would also send a strong message to its Asian neighbors. Obviously, countries may well differ in the role chosen for the government to play in the agricultural and food system. But this role is rarely going to be the subjugation of private marketing in the name of administrative control of domestic prices. Modern food systems are far too complex for such administration by government agency. Japan has taken so long to free up its distribution system not because the country needs the paternalism of state-distributed food but because powerful interest groups could continue to make money and exercise control through the parastatal mechanism. Parastatal agencies still permeate the agricultural and food sectors of a majority of Asian countries. If the trend toward deregulation and privatization in Japan were to continue, then one can expect other countries in the region to join the train.

These two strands will of necessity come together over the next few years. If Japan, Korea and Taiwan do indeed move to free up imports, shifting the burden of support to targeted payments from the tax base and at the same time encouraging private trading of basic foodstuffs, then the developing countries of the region will know that they have markets that they could penetrate if they can meet required quality standards. China and

Thailand have already begun to exploit these opportunities. Japanese and Korean investors in turn could invest in the growing agricultural and food processing sectors in those countries, as could US and European companies. Conversely, a lack of willingness to open markets and maintenance of tight control over internal food markets will discourage others in the region from developing competitive farm sectors of their own.

China holds another key to the agricultural trade policies of the region. Here the story of reform goes back to the introduction of an incentive system in rural areas which prevented widespread famine and put the country on the road to modernization. Unfortunately, the government kept tight control over the marketing of grains, even while allowing individual farmers to make production and storage decisions. The Grain Bureau of the Ministry of Commerce (since 1993 the Ministry of Internal Trade) “purchased, transported, stored, milled and retailed grain” (Crook, 1997). In 1992 Beijing introduced market reforms, partly to reduce budget costs but also to improve efficiency. Most of the provinces ended grain rationing, and consumers paid market-determined prices. Imports increased dramatically, causing the government to reassert some control over the market. When domestic prices rose in 1994, the government reinstated price controls. In late 1994 the central government shifted the responsibility for grain marketing back to the provinces. Each province is responsible for “stabilizing the area sown with grains; guaranteeing investment inputs; meeting central government stock targets; ensuring grain transfers among provinces; stabilizing grain supplies to urban areas; minimizing inter-provincial grain price differentials; controlling commercial grain sales; managing grain imports and exports; and elevating the level of self-sufficiency” (Crook, 1997). This “governors’ grain bag responsibility” policy illustrates the dilemma in which China finds itself, poised between a market economy with administrative oversight and a command economy with limited private incentives. How the policy develops will shape the agriculture of the whole Asian region and influence markets well beyond.

## ***B. The Regional Path to Freer Agricultural Trade***

The growth of regional trade pacts which started in the mid-1980s has posed a number of problems for the global trade system. Even now, the interaction between the regional and the multilateral trade liberalization process is one of the most important structural issues facing the WTO. It was initially feared that the spread of regional trade pacts would threaten the multilateral system. At the low point of the GATT negotiations, in 1991, there appeared to be a distinct possibility that the world trading system was moving towards one of trade blocs. The most usual scenario projected a European Bloc, based on an expanded European Community, an American Bloc, built on NAFTA, and an Asian Bloc, with Japan as the key economy (IMF, 1991). The three-bloc scenario caused considerable concern among economists as well as trade diplomats, not least that such talk might jeopardize the Uruguay Round itself by holding out the prospect of an alternative to the GATT system. One negative feature of such blocs was their presumed propensity to exclude or discriminate against trade or investment flows from each other. Trade wars could easily erupt under such circumstances, to the particular disadvantage of the smaller countries within the blocs. Countries outside the blocs would presumably hasten to be included, to at least get some shelter from the trade hostilities.

Success in the Uruguay Round has eased the fears on this score: the strengthened multilateral system represented by the WTO offers some defense against the warring continental blocs. Despite the risks associated with setting up regional preferences, the consensus now appears to be that no great damage has yet been done. Most of the recent regional trade agreements, in particular those conceived under the rubric of “open regionalism”, conform with the requirements in the WTO that they cover most traded commodities and do not involve an increase in tariffs against

non-members. As most of them have been formed in conjunction with liberalization of external trade, they might reasonably be expected to promote efficiency rather than shelter inefficiency. However, concerns remain that the proliferation of such agreements can impede liberalization, and that such technical devices such as “rules of origin” can be captured for protectionist purposes.

If one accepts the liberal purpose of the “open” regional agreements then they can be complementary to multilateral liberalization and become an alternative path to a similar end. The question is not one of choosing between the two but making best use of the advantages and disadvantages of each modality. The issue of the relationship between regional and global trade negotiations can therefore be usefully linked with the question of the scope of the negotiations. Three different levels can be identified, including unilateral trade policy decisions (where any negotiations are internal to the country making the change), regional talks (including bilateral and other group arrangements), and multilateral (in the WTO or other such body) negotiations. The scope of the negotiations can either be on a sub-sector or commodity basis, a sector or industry level or multiproduct in coverage. The matrix of nine negotiating level and scope combinations is shown in Table 8. At one extreme are unilateral decisions on trade policy (such as the height of the tariff) which have the advantage of speedy implementation, but may lack political support at home, as none of the exporting interests that will stand to gain are made party to the decision. At the other extreme, multisector global negotiations allow the maximum possibility for trade-offs and deals and include gainers as well as losers, but seem to take forever to complete and may in some cases hold back progress in policy reform as countries try not to “give away” trade barriers without getting something in return.<sup>20</sup> The question facing trade strategists

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<sup>20</sup> Robert Paarlberg has made a convincing case that such negative impacts on domestic policy reform can take place. However, calculation of “credit” for

at present is what the role of the regional and other intermediate levels of negotiation should be, and what should be the scope and coverage of those talks.<sup>21</sup>

Commodity or sub-sector agreements on a regional basis have often been used for granting preferences to specific developing countries and as discussed above have become less acceptable (and less useful) as the global economy becomes more integrated. Global commodity agreements have a long history but were usually illiberal in intent and infeasible in operation. The heir to this tradition is zero-for-zero agreements in particular commodity areas, as a way of getting progress where broader sector pacts are impossible. Whilst better than schemes to keep prices artificially high, such narrow schemes do suffer from the economic defect that they distort markets and the political drawback that they may let other sectors “off the hook”. In agriculture as a whole, single-commodity trade policy talks are somewhat unlikely to be fruitful except in special circumstances.<sup>22</sup> Broader, sector-level negotiations, covering groups of products, have also been seen as a way forward with trade liberalization. These are sometimes

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reform taken unilaterally since the Uruguay Round should be possible and would reduce the temptation to avoid needed domestic policy change.

<sup>21</sup> This perhaps makes the choice more logical and ordered than it is in practice. An alternative, less structured view of the process is implicit in the remark attributed to former US Trade Representative Carla Hills, “we will attack every trade barrier where ever we find it.” Nor should one discount the political motives for trade liberalization within regions which may dominate the economic considerations. Such political integration can borrow the language of trade liberalization but is in effect a separate process.

<sup>22</sup> One such circumstance might be a coordinated push from the private sector in a range of countries for free trade in a particular product. This could be the situation in the case of oilseeds. But then the issue of the terms under which non-participants in the agreement are treated becomes crucial. If not expanded on an MFN basis, the zero-for-zero becomes discriminatory.

discussed first at the regional level and “offered” to other WTO members for their participation (as was the case with the recent Information Technology Agreement). An agricultural sector initiative of this type would be worth contemplating, but one would have to make the case that it is easier to persuade, say, reluctant European importers join an agricultural trade pact negotiated by an Asia-Pacific regional group dominated by exporters than to have the same debate between the same parties in the WTO.

The choice between regional and multilateral trade approaches more usually refers to negotiations with a multi-sector or economy-wide scope. The merits of the regional trade path depend on the balance between the positive effects of trade creation, through the reduced protection in the import-competing sectors, and the negative effects of trade diversion, as higher-cost partner goods muscle out efficient third country suppliers. If the degree of external protection is low the trade diversion is likely to be small. If the low-cost suppliers can join the regional bloc, then trade diversion will also be reduced. “Open regionalism” is a phrase that has come to be used for some combination of low external protection and open membership and in addition meets the demands of the WTO, namely conformity with Article XXIV of the GATT (Bergsten, 1997).

Regional trade agreements themselves are not static institutions, nor are they passive participants in world trade. Few have kept the same membership for long, and all have evolved as a result of both internal and external dynamics. One such external force began to emerge piecemeal in the early 1990s. This was a new set of trade pacts which could be called network arrangements, which link free-trade areas by means of treaties among the blocs. The best known case was the European Economic Area (EEA), between the EU and the EFTA countries, which granted free movement of goods, services and factors between the two blocs. The structure was intended as an alternative to EU membership for the EFTA countries at a time when they had foreign policy objections to joining the

Union.<sup>23</sup> Another variation on the same theme is the Latin American Integration Association (ALADI) scheme in Latin America, a framework

agreement which is a

descendant of the original Latin American Free Trade Association (LAFTA). Regional groups are encouraged within ALADI, subject to common rules, but in addition individual member states can enter into economic cooperation agreements with each other and give limited preferences for imports from other members.

The major architectural innovation of the mid-1990s was to transform these networks into trade agreements that span the continents. This new breed of supra-regional agreements such as APEC and the FTAA are different from traditional regional trade blocs in that they have overlapping membership and join rather than isolate continents. The fact that a country can be a member of more than one such agreement is the key in this regard. They can include both countries and existing trade agreements as components. This new trade structure, if it survives, will no doubt undergo further development. The New Transatlantic Agenda, at present concerned with such issues as mutual recognition of standards and testing, could become a pre-cursor to a more formal agreement between the US, Canada and the EU. The EU and

Asia will no doubt find it in their interest to conclude agreements of their

Table 8: Matrix of Negotiating Options

	<b>Unilateral</b>	<b>Regional</b>	<b>Global</b>
<b>Commodity</b>	No tradeoffs; liberalization only likely if no domestic production or if domestic users can show over-riding national interest	Used as a way of granting preferential rents to selected exporters; distortions can be caused in exporter economy	Zero-for-zero on particular products; distortion from uneven protection; more likely on input items where strong interests in low prices exists
<b>Sectoral</b>	No inter-sector tradeoffs; injured parties can block liberalisation; no exporter interests engaged; uneven protection if "easy" sectors liberalized first	No inter-sector tradeoffs; danger of trade diversion and of uneven protection; excluded sectors may be let "off the hook"; contrary to Article XXIV	No inter-sector tradeoffs; no trade diversion but uneven protection likely; excluded sectors may be let "off the hook"
<b>Multisectoral</b>	More "equity" among import competing sectors but still no exporter interests engaged	Trade diversion a problem, along with investment diversion and "attention diversion"; could be faster way to get agreement; MFN issue becomes key	No trade diversion; less problem with uneven protection; could be slow way to get to agreement on trade liberalisation

<sup>23</sup> This idea of a network was suggested in some quarters as an approach to Asian trade integration, with the components being NAFTA, the CER and ASEAN (see Holmes and Falconer, 1992).

own to avoid the implications of the pivotal position of the US, just as the EU and MERCOSUR have been actively discussing such an agreement.<sup>24</sup> These supra-regional agreements go some way to meeting the objections of trade economists to the narrower regional blocs. They are large enough to contain low-cost suppliers of most products; they can absorb new members easily; and so far each has bent over backwards to be compliant with the WTO. In this sense they are each examples of “open regionalism”.

The new type of supra-regional trade architecture is particularly interesting from the perspective of international trade in agricultural goods. It was never likely that a three-bloc world of Europe, the Americas and Asia would have dealt very effectively with the issues of world trade in agricultural products. The blocs were bound to have taken very different views on such trade, and inter-bloc tensions would have prevailed. A European bloc was unlikely to have yielded to the American bloc any more by way of agricultural trade liberalization in direct inter-bloc dealings than could have been achieved in the WTO. Similarly, it was not clear that an Asian bloc that included Japan but not the US and Canada would suddenly have become more willing to liberalize trade in farm products. The historical tensions would all have been preserved in the interface between the Continental blocs.

By contrast, the supra-regional processes which span the regional blocs will not be able so easily to dodge the issue of agriculture. The problems of agricultural trade will tend to be internalized by the nature of the processes. The US, for example, could become a member of at least three trade pacts (the Americas, Asia-Pacific and Transatlantic) together covering all the major markets for its goods. The pressure to include agriculture will come

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<sup>24</sup> The free trade agreement between MERCOSUR and the EU is expected to be signed in 1999. The extent to which agricultural goods are included is an obvious sticking point in these talks.

from the lack of political support for any agreement that excluded a major sector of US exports. The way in which it is included will also tend to be liberalizing for agricultural trade on world markets, as other exporters would quickly have to conform in order not to lose out on the major markets of the world.

## **1. Regional Agreements in the Americas**

Latin America was an early convert to the regional camp. The Latin American Free Trade Area (LAFTA) and the Central American Common Market (CACM) were both established during the first “wave” of integration, following the lead of the European Economic Community (later the EU) and the European Free Trade Association (EFTA). Later the Andean countries decided to split off from Brazil, Argentina and Mexico to form the Andean Pact (AP). Each of these groups followed a similar economic policy based on import substitution, particularly for manufactured goods, in an attempt to catch up with the industrialized West. This strategy called for high protection against imports from third countries. Agriculture had a minor role and was often excluded from the trade liberalization. Statist and corporatist institutions controlled agricultural markets and producers were often taxed by policies designed to raise funds for industrial development.

The changes in economic policy in the region have been dramatic. As mentioned above, domestic agricultural markets have been liberalized. In keeping with this new-found liberalism, regional trade agreements in Latin America have begun to have an impact on agricultural trade policies and domestic programs. MERCOSUR, formed in 1991, made the bold decision to include agriculture in its free trade provisions, and now farm products flow much more freely among the four full-member countries (Argentina, Brazil, Paraguay and Uruguay) and with the new associates (Bolivia and Chile). The revival of the Andean Pact in recent years (among Bolivia, Colombia, Ecuador, Peru and Venezuela) has also stimulated agricultural trade among its members, in particular between Venezuela and Colombia.

However, the success of MERCOSUR seems likely to overshadow the Andean group and draw their members into a larger free trade bloc in the future. The same forces are acting on the Central American Common Market and CARICOM, both of which have largely liberalized agricultural trade internally but which may have to join forces with either NAFTA or MERCOSUR in the competition for regional market access.

Table 9: MERCOSUR Common External Tariff (CET) for Agricultural Goods

<i>Commodity</i>	<i>%</i>	<i>Commodity</i>	<i>%</i>
Beef	10	Sorghum	8
Rice	10	Soybeans	8
Wheat	10	Sunflower	12-14
Cotton	6	Milk	12-14
Maize	8	Sugar	not in CET

Source: Valdés in IATRC, 1997

In contrast to the enthusiasm for regional trade areas in Latin America, the US has always been more wary of such local entanglements, preferring the multilateral approach. This began to change in the mid-1980s as the US sought alternative trade strategies in the face of reluctance by trade partners to start another GATT Round. In North America, the US-Canadian Free Trade Agreement (1990) included agriculture in the tariff-cutting activity, but not in the non-tariff barrier removal.<sup>25</sup> Neither the US

<sup>25</sup> The exception to this was the liberalization of Canadian cereal import licensing, conditional on US protection levels being less than those in Canada. This condition was met soon after the implementation of the agreement. The

nor Canada thought of the other as a big potential market, and the GATT Round seemed at that time to be taking care of agricultural trade issues.

The North American Free Trade Agreement NAFTA (1992) also was overshadowed by the Uruguay Round, but in this case Mexico was interested in gaining more secure access to the US market, and so the issue of agricultural trade could not be overlooked. The result was a substantial improvement in market access through the provisions of two

bilateral (US-Mexico and Canada-Mexico) access agreements for agricultural products (to supplement the US-Canada bilateral that already existed in the earlier agreement) and the trilateral schedules for reducing tariffs within NAFTA. Some agricultural liberalisation was achieved at the time of signing the Agreement, and more will follow over the next decade. Non-tariff barriers were also phased out on US-Mexico trade, leading to a relatively free internal market in at least a

large part of the continent. Canadian-US farm trade however remains governed largely by the pre-existing Canada-US FTA, and hence is somewhat lagging on the path to liberalisation.

## 2. The FTAA and agriculture

The development of regional markets in the Americas is in general a healthy outcome of the process of national trade and agricultural policy reform coupled with the formation or strengthening of regional trade agreements of the “open” variety. The degree of uneconomic trade diversion has been kept low by the reduction in external protection in many

discrimination against sales of foreign wine in Provincial retail outlets in Canada was also curbed by the US-Canada agreement.

of the countries, particularly in Mexico and Latin America. External protection is also falling in the US and Canada, and this will further assist the process of developing competitive industries on a regional basis. This process is finding institutional expression in the FTAA discussions and will be put to the test once negotiations start in April 1998 in Chile. This freer trade within the region should itself have a profound impact over time on the structure of the agricultural sector and the policies that are employed to regulate and support it.

The task ahead for the FTAA in the agricultural area is to continue the positive development of the past decade through the pursuit of policies that are compatible with the final objective of a healthy, efficient and integrated agricultural market. This will involve some degree of coordination of domestic policies to prevent conflict in the region. But more important than coordination is agreement on the overall strategy to be pursued. This agreement would include the commitment to continue individual national reforms to free agriculture from the excessive attentions of the state; to stick to or accelerate the timetables established for intra-regional trade liberalization; to pursue the path of integration of the individual trade agreements in the Americas; and to develop a common approach to multilateral agricultural trade issues which would allow eventual merging of the various projected regional and supra-regional integrated agricultural markets. On the assumption that reforms do indeed hold, the integration of agricultural markets in the Americas may not be a distant dream. But it will take imagination and political skill to line up support and overcome the opposition to such liberalization.

### **3. Regional Integration and Agriculture in Western Europe**

The most significant impact of any regional trade agreement on agriculture is that of the Common Agricultural Policy on the farming sector of the

European Union.<sup>26</sup> Unfortunately, the impact has included the expansion of the production of many commodities well above the ability of the market to absorb them at supported prices, and led to the dumping of surpluses on world markets for many years. High levels of import barriers also disrupted world trade and led to conflicts with both developed and developing country exporters. But at least domestic price support policies disappeared in the member countries, and agricultural goods flowed relatively freely (save for some currency fluctuation adjustments) within the Union - albeit at high price levels.

The contrary experience was evident in the EFTA countries, who decided to leave agriculture out of their free trade zone. The same decision to exclude agriculture was made at the time of the series of bilateral trade pacts among the EFTA countries and the EC, following the desertion of the UK and Denmark from EFTA in 1973. Clearly, trade barriers could not be re-erected among former EFTA partners: free trade between EFTA and the EC looked to be the answer. But in agriculture and fisheries the issue did not arise. No new barriers were erected on farm products as no preferences were eroded. The talks aimed at establishing a European Economic Area took the same approach. Rather than open up the question of trade in agricultural products, both the EC and EFTA agreed that it be left off the table. By the time three of the EFTA countries came to join the EU, they still had relatively isolated and highly protected agricultures. Removing the domestic price policies in these countries (with the exception of Sweden, which had just undergone an agricultural policy reform of its

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<sup>26</sup> An intimate link between political and economic integration tends to mark Europe apart from other continents, where regional trade arrangements often are deliberately kept distinct from political integration and any hint of federalism is avoided. Nevertheless, the extensive experience that Europe has had in the area of regional trade arrangements makes it an important point of reference. Moreover, what happens in Europe itself has significant impacts on other countries and on the trade system as a whole.

own) implied a reduction in support to farmers. Joining the EU was considered by Nordic and Alpine farmers as a process of agricultural market liberalization, an outcome that the Norwegian farmers chose not to accept. Thus free trade has finally come to these countries in agricultural goods but at the high internal price levels of the EU.

Central European countries had been part of a somewhat different type of trade agreement, together with the Former USSR and other Eastern European countries. The Council of Mutual Economic Assistance (CMEA or COMECON) was founded in 1949 as an “Eastern European counter to the Marshall Plan” and ended up as a “counter to the Common Market” of the EU. It was intended to facilitate trade through complex book-keeping and planning devices. It did not promote free trade in the western sense. It did however provide secure outlets for predetermined sales of goods, including agricultural products. As such, it constituted a system of intensive intra-regional trade, even where such trade may not have been generated by market supply and demand. This trade collapsed at the time of the break-up of the CMEA and the Soviet Union itself, and made more difficult the process of transition to a mixed economy.

The key issue for the next few years is whether the countries of Central and Eastern Europe, as they line up for membership in the Union, will be able to resist the pressure to build up protection for their agriculture in anticipation of enjoying the high prices and secure markets of the CAP, or whether political leaders will be able to convince farm groups that their future lies more in becoming efficient and competitive and waiting for the EU to further reform its own policy by the time of accession. In this regard the creation of the Central Free Trade Area (CEFTA) and the Baltic Free Trade Area (BFTA) have significant implications for agriculture. They allow a continuation of trade within the region at a time when the Europe Agreements with the EU are acting as a magnet for trade to flow to and from the Union.

#### **4. Integrating the Eastern European Agricultural Market**

The most difficult challenge for the EU in the next decade is how to absorb up to 10 more countries from Central and Eastern Europe.<sup>27</sup> These countries have low incomes at present, on average only eleven percent of the EU-15 average. But they have good potential for steady economic growth, and high expectations on the part of their consumers. The workers in these countries are potentially mobile and will undoubtedly come looking for jobs if none are available at home. The population in these ten countries is about 29 percent that of the EU-15. Thus the challenge is to generate enough economic growth in these economies that they become a source of employment, a magnet for both domestic and foreign investment and a buoyant market for goods from the EU-15.

As integration takes place there will be pressure by producers in the present EU for relief from imports from the CEEC. Such ‘sensitive’ imports into EU, including steel, textiles and agricultural goods, are already controlled by quotas under the Europe Agreements.<sup>28</sup> Everyone agrees that

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<sup>27</sup> Ten countries now have Association Agreements that are intended to lead up to membership. The Czech Republic, Hungary and Poland along with Slovenia and Estonia, are considered to be the most ready for membership and might enter by 2002. Slovakia, Bulgaria and Romania, and the other two Baltic countries, Latvia and Lithuania are considered less likely to be prepared before perhaps 2005 at the earliest. Cyprus has been promised entry negotiations as soon as the issue of which parts of that divided country will be represented is settled. Malta has for now decided against negotiating for membership. Turkey provides the biggest problem for the EU from the point of view of possible accession. It has had an Association Agreement for more than thirty years, and now has a customs union agreement (which excludes much of agriculture). Although it has requested full membership, this is still a long-shot and would be opposed by several EU members.

<sup>28</sup> The apprehension is not all in the existing EU. The corresponding fear in the prospective members is that of the demolition of entire industries in these countries by competition from the west.

the markets must eventually be opened: the timing and sequencing is at issue. Too rapid an opening in advance of membership could provoke a backlash which would delay accession. Too slow a move to an open market increases the disillusion already felt in Central Europe about the willingness of the EU to take any political risks for the sake of securing democracy and establishing security.

The agricultural sector is in the thick of this debate. Those that would like to postpone the pressures on farmers in the current EU argue for a long transition. The new members would not get unlimited access to the markets in the west until producers in the west were able to withstand the competition. Thus the notion has been floated of a “green wall,” with different price levels and policies each side of the wall. The political ramifications of such a two-tier agricultural policy are unclear but unlikely to be positive. The economic costs of such a prolonged market segmentation are also difficult to calculate, as they depend on how the transition period is used, but could be large. A more rapid docking of eastern and western agricultural markets would avoid the costs of a transition that merely postpones needed adjustments in the west. This would clarify the signal to the new members and help to prevent the construction of uneconomic agricultural sectors in those countries.

The convergence of the countries of Central and Eastern Europe toward the level of economic and political stability necessary for membership is proceeding apace, and it will be difficult to postpone enlargement much beyond the first few years of the next decade. This puts their accession at the same time as the next stage in the GATT trade reform and indicates that there is at most five years to adjust current policies to meet the challenge. The nature of the challenge has been recognized by the Commission in the Agenda 2000 report. At the very least is the possibility of a large jump in budget costs if payment of hectareage and headage subsidies and structural grants are extended to the new countries. These countries would increase the agricultural capacity of the Union very

considerably. The extent to which the new entrants will be major exporters of farm products within the next five years depends upon a number of conditions, including their own recovery from the traumas of changing political and economic systems and the policies they chose in the interim. If the projections of substantial surplus production are realized, as we think is likely, then the cost to the budget of enlargement could be crippling to the EU.<sup>29</sup> The issue is whether the political system can respond in advance to avoid the problems or whether change has to wait as so often before for crisis.

Several tasks remain to be accomplished before the CEEC can join the EU without disruption beyond reasonable bounds. First is a change in attitude which would begin to see the positive side of the accession of a number of countries with high skill levels and adequate natural resources. Trade with such countries will be mutually beneficial and strengthen the EU in international terms. This is also true of the agricultural sector. If the EU sees the accession as a chance to adapt and take advantage of the expanded resource base, all countries will be the winners. The present negative view stems from the difficulties in managing the protected market along with the feeling that the competition for budget funds is a zero-sum game. To begin to discuss agriculture on a continent-wide basis could alleviate some of the natural concerns about increased competition for markets and funds.

The process of merging the agricultural sectors of the old and the new members can start well before entry. The Europe Agreements provide a framework for the convergence of the economies in general and of trade policies in particular. Agricultural policy should be included more fully in these Agreements, not to protect the present EU producers but to allow as rapid as possible integration of the agricultural sectors of West and Central

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<sup>29</sup> See Josling and Tangermann (1994) for a detailed argument as to why the CEEC are likely to become major exporters of a number of agricultural commodities.

Europe. To this end the Europe Agreements need to accelerate the liberalization of quotas on imports from the CEEC and improve the administration of those quotas so as to avoid giving so much of the benefits to the importers. The EU is already using the market-access guarantees negotiated in the Uruguay Round to increase imports from the CEEC. The aim should be to move quickly to trade unrestricted by quantitative barriers. Price differences reflecting different levels of external support could then be tackled as a part of the process of policy harmonization.

The tasks before the Union in preparing for entry are not too daunting, if the logic of the 1992 reform is applied and if the reforms have been continued beyond the first phase. The cereal price level for the expanded EU need not be different from the future reduced level for the current members. A relatively light intervention system, at a low price level, coupled with a set of bound tariffs (and a maximum applied duty rate) for imports, should support the wider European market. If in the next few years to come the new members have chosen prices at or below the EU level, and if that level is close to world market prices, then their incorporation should not cause problems. Exports could increase, but only minor subsidies would be needed to move them onto world markets. Problems are more likely if one of these conditions does not hold. If the CAP reform process stalls before that time, and hence the EU has cereal prices way above those in other major producing areas, the extension of these high prices to the countries of Central Europe would risk generating considerable export quantities which could only be sold with expanded subsidies or restrained by supply control. This would prove both financially expensive and also diplomatically difficult, as the EU would have to bargain for additional export subsidy allowances.<sup>30</sup> Other exporters are unlikely to

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<sup>30</sup> The CEEC countries declared some export subsidies in their GATT schedules, which must therefore be reduced. These could be aggregated with the subsidy allowances for the EU. They would not, however, cover the likely expansion of exports eligible for subsidy if the CEEC countries expanded output (and reduced

appreciate being told that EU expansion is going to increase subsidized exports, as this would represent a sure sign of trade diversion rather than trade creation from the process of enlargement

The Commission appears to be leaning toward the notion of a transition period for the harmonization of agricultural prices.<sup>31</sup> The argument seems to be based on the experience with the southern enlargement in 1986, where relatively smooth transition periods allowed the very different price levels of the applicants to harmonize with those of the CAP. This, however, begs the question of whether the analogy is closer to the Portuguese transition, a ten-year period designed to allow Portugal to adapt to Europe, or the Spanish case, a seven-year period for the EC to prepare for Spanish competition. In any case, since the establishment of the EU with its borderless internal market, the costs of having to maintain different price levels has increased sharply. The better model might be the recent accession of the three EFTA countries, where prices were harmonized from the date of accession but payments were allowed to be made to compensate the farmers whose prices declined. The problem with this analogy is that, if the CEEC were to get prices at the current level of the EU-15, the expansion of production, the hardship for consumers and the budget cost for the EU would be too great to bear. Hence if the CAP is not changed by that time, the choice will be between a slow transition and a costly division of the market or a fast transition and more uneconomic surpluses of farm goods. The strategy should be to achieve convergence and the creation of an integrated agriculture sector as swiftly as possible.

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consumption) as a result of higher prices. See Tangermann and Josling, 1994, Appendix II.

<sup>31</sup> This is the solution for those commodities where price gaps remain which is suggested by the EU Commission in their "Strategy" paper (European Commission, 1995)

This is the main reason why a continued reform of the CAP is necessary for Enlargement, to allow for a reasonably rapid CEEC accession.

## **5. Supra-Regionalism and Agriculture**

Is there an even more ambitious role for the supra-regional trade pacts that could be exploited by the multilateral process? Set against the scenario of unfulfilled promise of agricultural trade liberalization at the multilateral level, the regional initiatives have begun to look like useful building blocks for the future of the trade system. By the year 2005 there should be virtually no agricultural trade barriers left between the US and Mexico, though Canada will have to catch up with that schedule by means of steep reductions in tariffs for some high-tariff agricultural commodities on intra-NAFTA trade. The same would be true in Latin America, Central America and the Caribbean, if current timetables for liberalization are followed. The rather optimistic plans for a Free Trade Area of the Americas (FTAA) by 2005 include removing agricultural trade barriers. If several of the countries of Central Europe become members of the EU around the year 2002, and if the same “instant accession” arrangements as were negotiated with the recent EFTA countries are followed, there could be an agricultural free-trade zone of perhaps 21 countries in Europe by that time. Including the Euro-Med agreements with the countries of North Africa, and the Europe Agreements for the other Central and Eastern European Countries, the free or mostly-free trade zone could include over thirty countries.

In the Asia-Pacific region the APEC (Asia-Pacific Economic Cooperation) process calls for “coordinated unilateral” trade liberalization, extended to non-APEC members through the “most-favored nation” rule of the WTO, by 2010 for developed and 2020 for developing countries. By that stage APEC itself could have expanded to include several more Latin American countries and may even have spread to South Asia. Agriculture is deliberately not excluded from this process, though some countries will have to change their levels of agricultural protection rather rapidly if this target is to be met. Europe is unlikely ever to be content with less favored

access to US markets than that afforded the Asian countries, nor be placed at a disadvantage in Asian markets relative to goods from the US. A Transatlantic trade agreement would therefore seem to be a likely outcome of progress in APEC, if Europe did not somehow participate directly in the APEC-inspired liberalization process. An Asia-EU trade agreement would also seem to be inevitable at some stage (a series of meetings has in fact already started though not with an explicit free trade agenda), again unless the EU were to find a way to join the APEC process. Between them these agreements would have to incorporate the goal of freeing agricultural trade between the US, Asia and the EU, however improbable this may seem at the moment.

There is therefore the possibility that the pace of liberalization of agricultural trade may in fact be set by these regional agreements and processes. A liberal trade system may come about quicker from the incorporation of agriculture in the timetable of the regional agreements and supra-regional blocs than in the traditional negotiation of reductions in high tariffs within the WTO. Most present inter-continental agricultural trade flows will be internalized within these supra-regional pacts. Moreover, the pacts themselves are likely to use similar modalities to deal with agricultural trade issues, so as to avoid the proliferation of different trade rules for countries such as the US that are participants in more than one pact.

Supra-regional trade agreements do not in themselves solve the problem of the reluctance of importers to open up their markets. However, the political calculus might change enough for some serious liberalization to occur in agricultural markets as a result of such blocs. The US, for instance, will be in a stronger position to suggest major changes in farm product access in Asian countries if the prize were membership in a supra-regional bloc. Removal of export subsidies on agricultural products may be possible in the

context of a transatlantic deal with the EU.<sup>32</sup> Even domestic subsidies may be forced to conform with subsidy and competition rules within the supra-regional agreements. In all these cases the threat is of exclusion, and the cost of such exclusion will be high. Despite some obvious dangers in this emerging trade architecture, it does seem to offer a parallel and perhaps speedier path to a goal of free agricultural trade within a generation. In short, the growth of supra-regional blocs may be just the institutional structure needed to tackle the issues of agricultural trade and protectionism.

## 6. Agriculture and the Transatlantic Agenda

One of the most important tasks for the Transatlantic partnership may be to define and improve commercial relationships between the US and the EU. This issue has recently been revived by a Europe concerned that the US is drifting into isolationism or an obsession with Asia. As a result, there was considerable discussion in the early 1990s on the need for a new Transatlantic Treaty to keep the US engaged in Europe. This Treaty, by common agreement, would have to have an economic component. What this economic component could be is less clear. Some argued at the time for a Transatlantic Free Trade Area (TAFTA), but Governments did not seem to be willing to go this far.<sup>33</sup> Instead the EU and the US signed at the end of 1995 a joint declaration for a New Transatlantic Agenda, including an Action Plan which promises action on economic as well as security issues. More recently the issue has opened up again, with Frost's suggestion of a North Atlantic Economic Community (NATEC), the

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<sup>32</sup>For a discussion of this possibility see Tim Josling, "Agriculture in a Transatlantic Economic Area", in Bruce Stokes (ed.), 1996

<sup>33</sup> Presumably, the enthusiasm for a TAFTA will rise and fall with the prospects of an APEC that achieved trade liberalization within the Asia-Pacific region to the exclusion of Europe. The EU is unlikely to be willing to accept less favored access into the US market than that enjoyed by Japan.

counterpart to NATO.<sup>34</sup> This would apply the APEC style approach to regional trade agreements, encouraging others to join in the agreed liberalization to avoid the introduction of preferences.

Could such an agreement include anything meaningful on agricultural trade? In agriculture any discussion of US-EU relations carries with it the fear of failure and frustration, borne of the experience with the Uruguay Round and the previous twenty years of tension. However, the opportunity should not be lost for an improvement in trade relations in such an important area. Indeed, if domestic policy trends continue in both the US and the EU, there could be the opportunity for dramatic change in trade relations in agriculture in the not-too-distant future. This could take the form of an agreement to mutually forswear the use of export subsidies in those markets where the two compete; an agreement on domestic policies that would make them consistent with the Green Box category of "decoupled" support; and an agreement on the mutual development of quality and health standards and on mutual recognition of each others sanitary and phytosanitary measures.<sup>35</sup> However, care will have to be taken to resist the temptation to establish new trade preferences across the Atlantic, unless as a part of full FTA - which would itself only be desirable with very low levels of external protection.

Agriculture would obviously represent a possible sticking point in such discussions. But difficult trade issues must be faced rather than avoided if the transatlantic agenda is to be credible. A bilateral pact putting a moratorium on the use of export subsidies, for instance, would in itself give a boost to transatlantic trade relations as well as being acceptable to other countries. Rather than raise fears about trade diversion and corrosive bilateralism, the rest of the world would welcome such a pact as

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<sup>34</sup> See Frost (1997) and also Stokes (1996).

<sup>35</sup> These ideas are developed further in Tim Josling (1996)

contributing to peace and stability on world markets. The recent US period of high prices was perhaps the best time for such a pact to have been agreed.

Does the combination of the MacSharry reform in Europe and the FAIR Act in the US promise to reduce significantly the tensions across the Atlantic in agricultural matters? In the long run there is little doubt that the act of decoupling farm support payments from output will help to reduce the tensions between the US and the EU. However, the benefit may not be felt at once. Indeed for a time there may actually be an increase in transatlantic tension. The pressure is now on EU to make the next move in further policy reform. The Commissioner for Agriculture has said that he looks forward to a time when EU agriculture is internationally competitive without the aid of export subsidies. Such an eventuality would be hastened by a continuation of the policy reform of 1992. If “MacSharry II” were to bring EU prices to world market levels, international agriculture relations could improve markedly.

The climate of transatlantic relations may also depend on whether the US is really out of agricultural commodity support. Will next administration increase the safety net? Will the US revert to the old legislation when the current bill expires? If so, then there will be resistance to the negotiating away of farm support instruments. Congress may also not allow the US to lose market share to the EU. Export subsidies have been authorized, though that does not ensure that the funds will be appropriated. They may be kept as a weapon for the conduct of trade wars long after their use as cost-effective domestic market management (if such it ever was) has disappeared. Under these circumstances the prospects for peace look dim. But if the FAIR Act really represents a major shift away from government involvement in farm markets, then the possibility of a different US-EU relationship is not so far-fetched. The outcome may in part depend on world price developments. High prices would lead to less tension and less tendency to revert to the old policies. Low prices on the other hand could

be followed by increasing pressure to go back to commodity market support.

## **7. Agriculture in the APEC Process**

The potential role of APEC in agricultural trade reform cannot be denied. By setting a date by which free trade is to be achieved, and by specifically rejecting the attempts of some members to exclude agriculture from the commitment, the APEC process has raised its sights beyond that of the WTO. When APEC was first discussed, few would have thought it likely that any meaningful agreement could have been negotiated in the area of agriculture. The questions that therefore arise are how did such a commitment come to be made and how credible is it as an indication of what will actually happen.

The decision to move to free trade and investment among APEC members by 2010 for the developed and 2020 for the developing countries is itself of historic importance. If it remains on track it will represent the triumph of collective courage by heads of government over the politics of protection. Presumably, having decided to go above the heads of special interests and ministries on the industrial side, it required little more reach to include agriculture. But the way in which the free trade goal is to be reached is even more unusual. The process relies heavily on coordinated unilateral action (the APEC National Action Programs) rather than the bilateral negotiations (afterwards multilateralized) of the GATT. How does the inclusion of agriculture fit in with this process? It implies, in effect, that each APEC country will have to bring to the table plans for the unilateral liberalisation of agriculture. So far, commitments under the APEC umbrella have not gone far beyond an acceleration of Uruguay Round obligations and agreement on specific sector liberalization plans. The food sector was identified as one of the fifteen areas where the voluntary

program of liberalization was to be pursued, along with oilseeds and products. This at least suggests some continued willingness to move into sensitive waters.

This immediately raises the issue of credibility. Why, if agricultural policies are so difficult to shift, would one expect countries to be able to give them away in an APEC-inspired negotiating session? But it is precisely the novelty of the situation that may give some hope. If one holds onto protective policies and lays them reluctantly on the table, only a few advances will be possible. But if one starts with the commitment to remove all trade barriers, then the issue becomes one of timing rather than principle, and the need to balance “requests” and “offers” is diminished. This in effect brings the advantage of a regional approach to a broader, plurilateral arena. Of course, in the absence of a credible commitment the process yields nothing more than loosely coordinated unilateral action: this is not likely to be a good position for agricultural liberalization. But if the goal is credible, and countries behave as if it is possible, then the technique may work. APEC would have successfully avoided the confrontational aspects of trade liberalisation by emphasizing the common property (public good) benefits of a liberal trade and investment system.

### C. *The Way Forward in Multilateral Talks*

It would be difficult to find anyone, outside the ranks of the inveterate trade policy buffs, with much enthusiasm for yet another round of trade talks, and still fewer who relish the idea of further negotiations on agriculture. The long drawn out process of the Uruguay Round, seven years from start to finish, was not one that many wish to repeat.<sup>36</sup> But further negotiations are indeed on their way, and agriculture will be among the topics under discussion. The agenda is already being formed and the issues discussed. It is not too soon to identify which aspects of the international trade system for agricultural products still need fixing and how to best go about fixing them. In fact now is a particularly good time to be thinking about these issues, before attitudes are hardened and options foreclosed.

The Uruguay Round itself has already agreed the next steps for the multilateral process of trade liberalization in agriculture. The Agreement on Agriculture (in Article 20) called for talks to be initiated no later than 1999 (the last year of the implementation of the scheduled reductions in protection, at least for developed countries) on *the continuation of the process of reform of the trade system for farm products*. The Agreement confirms ‘the long-term objective of substantial, progressive reductions in support and protection resulting in fundamental reform’ (WTO, 1996, p55). The WTO ministers meeting in Singapore in December 1996 confirmed the timetable and recognized the need to firm up the agenda and begin the process of analyzing alternatives. The agenda itself will be decided by countries within the next year or so, initially by informal contact among the major actors. To this end an informal body known as the Analysis and Information Exchange Group has been set up within the

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<sup>36</sup> For a full discussion of the treatment of agriculture in the GATT and the reform of the agricultural trade rules in the Uruguay Round see Josling, Tangermann and Warley (1996) .

WTO Agriculture Committee to aid such discussions in advance of formal meetings.

The Round will have to decide on the next step toward the greater market-orientation promised at Punta del Este. This is the most challenging step. The reforms of the Uruguay Round were more successful in changing rules than in reducing protection and liberalizing trade. Protection in many markets is still very high, and allowable export subsidies still threaten the stability of markets. The strategy for the continuation of the reform process will therefore need to encompass additional market access provisions, further reductions in (or even elimination of) export subsidies, and more discipline in the area of trade-distorting domestic subsidies, if it is to lead to a freer agricultural marketplace. In addition countries will need to begin to confront the issue of state trading in agriculture. The use of export restraints may also be challenged, in part as a reaction to the concern over food security in importing countries.

The biggest task of the next Round will be to advance the process of reform by taking the next step towards a world market undistorted by high import barriers and government subsidies. This task was begun in the Uruguay Round, and the mechanisms are largely in place. However, it is in the nature of protectionist policies that removing the first few percentage points of a tariff or subsidy is relatively easy: the challenge comes when farmers begin to sell their enterprises. But there will also be anguish when reductions begin to cut into profits of those that feel themselves to be competitive. Though the ultimate test of competitiveness is survival in the marketplace, that test will be resisted by those whose livelihood is at stake. The range of protection levels exposed by the process of tariffication makes clear that the process of trade liberalization has far to go. The next Round will not in itself achieve the competitive environment which will make best use of the world’s agricultural resources. However, unless it can make a significant move in that direction, it will have failed to continue the process started with the Uruguay Round.

## 1. Improving Market Access

Tariffication, as was intended, has made the conditions of market access in agricultural trade significantly more transparent. What is now visible is the level of protection for long hidden by non-tariff barriers. This level of protection in agricultural markets is exposed as very high relative to the trade barriers in manufactures. It is as if the agricultural sector still has pre-Kennedy Round tariff protection. The question for the next round is what process can one initiate that would lead to a removal of this discrepancy in any but the longest time period. How does one get from tariffs of 100-200 or even 300 per cent to levels of 5 - 15 per cent found in most other areas of trade, or to zero if free trade is on the cards? This looks to be a tall order: it implies a continued period of significant tariff cuts extending well beyond the time-frame of the next Round.<sup>37</sup>

One way to engineer this reduction of trade barriers in a shorter time-frame is to negotiate a major ‘across the board’ tariff reduction, perhaps aiming for a 50 per cent cut in all tariffs over a five year period. This would, however, still leave some tariffs at a very high level. Alternatively, agricultural tariffs could be reduced on a formula basis, with higher tariffs being reduced at a greater rate. The ‘Swiss Formula’ which was used for tariff reductions in industrial goods in the Tokyo Round would be a candidate. This could be a faster and fairer way to the same end, with much of the ‘water’ being squeezed out of the high tariffs (and the element of ‘dirty tariffication’ being removed) in the first stage.<sup>38</sup>

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<sup>37</sup> Tangermann has suggested using the same base which was established in the Uruguay Round for the next set of tariff cuts. A further 36 percent cut from the same base would imply a 72 percent cut over the two “reform” periods. In this way the continuity of the process would be emphasized and the same percentage cut would have greater impact. See Tangermann (1997).

<sup>38</sup> The ‘water’ in a tariff is the unused protection when no imports can sell at the tariff inclusive price. The ‘dirty’ element in the agricultural tariffs refers to the

Another benefit of using such a formula approach is that it would reduce the distribution of tariff levels among products. The process of tariff reduction in the Round may have increased the variance of tariff levels.<sup>39</sup> The UR agreement provided for a simple unweighted average reduction of 36 per cent, with a minimum cut of 15 per cent for each tariff line. Many countries took advantage of the option of cutting tariffs on sensitive commodities by the minimum and making bigger percentage cuts on items of less domestic sensitivity. As an alternative approach to the problem of tariff dispersion, a maximum level of tariff could be agreed to which all higher tariffs would have to be reduced over an agreed period. This could be combined with an across the board cut to give both a general reduction as well as a consolidation of rates.

To remove some of the “policy water” a different approach could be considered. One could for instance eliminate the present gap between bound and actual rates. Bindings could be reduced to no more than the maximum applied tariff in an agreed historical period (say 1993 to 1998, if the negotiations were conducted in 1999).<sup>40</sup> This would lock in agricultural trade reform in a more effective way than at present. It would not, of course, remove the element of protection introduced through ‘dirty tariffication’, and there could still be ‘water’ in the tariffs as currently applied. It would only remove the discretionary element of protection that

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use of price gaps between domestic and world markets which overstated the existing protection at the time of tariffication, leading to larger than necessary tariffs. Tariff bindings were also often set well above the actual tariff in operation, giving an element of discretion to governments which one might call “policy water”. Thus a reduction in the high rates of tariff removes the water, cleans up the tariff and removes the discretionary element of ceiling bindings.

<sup>39</sup> This was the case, for example, in the EU, Japan and the USA. See Tangermann (1995).

<sup>40</sup> There would of course be a danger of announcing such a scheme in advance. Countries might choose to raise tariffs to their bound levels to avoid the cut.

countries were able to build into the Uruguay Round tariff bindings for their own flexibility. This would, however, increase considerably the credibility of the liberalization process. It would among other things put a limit to the spread of ‘price band’ systems of variable protection that several Latin American countries have adopted to stabilize domestic prices.

A somewhat different approach to the issue of tariff reduction has had some success in other areas of trade, such as information technology. This approach is to negotiate “zero-for-zero” agreements which would eliminate tariffs completely on particular goods.<sup>41</sup> Clearly there are advantages as well as disadvantages in such an approach. Political sensitivities restraining liberalization in some products such as dairy and sugar would not hold up a move to competitive markets in others such as oilseeds and pigmeat. Trade would therefore be expanded in the latter markets as protection was reduced. However, the benefit of this “trade creation” from the point of view of both the importing country and the world as a whole would be offset by the costs of “trade diversion” as zero-tariff items replaced the lower-cost but higher-priced goods still subject to tariffs.<sup>42</sup> The zero-for-zero approach rests in part on the notion that the isolation of the markets that are presently highly protected will force them eventually to come into line. Unfortunately, it is equally likely that one might “let off the hook” the sensitive commodities unless the sector-by-sector reductions were in a framework which ensured no long-term exclusions.

An alternative way to tackle the problem of the high levels of tariffs resulting from tariffication is to expand the guaranteed market access which forms a part of the provisions of the Agreement on Agriculture. Removing the TRQs, as discussed above, may not be an attractive option for the exporting countries. Expanding them, however, is one simple way of

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<sup>41</sup> This approach is discussed more fully in Miner *et al* (1996).

<sup>42</sup> The EU knows well the problem of “unbalanced” protection as a result of easy access to oilseeds negotiated in the Dillon Round.

reducing their importance, at the same time lessening the impact of the high ‘above-quota’ tariffs. Doubling the minimum access quantities, for instance, would make many of the high bound over-quota tariffs irrelevant. An increase in TRQs, say, of one per cent of the level of domestic consumption in each year over a five year period would remove much of their negative effect. In most markets the quotas would become non-binding before the five-year period was over. In effect, tariffication would have taken place at the level of the reduced tariff applicable to the TRQ. The main political objection to this could be that the “within quota” tariffs were generally left to the discretion of the importing country to fix at levels which they judged would attract the guaranteed access quantity. This implies that some form of re-negotiation might have to take place on the level of these tariffs.<sup>43</sup>

## 2. Removing Export Subsidies

The practice of subsidizing exports of agricultural products has been sanctioned by the Uruguay Round, albeit in a reduced form. Countries which import agricultural products have been the gainers in economic terms from the subsidies, but even among these countries the disturbance of the domestic market has often caused problems. In the next round of negotiations, it will be more difficult than ever to persuade countries who export agricultural goods with little or no subsidy to allow countries such as the EU and the US to continue their market-distorting practices. A further push to rein in these subsidies is likely to be high on the agenda of the Cairns Group.

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<sup>43</sup> This of course also offers a possibility to start such tariffs for within-quota trade at a reasonable level in relation to other goods. All “within quota” tariffs could be bound at (say) 20 percent, and not reduced until they became the operative tariff for the bulk of agricultural trade.

Elimination of export subsidies altogether would clearly have significant advantages. The pre-requisites for dispensing with export subsidies are a renewed confidence in world markets, with firmer and more stable price levels for the major products, and reduced dependence on intervention buying in domestic policies. The former condition depends on the success of the Agreement in increasing trade and reducing protection. As for domestic programs, it is possible that practice and sentiment in both the US and the EU may have moved away from the use of market support policies to other instruments by the turn of the century. If that were the case it could be politically easier to get effective curbs on the use of export subsidies by the time of the New Round. A new set of negotiations could, say, set the target to phase out export subsidies over a five year period, by 2005. If such a move was successful, export subsidies for agricultural products would have been relegated to an inglorious place in trade policy history.

### **3. Curbing Export Taxes**

The practice of export taxes and export restraints through quantitative controls is also likely to be addressed in the New Round. Within the GATT export controls are generally disallowed, though export taxes are deemed innocuous. Article XI of GATT 1947 prohibits quantitative export restrictions but makes an explicit exception for “export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party”. As exporters do not usually complain about restrictions imposed on their competitors, most export restrictions go unchallenged. But there is a clear conflict between the ability of exporters to withhold supplies to relieve domestic shortages and the reliability of the world market as a source of supplies for importers. In periods of general tight supply the effect of export restrictions would be to exacerbate the shortage.

As a result, importers such as Japan may lead a movement to constrain the ability of exporters to restrict supplies. After all restraints on exports are no

less inconsistent with an open trade system than restraints on imports. Export taxes should be included under the same qualifications as quantitative restrictions. The argument has already surfaced in connection with the Food Security Declaration appended to the Uruguay Round Agreement (the Ministerial Decision on Measures Concerning the Possible Negative Effects of the Reform Program on Least-Developed and Net Food-Importing Developing Countries). It seems inconsistent to leave in place the possibility of export taxes and quantitative restrictions that have an immediate and harmful impact on developing country food importers.

#### **4. Reinstrumentation of Domestic Support**

It is one of the ironies of the Uruguay Round that, although the biggest conceptual breakthrough was the acceptance by countries that domestic policies were a legitimate concern of trade talks, the actual disciplines imposed on those policies were rather weak. The question for the next Round is therefore whether to strengthen or abandon the attempt to constrain domestic policies. In one sense the issue is less crucial than in 1986. Most developed countries have modified their domestic agricultural programs in recent years to improve the targeting and reduce the output-increasing nature of farm income supports. The AMS constraints are as a consequence not binding in most cases.

However, this does not mean that the constraints on domestic support have been ineffective. The role of the Agreement in supporting this domestic reform process should not be underestimated. The process of reinstrumentation of domestic support programs, away from those that most impede trade, has begun. But the AMS constraint on domestic policy puts useful pressure on countries to continue this process. The shelter of the green box is both to guard against challenge from trading partners and to avoid being counted toward the AMS. This suggests that the AMS constraint should in fact be tightened to avoid the temptation of backsliding and to promote further reforms. The present reforms are in general less secure and easier to reverse than trade rules.<sup>44</sup> This tightening would make the “green box” much more effective. Exemption from the AMS and avoidance of challenge between them make a powerful case for making domestic policies conform with the green box criteria.

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<sup>44</sup> The reform of the CAP is not yet in “permanent” form, and the US Farm Bill only lasts for the next seven years, at which time Congress may decide that direct decoupled payments are not enough to support rural incomes.

The ‘blue box’ containing the US and EU direct payments which were granted exemption from challenges under the Blair House Agreement was a creature of its time, necessary to get agreement to go ahead with the broader Uruguay Round package. It is, however, still a somewhat awkward bilateral deal not appreciated in other parts of the world. Such an anomaly can surely be removed in the next round. The policies of the US and the EU themselves are changing for internal reasons. The new US Farm Bill goes further than ever before to make the payments to farmers decoupled from output and therefore compatible with the green-box. The EU is considering a similar move as a continuation of the reform started in 1992, as a way of making the CAP consistent with enlargement. The task for the New Round will be made much easier if the EU and US have both modified their payments such that they meet the conditions laid down in the green box. The “blue-box” can essentially be emptied and locked.

#### **5. The Politics of the Next Round**

The possibility for further reform rests on the coincidence of the direction of recent trends in domestic, regional and multilateral policies toward agriculture. The next steps should be easier if most countries are moving down the same path. But such arguments for taking further action on agricultural trade reform will not carry much weight if the political signals are wrong. This implies that internal political opinion must be in favor of entering into another round of trade talks on agriculture in at least some of the major participants. In the past this has meant that the US has to be the driving force, backed up by Canada and the smaller agricultural exporters, for putting agriculture on the agenda. The EU and Japan have reluctantly agreed to the agenda despite vocal domestic opposition and have dragged their feet once talks have begun. However, this hesitation is itself costly in terms of the negotiations as a whole. The tantalizing question for the next round is whether the dynamics can be changed.

The best hope for change lies with the European Union. Until now the agricultural stance of the EU has hung like an albatross around the neck of

its trade negotiators. The agricultural issue is still going to be problematic for the EU and therefore could still limit the position of the EU on other matters. But the EU as a major exporter has an interest in expanding markets. Trade wars fought with export subsidies are not in the interest of the EU as a whole: they are an unfortunate and costly side-effect of the old-style CAP with rigid intervention at high prices and no other way of reducing stocks. Indeed the EU has a strong interest in promoting freer agricultural trade, including the removal of export subsidies. Continued reform of the CAP along the lines started in 1992 will allow the possibility for a more constructive position on agricultural trade liberalization than was taken in the Uruguay Round. The negotiations scheduled for 1999 to continue the process of trade reform in this area will be a test of the ability of the Union to resist protectionism in favor of openness in agricultural markets.

These issues will help to determine the politics of the next set of WTO talks. The EU could continue to 'run interference' for the protectionist elements in East Asia, taking the brunt of the pressure from the US and others to liberalize markets. Or, the Union could itself put pressure on Asia to open agricultural markets, so as to help the export prospects for the newly-competitive agriculture of the enlarged Union. This would isolate those governments which have until now resisted international efforts to modify their domestic policies and would almost certainly lead to further trade liberalization.

This transformation of the EU from being a reluctant partner in multilateral trade liberalization in agricultural products to being a leader in the process will require a consistent and credible strategy. The Uruguay Round has made such a task somewhat easier. Essentially the only import barriers are bound tariffs, though sometimes at a very high level, and export subsidies are declining according to the agreed schedules. The battles of the Uruguay Round have been fought - and lost. The EU could now decide that its destiny is as a competitive exporter of high quality agricultural and

food products, and therefore that it is in its interest to reduce the tariff barriers as quickly as possible and to phase out export subsidies. It could take the high-ground of the negotiations by putting forward a date for the end of export subsidies, perhaps the most unpopular of all trade policy instruments in agriculture and the cause of much disruption in world markets. And it could offer to end the use of the Blue Box, the mechanism agreed at the Blair House agreement between the US and the EU to exempt each other's cereals payments from reduction so long as they were tied to acreage controls.<sup>45</sup>

What then of the role of the US in the next round of talks on agriculture? Will the US be in a position to take the lead in suggesting the path toward reform? Clearly the outcome of the debate over fast-track negotiating authority will influence the answer to this question. Without fast-track negotiating authority, and with a Congress wary about further attempts to liberalize trade, it is not easy to see a leadership role in the next round. But even with fast track certain hard decisions have to be made. The US will need to offer to others some incentives to allow them to strike a deal on agriculture. The EU may want some continuation of the Peace Clause, to avoid continuous WTO challenges of the day-to-day operations of the CAP. Asian countries may hold out for assurances against the use of export embargoes. But most of all the US is going to have to face up to granting better access for some of the commodities which have so far not been opened up to imports. These include sugar, dairy products, peanuts and citrus fruits. Open markets also imply transparent health regulations, allowing such imports as poultry into the market subject to meeting the same conditions as imposed on domestic supplies. The process of opening

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<sup>45</sup> Now that the US has enacted the 1996 Farm Bill which makes the former deficiency payments available to farmers without any need to produce commodities (i.e. they are completely decoupled and thus presumably can be put in the Green Box of acceptable subsidies) the EU is alone in needing the Blue Box protection against reduction commitments and challenges by trade partners.

up US markets to NAFTA partners has already begun. The putative date for an agreement on free trade in the Western Hemisphere is only seven years away. The Administration has consistently supported the APEC objective of free trade and investment, and this objective is scheduled to be achieved within twelve years.

The Cairns Group will probably also play a key role in the next round, as they did in the Uruguay Round. There will once again be a tendency to postpone awkward decisions on agricultural liberalization until the last moment. The "last moment" in the case of the next round of agricultural talks may be the expiry of the peace clause, in 2003. After that there is the likelihood that the special protection given to agricultural programs by that clause will give way to the full rigor of the subsidies code and the anti-dumping regulations. This should concentrate the actions of the negotiators. The role of the Cairns Group in such a situation would presumably be to block such an extension of special protection until an agreement was found on the issues of market access and export subsidies. If the argument underlying the case for further agricultural trade reform at this time is that it is essential to engaging developing countries in the process, both regional and multilateral, of trade liberalization, then these countries themselves will want a role in setting the agenda. The Cairns Group, perhaps expanded to include more reform-minded developing countries, could provide a ready vehicle for such an influence.

## V. Conclusion

For the first time for many decades the forces which push domestic, multilateral and regional aspects of agricultural policy are all acting in the same direction. This means that the location of policy change is of less importance than the direction and type of change. This gives a real prospect of constructive movement at the level of both the regional trade agreement and the multilateral process towards the goal of a competitive agricultural trade system which complements rather than threatens the actions taken domestically. The goal for the individual regions is to develop sound, competitive regional agricultural sectors under low external levels of protection. The goal for the multilateral system should be to encourage this movement and to make sure that it happens within an ever strengthening set of rules at the international level.

The impact that domestic policy reform has on regional and multilateral trade policy is to facilitate the process of trade liberalization and market integration in agriculture. In turn the terms of regional and multilateral trade agreements will have important direct effects on the conduct of domestic farm policy. There is no necessary implication in most regional trade agreements that countries would abandon national agricultural policies altogether, but they will tend to be modified over time to make them innocuous to partner countries. Freer trade in agricultural goods will require, for instance, a move away from subsidies that distort competition within the region. This suggests that each regional agreement will develop a type of “green box” of national policies which are deemed to be internally acceptable. There will also be pressure to harmonize internal regulations and standards as a way of reducing within-bloc transactions costs and reducing potential for conflict. The fact that these are consistent with multilateral trends makes the dangers of developing mutually antagonistic trade blocs less immediate. The dynamism of the regional

process can help the rather cumbersome global negotiating machinery. The uniformity of global rules can keep the regional pacts consistent with each other. But for this benign outcome to materialize the momentum of the past few years must not be lost.

The arguments in this paper lead to a number of actions which need to be, at least conceptually, coordinated. These actions would involve declarations, decisions and negotiations at various levels. At the level of the individual country, it might be helpful if the US, Canada, the EU and Japan (i.e. the “quad”) were to signal their own long run expectations in the area of agricultural trade. They obviously could not agree initially on modalities, but, if they could agree on a set of principles, this would give a framework for other countries to consider when formulating their own positions. The ideal signal from the Quad would be to agree to a four-part statement of principles, along the lines of the following:

(i) That competition in agricultural markets should be free of manipulation by subsidies, cheap credit, abuse of public or private market power. To this end the use of export subsidies should be phased out, export credit terms should be made compatible with the OECD code, export taxes and quantitative restrictions should be subject to strict limits under the WTO, and public and private exporting agencies should be encouraged to compete to best serve the interests of farmers and consumers.

(ii) That access into markets for imports be improved until entry was no more restricted for agricultural and food goods than for non-agricultural goods. This would involve significant lowering of tariffs, the removal of any remaining non-tariff import barriers, the acceptance of the responsibility by those countries using public importing agencies to maintain access to domestic markets, and the phasing out of preferential access over time, both for selected groups of countries and for regional trade partners, by applying the principle of reciprocity and through a reduction in the non-preferential (MFN) rate where appropriate.

(iii) That domestic farm programs should continue to evolve in the direction of the use of less trade-distorting instruments. This means that programs should be developed that are decoupled from commodity production and are well-targeted at particular categories of farmers, types of farming practice, or regions that merit support.

(iv) That national regulations governing food safety, animal and plant health, and the safety of farm workers be formulated in a way that minimizes the chance of their use for purposes of protection of economic interests and the restriction of market access. This involves developing credible regulatory agencies that are separate from those with responsibility for farm support programs. It also requires further efforts at devising acceptable multilateral standards and encouraging the spread of mutual recognition and equivalency agreements. Labeling to give consumers choice among products along with information about their attributes would in many cases be the least trade-disruptive solution.

The countries of the Quad would also need to “sell” these principles to their skeptical domestic constituents. This could be done in the following way:

- The US Administration could emphasize that it was clearly in the interests of the US agricultural and food industry to engage in another set of talks on agricultural trade reform. To delay doing so now would be to send the wrong signal to Europe and other industrial countries, to miss an important window for liberalization of Asian markets and to risk reversal of the liberalization trends in Latin America. The major “prizes” to be won are an end to export subsidies, a resolution to the issue of the use of parastatal export and import agencies, and more secure access into the growing Asian market, including China, on terms that would preclude them following the Japanese down the path toward high protection. Creating a more open food system also means allowing expanded competition from imports of food and agricultural goods from others. On balance, US agriculture will be stronger, and

US consumers will have greater choice. US consumers would be assured of stricter quality controls and farmers of protection against imported diseases through a transparent process which was independent of economic self-interest.

- The Canadian government could make a similar argument in its own domestic debate. Reform is in the interests of Canada and the Canadian farmer. The removal of export subsidies would be the main goal for Canada. Without programs such as the EEP and the EU’s export restitutions the need for strict controls on export marketing would be less, and the principle of single-desk selling may modulate into the practical issue of the most efficient way of selling Canadian food exports. Reductions in the high level of tariffs on supply-managed commodities would present problems for some Provinces, but it is in the interests of Canada as a whole to free up the internal (as well as the external) market for these products. The government is likely to have the support of the food processing industry in this endeavor. Canada would benefit from freer trade in agricultural goods within the Americas, as well as within APEC and the WTO, and creativity in this areas is an attribute that Canada can bring to the table.
- Successive Japanese governments have reluctantly accepted the principle of freer trade in agricultural goods (in the APEC context) but will need to tread carefully to be able to bring the public along. In garnering support from domestic interests the government should focus on the benefits that an importing country derives from a well-functioning trade system that is not disrupted by export embargoes and supply restrictions. Japan still needs to correct its own serious domestic agricultural problem, where a few crops are supported at such a high price that all others become unprofitable by comparison. Compensation payments should be offered to those that are most affected by lowering prices for rice, sugar, wheat and beef. Japanese agriculture could emerge as a stronger industry, based perhaps on the Dutch

experience, as one that provides high value, quality products rather than relatively homogeneous commodities available much cheaper from other countries. Continued deregulation of the agricultural and food distribution chain also promises to help Japan remain competitive and recover the dynamism in an economy that has flagged in the past few years.

- The European Commission needs to sell the continuation of agricultural trade reform as a natural counterpart to the enlargement of the Union and a necessary step toward closer economic (and political) union. As an agricultural exporter and home to many of the world's major food firms the interest of the Union is best served by freer trade in global markets. With so much actual and potential trade diversion (high priced intra-EU agricultural trade), the reduction of the EU's protection is sound internal market policy as well. Decoupled farm support solves many of the problems of enlargement, in particular if compensation payments are paid in part from national treasuries. Adjustment to a competitive agricultural environment would be easier under multilateral reforms offering expanded access to Asia and the Americas for European agricultural raw materials and foodstuffs. The EU also has to convince all its members that post-colonial, commodity-based trade preferences are less help to the recipients than freer trade and the investments that would follow such a move.

Besides the positions of the Quad members, other groups will have to take positions of leadership if agricultural trade reform is to continue. One such group is the Cairns Group, who have already made clear that they are going to stay in business and act as the agricultural conscience of the WTO against the temptation to "cut a deal" on other areas and leave this sensitive sector alone. The Cairns Group has another important function, to represent the interests of smaller agricultural exporters, particularly among the developing countries. As more countries liberalize their import regimes, the issues which brought the Cairns Group together - concern that world

markets were distorted by export subsidies and lack of market access for agricultural goods - are likely to become even more relevant to them. Their own open markets are vulnerable to being swamped by dumped produce from other countries and yet their exports still face significant trade barriers. An enhanced Cairns Group representing the "newly liberalized" countries searching for an equitable trade system would have even more clout.

The same general principles outlined above for the Quad could be adopted by various regional groups, with the additional proviso that their internal liberalization should go hand in hand with reductions in external protection. Such regional groups should concentrate on developing agricultural sectors within their regions that are competitive with low-cost producers in other parts of the world. Similarly, regional standards should be formulated in a way that is consistent with other regions. The supra-regional negotiating processes, such as the FTAA and the APEC, have already indicated targets of liberal trade and investment. But they can go further to incorporate measures which need to go hand in hand with liberalization. A particularly crucial group in this process is the APEC, which could announce that its own plans for free trade and investment by 2010/2020 need to be accompanied by measures to assist rural development, open trade and investment in foodstuffs and offer assurances of food security.

The WTO should stamp its own mark on the agricultural agenda by adopting a firm target for multilateral liberalization in the sector. This target should be consistent with the regional pacts and the supra-regional processes. One possible date would be 2020, the target year for all of the APEC countries to embrace free trade and investment. An APEC resolution that ensured that this agricultural free trade zone was to be open to all other parts of the world prepared to make similar offers of unlimited access would set the tone for all intermediate steps, whether in the WTO or in the regional trade pacts. It would be the task of the WTO to ensure that this agreement was indeed extended to all countries without

discrimination. The process of agricultural trade reform started in the Uruguay Round would then be complete.

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Next Steps in Agricultural Policy Reform**

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