

Developed Countries and the New Round: Policy Trends and Reform Objectives in Agriculture

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Introduction

Agricultural policy in the OECD countries is in the midst of a significant paradigm shift. The pace however is hardly dramatic. In contrast to the situation in Latin America, and in many parts of the Caribbean region, agricultural policy reform in the industrial countries has come only reluctantly and with a great deal of domestic opposition. In the period up to 1985 the farm policies in these countries had become so entrenched that they seemed almost to be immune to both internal and external pressures. However the changes in New Zealand's policy in the mid-1980s showed that governments could under certain circumstances change farm policies quickly and radically. Other countries, such as Sweden and Australia followed suit. Finally the agricultural "superpowers" got into the act: reform of the EU's Common Agricultural Policy (CAP) in 1992 and the 1996 Farm Bill in the United States represented very significant changes in direction for farm policy. Taken as a whole, these changes usher in a new era of relations between governments and the agricultural sector. Even in Japan the basic law which governs the

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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 slow but fundamental changes which are taking place in the agricultural policies of the major industrial countries have benefited greatly from the encouragement and underpinning of international agreements. The changes in domestic agricultural policies have generally been in the direction of improving the climate for agricultural trade, in contrast to the policies espoused in the nineteen-sixties and nineteen-seventies (stock accumulation, export subsidies, domestic supply control) 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. Regional trade agreements, particularly in the Americas and in Australasia, have added to the pressure to move to liberal trade. 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 New Paradigm in Domestic Policy

The reform in the agricultural policies of developed countries represents a new paradigm for domestic policy towards the agricultural sector that is much more trade-friendly as well as more efficient. This paradigm shift has been away from the manipulation of the commodity price level as the main way to assist the agricultural sector towards the payment of direct payments to farm families on the basis of present or past activities. Early signs of this shift in developed countries were the adoption of commodity-based deficiency payments in place of price supports, so that consumer demand could respond to market prices. These deficiency payments over time have become decoupled from present production so as to reduce the incentive to over-produce. The decoupled payments have in some cases been targeted to various environmentally-friendly farming practices. Income insurance and crop insurance schemes have also been introduced to act as a stabilizing device for rural areas.

The shift occurred because the old paradigm was clearly inappropriate in an open world economy and a less regulated domestic market. Commodity price intervention rewarded farmers according to their output of the product, regardless of the state of the market. Farm output and structures responded to the policy signals rather than consumer demand, and agriculture became dependent upon further government assistance to dispose of surpluses. Moreover, environmental groups began to point out that farming systems geared to high price policies were creating problems for the water supply, for worker safety, for public health and for the preservation of plant and animal species. Targeting payments to the farmer has the advantage of being more direct, involves less distortion in production incentives, can be tied to environmental standards, and allows the consumer to choose more freely among competing products.

The change was resisted at first by farmers who would prefer to be paid “through the market”, however much that market was distorted by border protection and export subsidies. Moreover, the world market was often deemed, with good reason, to be unreliable and unstable. What convinced governments to change was in part a growing awareness that the policies were not achieving their objectives: farmers who needed help the most were not the ones who had the most product to sell. In part it was a recognition that the operation of such policies in different countries effectively offset each other, so that a coordinated removal of such policies would have less impact on farmers than a unilateral change by one country. It was also a reaction to the growing political visibility of environmental groups in many countries, and to the need for farmers to be more responsive to “green” concerns. Coupled with these specific reasons was the more general change in the role of governments in the marketplace. As the notion that governments could or should control prices began to be replaced by the idea that market forces should be the main determinant, the end of commodity price-support was in sight.

This change in paradigm has been accompanied by a shift in the political influence of agriculture. This has in part to do with the general unpopularity of programs that support particular groups at the expense of the consumer or taxpayer. But in the case of agriculture it may also be connected with the move away from commodity based support systems. If the government supports the price of a commodity, by restricting imports, subsidizing exports, buying up

surpluses or taxing substitute products, then it usually needs to work through the processing sector or the wholesaler to implement the policy. Sugar policies are operated largely through sugar beet factories and cane refineries. Dairy policy is implemented through the dairies and creameries that take delivery of farmers milk. Grain policies involve storage and shipping of cereals through merchants and middlemen. Oilseeds policies involve oils and meals from the crushing activities as well as just seeds and beans. When the basis of farm payments is the output of commodities, there is some coincidence of interests between the processor and the farmer. When the farmer gets paid compensation bonuses on the basis of historical hectareage and regional yield, the processor has less interest in the profitability of the domestic producer and is more willing to import the raw material and look for the cheapest source of supply.

This “decoupling” of support from output has in turn had a profound impact on the range of trade policy choices in the sector. It essentially means that a country can recast its trade policy for agricultural goods to be consistent with that for non-agricultural goods. Shifting from price supports to income insurance schemes, for instance, gives the possibility of relaxation of import regulations. One is substituting financial instruments for physical commodity market intervention, generally at lower economic cost. Similarly, production constraints previously needed to limit government payments on export subsidies would no longer be needed if the compensation payments to farmers were not influenced by market price. The decline of commodity programs liberates trade policy, just as the de-linking of price from income liberates social and environmental policy. These trends in domestic policies have manifest themselves in different ways in different OECD countries, but the common thread is to be found in most of the industrial nations.

The transfers effected through specific policies for a 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 1). 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, 1997). 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.¹

Table 1: Producer Subsidy Equivalents (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, 1997

The beneficial effects of the shift away from direct price supports are beginning to show up in the aggregate statistics that monitor the development of farm policies. The OECD calculations split the Producer Subsidy Equivalent (PSE) into that which is given through market price support (MPS) and that which comes from direct payments and “other” support (not commodity-related). In 1986-88 market price support made up 79 percent of the total subsidy equivalent for all the OECD countries taken together. By 1996 the MPS had dropped to 60 percent of the PSE. The change is primarily due to the MacSharry reforms in the EU. The share of MPS in PSE in the EU dropped from 98 percent to 51 percent. By contrast, Japan still relies predominantly on market price support: the ratio of MPS to PSE is still at 85 percent, the same value as in 1986-88. The next round can therefore take as given the start of serious domestic

¹ These numbers tend to confirm the impression from the average unweighted *ad valorem* agricultural tariffs of a level of protection of about 40 percent for agriculture as a whole.

policy reform in industrial countries (with the partial exception of Japan) in the direction of less trade-distorting policies, and hence push ahead with further necessary changes in the trade rules.

Constraints Shaping OECD Agricultural Policies

Two sets of external constraints can be identified as shaping farm policy in the developed countries in the past dozen years. One is the rise of regional trade blocs as elements of commercial policy. This has sometimes encouraged more liberal agricultural trade and sometimes worked in the other direction. In the Americas the trend has been for the emergence of regional trade blocs to support the move away from protected national commodity markets toward integrated regional markets for agricultural goods. This is clear in the case of the US and Mexico, where the prospects are for a single regional market with modest external protection for most commodities within a few years. Mexico coordinated its domestic policy reform with the signing of the NAFTA, using the latter as an additional reason to undertake the former. Even Canada, which opted out of the single North American market for sugar, dairy and poultry products, has felt obliged to modify a number of its policies to facilitate the development of NAFTA. The US has perhaps felt the impact of regional trade pacts on domestic policy the least, but that is likely to change with the discussions on access of Brazilian and Argentine agricultural exports into the US under the terms of the FTAA.

In Europe, where regional markets are protected from third country imports, regionalism is not a major force for liberalization. The expansion of the European Union to include countries of Central and Eastern Europe has raised the specter of more countries falling within the protectionist orbit of the CAP.² But in one respect regionalism is having a constraining effect even on the CAP. There are political attractions to negotiating free trade agreements with South Africa and the Mediterranean countries, along with a desire for commercial purposes to gain

² It should however be pointed out that Finland and Austria “decoupled” some of their farm support policies in the process of joining the EU. Their previous price levels had been higher than those of the EU and their farmers would have taken a substantial cut in income in the absence of direct income payments by way of compensation.

access to Mexico and the MERCOSUR countries. This is making it increasingly awkward to have an agricultural trade policy based on the CAP and hence inflexible with regard to access.³

In Asia, regional integration has lagged behind other regions, and it would be misleading to give credit to regionalism for any changes in Japanese or Korean agricultural policy.⁴ One should however acknowledge that bilateral pressure from the US on these two countries probably has had some liberalizing results, whilst at the same time leading to resentment and conflict. On a more positive note, the Closer Economic Relations Agreement between Australia and New Zealand has certainly changed the context in which agricultural policy is framed in those countries, and has presided over the creation of an open trans-Tasman market.

The second external factor in the change in agricultural policies has been the introduction of new rules for agricultural trade at the multilateral level. It is generally agreed that the completion in 1993 of the Uruguay Round of trade negotiations marked the first time that effective international constraints had been put on domestic agricultural policies. The Uruguay Round Agreement on Agriculture (URAA) put in place a set of rules which has already gone some way toward shaping the development of such policies. Bound tariffs have 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.⁵

The extent of progress made in agricultural trade reform can be judged by contrasting the current situation with that which prevailed prior to the Uruguay Round. World markets for the major temperate zone agricultural products had been in disarray for two decades before that, as the surpluses of the 1960s gave way to shortages in the 1970s, with the vagaries of weather

³ Access problems are particularly difficult with respect to the supply-control commodities (dairy and sugar) and the commodities in chronic surplus (cereals and beef). Other difficulties are related to regional concentration of producer interests (such as Spain and Italy for olive oil, Italy for rice, and France, Germany, Spain and Italy for wine) which make it difficult to consider liberalized access for these products.

⁴ The apparent agreement within APEC to move to a free trade and investment zone would appear to qualify as a major constraint on Japanese and Korean policy. However it is too soon to point to any concrete results from this statement of intention.

⁵ See IATRC (1997) for a more complete discussion of the Uruguay Round results and Josling (1998) for the need for further reform of the agricultural trade rules.

exacerbated by destabilizing trade policies. The 1980s began with a brief “shortage” of grains, caused largely by a surge in demand but again made worse by the reaction of the major countries, and then a long slump in the prices for the main traded commodities.⁶ By the middle of the decade, as the Uruguay Round was about to begin, soaring budget costs from farm programs were conflicting with pressures for fiscal restraint. It became widely recognized in the US and Europe that the situation was rapidly becoming untenable. In earlier trade negotiations, the farm policies of the major industrial countries had been required to make only relatively minor changes to bring them into conformity with the agreements. Thus the key question for the Uruguay Round was whether there would be the will to engage in a set of multilateral talks which would effectively put constraints on domestic agricultural policies.

As it turned out, domestic policies in the developed countries were, in the process of changing, if more for domestic than external pressures. The same issues were faced in country after country. Three domestic pressures can in particular be isolated. The first internal pressure came as a result of changing market balance in the traditional temperate zone agricultural commodities coupled with a shift in the set of acceptable agricultural policies. Traditional agricultural policies were not able cope with the changes in cereals, oilseeds, dairy and beef. Advances in technology and structural change in agriculture increased yields, but domestic market growth was slow. The choices were to control supply, an unpopular solution with farmers; to store the surpluses against the next period of shortage; to export with generous subsidies, thus distorting other countries markets; or to lower farm support prices.

Until the mid-1980s most countries tried a combination of supply control and surplus disposal, with some attempts to constrain price increases. The situation began to change in the period after 1985, as countries came under pressure to both modify their domestic policies and incorporate new trade rules into the Uruguay Round Agreement which reinforced the domestic policy changes. Prices were reduced in an attempt to lower incentives and stimulate consumption. This

⁶ The behavior of commodity markets over this period is discussed fully in Chapter 6 of Josling, Tangermann and Warley (1996).

price-reduction option was made more palatable by paying compensation to those who were disadvantaged. The EU resisted until 1992, when the MacSharry reform allowed the CAP to live with the new trade regime. The US followed up with the FAIR Act in 1996, which effectively decoupled payments to grain and oilseed farmers and removed the main requirements for supply control.

Meanwhile a second contributing factor to agricultural reform was beginning to be significant. The agricultural sector had been changing at a rapid rate, making the old style agricultural policy mechanisms less relevant to the needs of the industry. The support of raw commodity prices in the market through the with-holding of supplies or the buying up of surpluses effectively breaks the link between producer and consumer. Just as the market was getting more sophisticated and differentiated, the policy was sending the message to farmers to “produce low quality goods for government stocks”. Just when supply chains were being set up for the provision of goods to supermarkets, farmers were being encouraged to take land out of production and live on payments for keeping farmland idle. Clearly the vast expense of farm policy was not helping farmers to meet the challenges of providing for modern consumers. The farmers that prospered were those that took advantage of the changed conditions and began to service the differentiated market.

A third “internal” factor also began to have an impact on agricultural policies over the 1990s. The rise of environmental consciousness in OECD countries, together with increasing concern over food safety and the conditions under which livestock is reared. These concerns began to impinge on agricultural policies primarily through the presumed link between intensive, chemically-dependent farming practices and the cleanliness of water supplies, the health of the food supply and the habitat for wildlife. Thus the domestic farm policies came under pressure to change in a way that would reduce the conflict between chemical farming and a safe environment. This pressure is still increasing in most of the OECD countries to modify farm policies to incorporate more directly the needs of the environment in farming decisions.

Objectives of OECD Countries in the New Agricultural Round

It is not possible to group all countries of the OECD together with respect to agricultural trade issues. Divisions on several issues are considerable. However one can divide the OECD members into four groups, each with a different set of objectives and constraints. The first group comprises Australia and New Zealand, who, along with other members of the Cairns Group, have taken a firm position on the desirability of expanding market access and on removing export subsidies and export credits. Their own internal protection is generally low, indicating that they could agree to substantial cuts in global tariff rates for agricultural products without falling afoul of domestic interests. The second group is the “North American” OECD members, led by the US but including Canada (although also a part of the Cairns Group) and Mexico. This group will also wish to continue the pressure exerted in the Uruguay Round for an opening up of agricultural markets, but will be subject to more constraints as a result of internal policies. The third group includes Europe, embracing EFTA and the countries of Central and Eastern Europe that are either OECD members or closely aligned on policy terms. This group will not be at the forefront of the pressure for trade liberalization: they will tend to argue for more cautious market opening. However, they know that many internal European trade issues would be resolved if they were to be forced to adopt a more liberal stance on agricultural trade issues. As a consequence one can expect to see ambivalence and inconsistency in the position of these countries in the talks. The fourth group includes Japan and Korea, whose stance in the Round is likely to be rather different from that of the US, Europe or Australasia. These countries view the prospect of a more open market with a mixture of apprehension and mistrust. On the one hand they are both very open economies, depending for their economic life on exports of manufactured goods to other OECD countries. On the other hand they have small-scale, high cost agricultures of their own which would have difficulty competing at world market prices. Thus their view is colored by the need to ensure reliability of supplies and the concern that to rely on the world market for any larger proportion of consumption will leave them vulnerable to shortages, natural or man-made. Coupled with the difficulties of finding alternative work (or social safety nets) for the farmers

that would be displaced by liberalization, this imposes a very real limit on the extent to which they can modify their agricultural policies in the context of the next round of trade talks.

The Agenda for the Next Agricultural Round

It seems likely that the next round of agricultural trade negotiations will be cast essentially as a continuation of the reforms and liberalization started in the Uruguay Round. This implies that the framework is likely to be similar to that which emerged from the Round and which is now embedded in the Agreement on Agriculture. Thus the three main areas for discussion will be market access, export competition and domestic support. In addition, the question of the working of the Uruguay Round Agreement on Sanitary and Phytosanitary Measures (the SPS Agreement) will be discussed largely in its agricultural policy context. Issues that are sometimes thought of as “new” will probably be handled conveniently within this now familiar framework. The question of the allocation of tariff rate quotas (TRQs) is clearly one of market access, and can be addressed under that agenda item. Countries have indicated a wish to confront the issue of state trading in agriculture, but that topic can usefully be separated into the components of market access (state trading importers) and export competition (state trading exporters). The use of export restraints may also be challenged in the next round, in part as a reaction to the concern over food security in importing countries. But this also can be subsumed under the heading of export competition. Thus by expanding somewhat the definition of the three major agenda items one can incorporate the “new” as well as the “old” issues. The possible position of the four major groups of OECD countries are summarized in Table 2 and discussed more fully below.

Table 2: Summary of Possible OECD Positions in the Next Round of Agricultural Negotiations

Element	Australia / New Zealand	US / Canada	Europe (EU, EFTA and CEE)	Japan / Korea
Market Access	<p>Lower tariffs and lower tariff peaks;</p> <p>Regularize TRQ administration and expand TRQs;</p> <p>Discipline STE importers;</p> <p>Tighten safeguards</p>	<p>Lower tariffs but sector by sector approach;</p> <p>Regularize TRQ administration and expand TRQs;</p> <p>Discipline STE importers;</p> <p>tighten safeguards</p>	<p>Modest lowering of tariffs but wary of sector by sector</p> <p>Regularize TRQs but expand cautiously;</p> <p>Discipline STE importers;</p> <p>keep safeguards</p>	<p>Modest lowering of tariffs but reducing peaks not favored;</p> <p>Fewer problems with TRQ administration</p> <p>no increased disciplines on STE importers;</p> <p>keep safeguards</p>
Export Competition	<p>Abolish export subsidies as soon as possible</p> <p>Export credits need to be restricted</p> <p>Export STEs allowed with restrained powers</p>	<p>Reduce export subsidies with aim of abolition</p> <p>Export credits subject to some limits</p> <p>Impose strict limits on export STEs</p>	<p>Keep export subsidies when needed for domestic market clearing and maintaining market shares</p> <p>Constrain export STEs</p>	<p>Content to abolish export subsidies</p> <p>No incentive to restrict export credits</p> <p>Curb on export embargoes and taxes</p>
Domestic Support	<p>Tighten green box</p> <p>Abolish blue box</p> <p>AMS constraint tightened</p>	<p>Green box should not be expanded</p> <p>Abolish blue box</p> <p>AMS constraint not important</p>	<p>Green box should be expanded to allow for environmental payments</p> <p>Keep blue box</p>	<p>Green box could be expanded to include “food security” payments</p> <p>Blue box not important</p>
Other Issues	<p>Don't reopen SPS Agreement</p>	<p>Don't reopen SPS Agreement</p>	<p>Open up SPS to allow for consumer concerns</p>	<p>No position taken on SPS revision</p>

Australia and New Zealand in the Next Round

Australia and New Zealand played an important part in the Uruguay Round discussions on agriculture, in particular through their participation in the Cairns Group. The Cairns Group will probably also play a key role in the next round, perhaps with expanded membership. One function of the Cairns Group in general, and Australia and New Zealand in particular, is to keep the pressure on the US and the EU to reach agreement. There will once again be a tendency by the major protagonists 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 prospect 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 minds of the negotiators, in particular the EU. The role of the Cairns Group in such a situation could presumably be to block such an extension of special protection until an agreement was found on the issues of market access and export subsidies.

With respect to particular issues on the agenda, one can expect Australia and New Zealand to be in the forefront of those arguing for improved market access. This will no doubt include reducing tariff peaks, regularizing the administration of TRQs (though they do not at present appear to favor the auctioning of those quotas) and imposing some burden on importing state traders to at the least fill quotas. The expansion of TRQs could also be supported by Australia and New Zealand. On export subsidies, the position is clear: along with most members of the Cairns Group they would like to see such practices disappear. Export credits are also blamed for distorting markets to the disadvantage of the smaller exporters who cannot afford such programs. On the other hand there is some ambiguity with respect to the position of these countries on the issue of single-desk sellers. Export STEs have been a prominent feature of the agricultural policy of these countries for many years, and they have parried attacks in the GATT which accused

them of export subsidization through price discrimination.⁷ But the parastatals are losing their monopoly powers so rapidly that it is likely that Australia and New Zealand will be able to lead the charge against export monopolies in the next round with no domestic conflict to constrain their position. On the issue of domestic subsidies, it is clear that Australia and New Zealand will resist any loosening of the green box criteria and may push for a more restrictive approach to the AMS. On the SPS agreement, both countries will likely argue that it is being effective and should not be opened up.

North American Positions in the Next Round

Though each country will negotiate separately, the attitude of the US will undoubtedly influence the position taken by other North American countries in the next Round. But what will be 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 US 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. In particular, the US is going to have to grant better access in its own markets 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 domestic market subject to meeting the same conditions as imposed on domestic supplies. The process of opening up US markets to NAFTA partners has only just begun. The putative date for an agreement on free trade in the Western Hemisphere is only seven years away. In addition, the Administration has consistently supported the APEC objective of free trade and investment, and this objective is scheduled to be

⁷ For many years Australia ran a “home price” scheme for many major products which kept the domestic price above the export price. It was argued in the GATT that this did not constitute an export subsidy. Although two price schemes have been abandoned a similar issue has now arisen with regard to price pooling, the payment of a pool price to producers based on an average of different end uses for the product.

achieved within twelve years. But whether the political will is present to support a liberalization of US markets is not certain.

Thus the US and Canadian views on market access are still unclear. Canada will resist too drastic a reduction in tariff peaks, since these peaks are particularly high for Canada. Canada favors, and the US has supported, the notion of “zero-for-zero” agreements that would accelerate trade liberalization for particular commodity groups (such as oilseeds). This would tend to go against the notion of reducing protection across the board. But the US and Canada are likely to agree with the Cairns Group on the need to improve the administration of TRQs and to expand them to increase market access, as well as on the need to make sure that STE importers do not restrict imports. They will also wish to ensure that the safeguard system is not abused. The US is likely to be somewhat more cautious on the abolition of export subsidies (which Congress regards as a war chest for fighting the European Union) or the curbing of export credits, which form a part of foreign policy as well as getting rid of exports. The US would also go along with the Cairns Group view that export monopolies should be restrained, but Canada would have difficulty agreeing with that position.

On the issue of domestic subsidies it is possible that the US could differ from the Cairns Group. The US has tended to downplay the significance of the AMS reductions, on the assumption that any strict rules would be difficult to enforce. Recent events in the US have exploited the ambiguities in the AMS measure, as farmers have been given an additional \$6 billion at a time of low prices.⁸ The US will no doubt be inclined to push for the elimination of the blue box, since the 1996 FAIR Act has arguably put US programs within the green box category. On the question of the widening of the green box, the US is likely to take the view that the definition should not be broadened to include European environmental programs. Similarly the US is against the opening up of the SPS Agreement: having won the battle to enshrine “science” above politics, the notion of recognizing “consumer concerns”, as requested by the EU is not attractive.

The European Position in the Next Round

The European Union approaches the new Round of agricultural trade negotiations in somewhat of a quandry. On the one hand the lesson taken by many in Europe from the experience of the Uruguay Round was that Europe had exhausted all its energies defending the CAP from attack. This meant that it had no time to develop a positive strategy to pursue changes that it would like to have seen either in trade rules or in the policies of others. The notion that it had already “reformed” the CAP, with dairy quotas in 1984 and a budget ceiling in 1988, was not convincing to its partners. Even after the introduction of the MacSharry reforms in 1992 it was clear that the EU still required high border protection to preserve its domestic policy. On the other hand, to go into the next Round in a position of strength would require further reforms in advance of the talks. This has been widely rejected by EU farm groups as well as by the French government. As a result, the likely outcome is a set of modest reforms (known as Agenda 2000, and largely justified as needed in the light of the start of talks on enlargement) which will have to be supplemented later as the final package becomes clear.

On market access, the EU is going to be cool toward any sweeping cuts in tariffs. Though an exporter, it still feels under pressure from competing imports of temperate zone goods. As a result it would like to see Asian markets expand, but cannot move too far from its traditional protection of the domestic market. A modest across-the-board reduction in tariffs is likely to be the preferred outcome. But the EU will be vulnerable on the issues of the widespread use of specific tariffs, the use of reference prices for fruits and vegetables and the high degree of excess protection for cereals as afforded by the bound tariff relative to the “maximum duty-paid import price” for cereals which was agreed in the Uruguay Round. The position of the EU on state trading is unclear: as an exporter there are good reasons to believe that the EU would side with the other exporters to put additional disciplines on such agencies.

⁸ It should be pointed out that other countries are also in the process of compensating farmers for income losses. However so far this has not taken the form of higher prices, and thus could come under the heading of direct income payments. Such largesse may well, however, encourage farmers to stay in production.

On export subsidies the EU position is likely to be that they are essential to the clearing of markets at least for the next few years. Whether they could be persuaded to end them in principle is not clear. The Commission would rather not have to use them as instruments of policy, but it would be unacceptable to lose market share too rapidly in the cereals and dairy markets as a result of not being able to lower offer prices. Export credits are not used in Europe and there are no single-desk sellers. The EU is likely to go along with further constraints on these two activities.

One of the most contentious issues is likely to be the “size” and “composition” of the green box. For the EU the green box represents a possible way out of the dilemma of how one satisfies political imperatives for the maintenance of farm incomes and at the same time lives within the constraint of the WTO. Payments, perhaps from national sources, aimed at recompensing farmers for the “multifunctionality” of European agriculture would be allowed even if not totally consistent with current definitions of trade-neutral instruments. Whether the EU will argue that the concept of the green box needs to be changed or merely that different policies will be allowed to slip into the box is not clear. Moreover the Commission runs the significant danger of raising the expectations of European farmers that the multifunctionality card can be played to gain more protection at the border – an idea which would certainly deadlock the talks from the start. On the blue box, the EU is likely to defend it in the early stages but can change their own compensation policies without too much inconvenience (and to domestic advantage) to make them compatible with the green box, as did the US in the FAIR Act.

With respect to other matters, the EU has indicated that it would like to reopen the SPS agreement so as to be able to take into account situations where consumer concerns are hanging over markets. Action taken for these reasons runs foul of the SPS agreement unless there is scientific basis for consumer fears. The concern is that relying on science alone will result in politically unacceptable solutions and hence to a lack of credibility of the WTO rules. In addition, the EU may want some continuation of the Peace Clause, to avoid continuous WTO challenges of the day-to-day operations of the CAP.

Japan and Korea in the Next Round

The position taken by Japan and Korea will tend to be dominated by concerns over food security. The definition of food security, however, may remain contentious. In Japan and Korea there is a strong tendency to equate food security with a high degree of self-sufficiency. At a psychological level this might be understandable, but it poses a significant challenge to a global trade system. One element of food security is, however, quite consistent with the development of an open food system. Asian countries may hold out for assurances against the use of export embargoes and a curb on the use of export taxes.

On market access, the Japanese feel vulnerable to suggestions of cutting tariff peaks or introducing maximum tariffs.⁹ They are more likely to favor modest tariff cuts, perhaps across the board. They have less objection to the present administration of TRQs, will be wary about expanding them too fast, and can be expected to be against any notion that the TRQs be linked with imports by private firms. On the issue of further disciplines on state trading importers, one would not expect Korea and Japan to be forthcoming, at least until their own internal distribution systems have been reformed.

The Japanese position on export subsidies has been that they are responsible for market disruption and should be discontinued. However, Japanese state trading importers are known to favor dealing with sole sellers in export markets. One can expect only lukewarm support for the notion of constraining the activities of single-desk export agencies. Korea likewise would not normally be a strong supporter of export subsidies. However there have been occasions when that country has wished to subsidize some exports but been unable to do so because of the WTO commitments. Should export subsidies be allowed to continue, one could expect to see Korea arguing for a reallocation of subsidy “rights” to reflect current market conditions.

⁹ The adoption of tariffs for rice is strictly not a matter for the next round. It was agreed in the Uruguay Round, subject only to the delay in implementation in the case of Japan and Korea. If they wish further delay those countries will have to offer substantial market access guarantees to trade partners. It seems more likely that they will settle for tariffs at a high level instead.

The main contribution of the Japanese and Korean governments to the agricultural talks is likely to be in the area of food security, in keeping with their main concern. The question is “where to incorporate such concerns?” One possibility, borrowing from the European position, is to declare the provision of food security as one of the “multifunctional” facets of agriculture. But this raises the question of how to reward such an attribute without harming farmers in exporting countries. Whereas one might be able to argue that environmental contributions can be acknowledged without undue trade disruption, it is not easy to see how one can both promote self-sufficiency (the usual index of food security suggested in such discussions) and preserve an open food system. This is the dilemma which Japan and Korea will have to address in the next round.

One way out of the dilemma is to emphasize the issue of export restraints and taxes. If a food security package was to be put together which satisfied Japan and Korea that the trade system had an obligation to maintain exports even at times of domestic shortage then the concern with self-sufficiency could be reduced. But this may require more obligations on access to supplies than the exporters are willing to concede. This is one area where the developing food importers could really have an impact. A package which combined greater import access with supply assurances could go some way to defusing the current tension between exporters and protected importers in international agricultural markets.

Prospects for Further Reform of Agricultural Trade

There is good reason to believe that the next round of agricultural trade talks could be less contentious and protracted than the last. Although such an optimistic view depends crucially on the full and timely recovery of the Asian economies, the signs are in general more favorable than in the years before the Uruguay Round. The multilateral trade system is in much better shape than in the mid 1980s, when serious disagreements existed as to whether even to hold a new round of trade negotiations. For one thing the existence of the WTO gives the trade system the legitimacy that was lacking in the GATT, together with a stronger dispute settlement process and

a policy coordination function.¹⁰ The agricultural negotiations will both benefit from the participation of a wider group of countries. Not only are there more members of the WTO now than there were GATT contracting parties in 1986, but many more developing countries have open economies and feel themselves to have a major interest in the talks. The WTO is much more truly global in scope and covers a much greater proportion of world trade than did the GATT. It is in a much better position to chart the course for multilateral trade policy now than was the GATT in 1986.

Structural changes in the agricultural and food markets of the world will have a major impact on the next round of trade talks. As mentioned above, one of these changes is the process of intra-industry reorganization that is in the process of transforming isolated national markets into parts of an integrated global system. This is being driven by firms seeking lower production costs and broader markets over which to spread costs and is a consequence of the relaxation of investment and trade regulations. In other words, the food and agricultural sector is not escaping the pressures of globalization that have swept so many parts of the economy. It is true that agricultural products are rarely assembled from out-sourced materials, as happens with cars and computers. Farmers don't often move their activities offshore to take advantage of lower-wage labor, though it is not unknown.¹¹ But through various more subtle changes a similar quiet revolution is underway.

The most notable indication of this change is that the growth in trade in high value added products has been much greater than that in homogeneous bulk products. In 1985 trade in high value added products was barely one half of total agricultural trade. By the year 2000 it is estimated that this share will be around three-quarters of agricultural trade. Part of this is due to

¹⁰ The popularity of the dispute settlement process is indicated that the WTO has recently begun to consider the 100th dispute. Over half of cases have been initiated in the past three years, and about 60 percent of them concern some aspect of the food and agricultural trade.

¹¹ Many farmers and farm businesses in California saw the opportunity for the production of fruits and vegetables in Mexico for sale to the US market, even in advance of NAFTA. Moreover there is a large scale movement of feeder cattle across the US-Canada and US-Mexico borders which has many similarities to inward processing and other trans-border transactions.

the effects of rising incomes, as consumers shift away from unprocessed foods. But much of the growth in high value added goods is due to increasing product differentiation as producers and food retailers attempt to convince consumers of the merits of particular geographical locations, recipes and brand names. Goods that were once considered “non-tradable” have found a place in foreign markets for ethnic and exotic foods. Product differentiation, segmentation of the market and quality attribution along with the growth of “non-traditional” trade is the key behind the growth of agricultural exports from many countries in Central and South America as they free up foreign exchange markets and begin enthusiastically to trade. It is also behind much of the rise in US agricultural exports, including to the old, saturated markets of Europe. Europe itself is enjoying a minor export boom in the same types of commodities, breaking out of the trap which for years had made it focus on a few undifferentiated products such as wheat, sugar, skimmed milk powder and butter which could only be sold with heavy subsidies.

This shift in the type of trade raises new issues that need to be resolved. These include the areas of intellectual property rights on seeds and genetic material, geographical origin protection, labeling of organic produce and of goods containing genetically-modified organisms (GMOs), as well as issues of animal and plant health and human safety. Another round of trade negotiations might well be justified on these grounds alone, regardless of the “old” issues of market access and export subsidies. The probability is high of significant tensions in this area if rules are not clear and widely accepted. Indeed the widespread use of crops that incorporate biotechnology may very soon collide with the equally widespread fears of consumers, often encouraged by those with other agendas, about their safety. Unless public authorities regain the confidence of the public, trade rules that aim to facilitate trade can themselves lose credibility in the public eye.

All these changes are in the direction of a more sophisticated agricultural industry aware that the future depends on satisfying a variety of consumer tastes and competing for the consumer dollar with other goods and services. This will eventually transform the politics of agricultural trade within the OECD countries. More actors are becoming involved in the political process, and the center of gravity is shifting perceptibly away from the primary producer. Policy is becoming less “commodity” focussed and the emphasis is switching to adding value to the raw material and

marketing the final product. These changes are driving agricultural trade policy reform. In a situation where the “market” is an administered price supported by public purchasing agencies, free trade poses a real threat. In a world where farmers produce for the market, improvement in access to overseas markets compensates in part for more domestic competition. A freer agricultural market no longer means a collapse of prices and mass rural depression. Today it is more likely to spark rural entrepreneurship and healthy market development based on response to the changing food habits of middle-class consumers.

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Policy Trends and Reform Objectives in Agriculture

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