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Agriculture in the Uruguay Round ambitions and realities

H. Guyomard, L-P. Mahe, K. Munk, T. Roe *

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The Directorate-General for Economic and Financial Affairs,
Commission of the European Communities,
200, rue de la Loi
1049 Brussels, Belgium

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H. Guyomard, L-P. Mahé, K. Munk, T. Roe *

* H. Guyomard is from INRA – Station d'Economie et Sociologie Rurales de Rennes, L.P. Mahé is from ENSA – Département des Sciences Economiques et Sociales de Rennes, K. Munk is from the EC Commission – Directorate-General for Economic and Financial Affairs, T. Roe is from the University of Minnesota, Department of Agriculture and Applied Economics. The authors would like to thank E. Guth, J. Schaps, an anonymous referee and the editor for helpful comments on an earlier draft.

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SUMMARY

Agricultural trade policies are basically a function of domestic policy considerations *which have produced high levels of support in many countries*. New policy instruments such as direct payments, which are more demanding in *terms of* information costs but *which* distort *the* resource allocation *less*, are becoming more attractive. Unilateral liberalisation is, *however*, unlikely. Freer trade is a public good which requires international collective action to be provided. Countries *which* have a clear-cut trade interest in liberalising markets for commodities they export can play the role of catalyst in international co-ordination. The existence of big players is a favourable factor. Hence, the drift of the Round towards *a coordination of US-EC interests*. Both political economy and trade interest considerations suggest that an agreement *reached will have its main impact on crops which are widely traded. The main constraining factor of an agreement on EC and US agriculture will be the discipline it will impose on the use of export subsidies*. Agriculture will still not come fully under *the GATT rules which apply to other sectors, but* the CAP *is likely, in the future, to* be more constrained *by international commitments* than in the past.

1. INTRODUCTION

The pattern of agricultural policies emerging across the world at the end of this century exhibits distinctive features. Nearly all of the industrial countries hold resources in agriculture behind a panoply of protectionist barriers that insulate the primary sector from international competition. Meanwhile, developing countries tend to support their urban-industrial sector at the expense of their primary industries. As a consequence, world markets for agricultural temperate-zone products are heavily distorted. Exports from the third world face competition from rich countries which restrict access to their domestic markets and/or dump their surpluses on the world market. Many of the new industrialised countries tend to imitate this pattern and raise barriers to agricultural trade as the development of their industrial sectors gains momentum.

In the industrial countries, agricultural policies based on heavy government interference with market mechanisms are now viewed as a serious problem. Huge budget costs, surpluses, environmental degradation and the unsatisfactory levels and distribution of farm incomes have strengthened opposition to these policies. At the same time, trade conflicts have multiplied as evidenced by the increasing number of complaints processed by the GATT panels, and by the export subsidy war on grain trade between the European Community (EC) and the United States (US).

In 1982, ministers of the OECD countries issued a declaration on agricultural trade aimed at a major effort of reassessment and progressive reforms of agricultural policies. In 1986, the Uruguay Round was launched by the declaration of Punta del Este. Although this declaration expressed a consensus on the need for policy reforms, the contracting parties of the GATT quickly showed large divergences in their views on the Round, and in their willingness to make concessions. Negotiations have already been underway in excess of the four years initially foreseen. This is also the first time that agricultural issues have played such an important role, with several crises triggered when the United States, the Cairns Group and the developing countries insisted on conditioning any general agreement on resolutions of agricultural disputes.

The general purpose of this paper is to identify and assess the main factors determining the likely outcome of the agricultural component of the GATT negotiations. These factors are of political and economic nature. First, the political market, biased in favour of supported farmers in nearly all industrial countries, tends to block the reform process implied by a GATT agreement. Second, the economic costs generated by current price policies have made new instruments like direct payments more attractive with regard to both efficiency and distributive goals. The latter factor, favourable to domestic reforms, is enhanced by international pressure due to the existence of potential trade gains from liberalisation in some large countries for some commodities. These expected gains are sufficient to circumvent the free-rider problem built in to the international trade game. Hence, the role of the US as a catalyst in the negotiation process and a drift of the Round toward an US-EC conflict. However, in most countries, the distribution of the benefits from liberalisation greatly varies across commodities so that all countries, including the promoters of freer trade, still want to protect some of their agricultural sub-sectors. As a consequence, all contracting parties have an ambiguous position with respect to broad principles. A far-reaching agreement is thus unlikely, but agriculture will in the future be more under the discipline of the GATT, particularly in the area of export subsidies for the largely traded commodities.

The paper is organised as follows. Section 2 reviews how arguments of political economy and public finance can be used to explain government attitudes towards agricultural policies, and then applies the collective action approach to the GATT game. In this light, Section 3 reviews the negotiation positions and potential coalitions of the main players in the Uruguay Round. Section 4 identifies the scope for compromise in the US-EC agricultural trade confrontation. The final section contains the conclusions.

2. THE ECONOMIC AND POLITICAL RATIONALE OF GOVERNMENT INTERVENTION IN AGRICULTURE : IMPLICATIONS FOR THE GATT GAME

In the early 1980s, an increasing awareness and documentation of distortions in world markets emerged. Efforts to explain the patterns of these distortions are generally drawn from the literature on political economy and public choice and from the modern theory of public finance[1]. The collective action approach also provides a framework to characterise the nature of the trade negotiations game.

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[1] The observed patterns of agricultural trade across countries cannot be explained on the basis of comparative advantage only. Government intervention is a significant explanatory variable (see, for example, Wolrath, 1988).

a. Patterns of agricultural policies and issues in agricultural trade regulation

Many studies of agricultural protectionism (e.g., Anderson and Hayami, 1986 ; Parikh et al., 1987 ; Krueger et al., 1988 ; Webb et al., 1990; Lindert, 1991) have revealed a fairly consistent pattern of protection across countries and time. The general conclusions are : i) in general, rich industrialised countries provide more support for agriculture relative to other sectors than do poor countries, ii) importers of agricultural commodities tend to be more protectionist than exporters, iii) exporting developing countries often tax their agricultural sector, both directly by interventions within the sector and indirectly by protecting their urban industrial sectors, and iv) the level of protection is positively correlated with the level of per capita income. Hence, newly industrialised countries tend to shift from taxing to protecting their farm sector.

This situation creates major tensions between exporters of primary products from the developing world and protectionist industrial countries, and among the latter themselves. The food trade balance sharply deteriorated in *many* developing countries from the late 1960s to the mid-1980s while, at the same time, food surpluses have increased steadily in industrial countries. Agricultural policies are not the sole explanation for this outcome, but they have undoubtedly contributed to it as policies in the North have depressed world prices and policies in the South have further decreased producer incentives.

Many studies have then attempted to evaluate the implications of trade liberalisation in the industrial countries on the economies of the developing countries. Despite some discrepancies, it has generally been found that liberalisation in the North causes general price increases (including increases for wheat). Food-importing countries might therefore suffer from agricultural policy reform in the industrial countries (Parikh et al., 1987). Nevertheless, others stress that reforms of agricultural policies should benefit developing countries as a whole, particularly if they deregulate their own agricultural sectors too and if, at the same time, industrial countries liberalise non-agricultural trade (Anderson and Tyers, 1990 ; Burniaux et al., 1990 ; Zietz and Valdès, 1990). At least the developing countries which export agricultural commodities competing with temperate-zone products will almost surely benefit from agricultural trade liberalisation in rich countries.

The picture in OECD countries follows the same logic. Most net exporters of temperate-zone products like Australia and New Zealand should benefit from easier import access and better terms of trade, in contrast, *net importers like* Japan and *most European countries* would benefit from domestic reallocation of resources, *but lose from adverse terms of trade effects.* The potential economic gains have, in general, been unable to trigger political action toward reform in the latter group of countries. Short-run political costs seem to have received more attention than long-run economic benefits although recently some countries have unilaterally undertaken large-scale reforms of their farm policies : New Zealand, Sweden and the EC are cases in point.

b. Political economy of agricultural policies

Central to the public choice-political economy approach are the political forces created by the behaviour of individual farmers and their coalitions. These groups include the numerous producer associations that seek to obtain from the state, through economic policy, that which they cannot obtain from the market alone. They are effective in industrial countries because their number in proportion to the country's population is small and because a large share of their income is due to specialisation in a small number of enterprises (Olson, 1965). These two factors tend to lower individual farmer costs of lobbying to seek legislation in their favour. Benefits of agricultural policies tend to be concentrated on farmer groups while costs are dispersed to the larger population. Hence, the relative oppositions to farmer political forces tend to be weak because the costs to individual consumers or taxpayers of forming a lobbying body to countervail these forces are high in comparison to individual returns.

Four economic features tend to facilitate agricultural interests in gathering political support.

i) The first is price instability. Price instability generates an asymmetry in the development of regulation in agriculture. When financial stress occurs as a result of adverse price conditions, policies are often introduced to alleviate income losses. However, these policies are seldom withdrawn when economic conditions improve. Part of the reason for this is that agriculture is characterised by sector-specific resources, in addition to land, that cannot be easily reallocated to other sectors. Consequently, the value of protection becomes embodied in these sector-specific factors, e.g., land values, used machinery prices and so on. When conditions are better, the rise in the value of these resources is associated with both improved economic conditions and economic policy. Hence, withdrawal of the previously given economic support will tend to dampen the recovery, or, if withdrawn after a recovery, it will tend to induce another albeit modest decline. Producers are aware of this potential decline in value of their sector-specific assets and therefore have an incentive to engage in political actions to avert this eventuality. Hence, stabilisation tends to degenerate over time into permanent support.

ii) A second related economic force that makes reform difficult is that agriculture is characterised by increasing capital-deepening over time. Investments in land improvements, buildings, irrigation, or livestock have increased productivity but also created financial liabilities. Furthermore, these investments are too difficult to reallocate to other sectors of the economy. Such capital-deepening has, for example, clearly occurred in US and EC agriculture in anticipation of continued support policies, i.e., in an artificial policy-induced economy that cannot be sustained in the presence of free and open world markets. Consequently, at the margin and in the absence of compensatory payments, agricultural policy reform will almost surely lead to a decrease in returns to resources. Since, as mentioned, the value of economic policy affects the value of sector-specific assets, agricultural policy reform implies a real decline in the returns to these investments and a sharp decline in the rate of investment. This decline in wealth is, for example, well known to US producers following the decrease in land values during the 1980s.

iii) Land is also related to space, to environmental amenities, to rural development and to natural resources. The increasing concern about the rural environment has drawn attention to the need to discipline agricultural practices harmful to natural resources. This has also created new support for the country life in general, a support which policy makers have difficulty in providing through policy instruments that are decoupled from production incentives.

iv) Finally, food, being closely associated with health and basic needs, has therefore clear emotional connotations. In Europe and Japan this concern was originally related to food security that further motivated the development of agricultural policies after the second world war. More recently, the food safety argument has served as a justification for non-tariff barriers and other forms of regulation.

A dynamic element to the political economy of policies was stressed by Honma and Hayami (1986). When the farm sector loses comparative advantage during a country's process of industrialisation, obtaining political support is often facilitated. This increase in support was observed in Japan in the 1950s, and is now taking place in the new industrial countries of South-East Asia.

Together, both economic and institutional forces make reform particularly difficult. The institutional reasons lie in the rigidity inherent in public choices such as the various channels of congressional committees, legal statutes and the numerous agencies that provide, bring into play and support the mechanisms of policy implementation, co-ordination and communication in the agricultural policy process. Policy reform in itself would then entail a substantive dismantling of this structure, not unlike the dismantling that has been associated with the structural adjustment and stabilisation policies prescribed to many developing countries by international institutions. Hence, there has been insufficient incentive to deregulate farm policies unilaterally, and instead an incentive to "free-ride" by encouraging other countries to reform.

c. The pressure for agricultural reform : a public finance explanation

Besides the political economy approach, there have also been attempts to explain agricultural policies on the basis of modern public finance theory (Sah and Stiglitz, 1985 ; Newbury, 1987 ; Munk, 1989). The public finance analysis supplements the political economy approach by explaining the behaviour of governments in choosing policies which achieve distributional objectives in the most cost-efficient way. Modern public finance theory (Atkinson and Stiglitz, 1980) emphasises that government intervention is associated with "information" costs (i.e., costs of collecting information, enforcement costs and other administrative costs). Thus, lump-sum taxes are not a feasible instrument because they are, in general, associated with prohibitive information costs. For this reason, government revenue has to be raised by taxes which are associated with both distortion and administrative costs. Since real distribution objectives cannot be achieved at no cost, this explains why governments use policy instruments, which create distortions, both in order to achieve redistribution objectives and in order to raise their revenue. Governments may redistribute income to producers by either price support or direct income payments. Which instrument is most efficient depends both on the administrative and the distortion costs involved. Price support is associated with relatively high distortion costs but relatively low administrative costs, and vice versa for direct income support.

Price policies compare relatively favourably with direct income support policies if i) the administrative infrastructure is weak and the implementation and enforcement costs of alternative transfer instruments are high, ii) the price support is given to a product for which the country is a net importer, so that price support is associated with positive government revenue (i.e., tariff revenue), and iii) the supply elasticity is low, so that the costs in terms of distortion and production are small.

The underlying factors which provide the rationale for government use of price support policies change over time. The importance attached to agricultural income seems to increase with the level of economic development for political economy reasons mentioned above and because the relative income position of farmers deteriorates. Also, the administrative costs of direct transfer instruments are likely to decrease with economic development, whereas the distortion costs of price support that come with economic development are likely to increase.

Both the political economy and the public finance explanations are consistent with the observation that developing countries with weak administrative infrastructure and high opportunity costs of government revenue tend to protect import-competing agricultural and industrial products, but impose negative protection for exportable commodities in order to raise tax revenue. The public finance theory also explains the introduction of price support policies during the transition from developing to developed country. The administrative structures during this period are still weak. The agricultural sector becomes a declining industry, agricultural income falls behind the national average and pressure builds up among farmers to lobby for support which the government can easily provide through price instruments. Finally the public finance approach, suggests that a move from market price support to direct income support may take place in the course of further economic development as the relative costs of income instruments fall relative to those of price instruments.

d. Collective action at the international level : the Uruguay Round as a game

The public finance approach has suggested that economic conditions in industrial countries are now favourable to the adoption by governments of new policy *instruments* to support agriculture. On the other hand, the political economy approach concludes that farmer*s* have been able to keep the domestic political balance in their favour, thus halting the internal reform process. The result is that *no* single country is likely to pursue an unilateral reform even though doing so would *produce significant economic benefits.* Trade negotiations between industrial countries are therefore particularly difficult since governments must negotiate with these special interests in mind. Collective action at the international level helps to understand why and how these contradictory forces, channelled into the agricultural trade game of the Uruguay Round, contribute to delineating the contours of the likely final agreement.

Insights into international trade relations can be obtained when governments of the various countries are viewed as rational decision-makers in a non-cooperative economic game. Without co-ordination, the players pursue agricultural policies taking into consideration the interests of their respective agricultural producers, consumers and tax payers, disregarding the effects their actions have on other players. This *generally* lead*s* to a sub-optimal outcome. International co-ordination of agricultural trade policies holds out the promise of improving the situation. Many economic studies suggest that aggregate welfare in most countries would improve from liberalisation in agriculture trade. On this basis, one would therefore expect the Uruguay Round, which provides a forum for co-ordination of agricultural policies, to lead to substantial freer trade in agricultural products. Such expectations are, however, clearly based on wrong assumptions.

A GATT agreement in agriculture will only come about if the outcome created by such an agreement by the main players is considered an improvement in comparison with maintaining status quo. There is ample evidence that government preferences are such that major unilateral trade liberalisation is a preferred option in only very few countries. Moreover, freer trade *world-wide* is a public good since freer trade also benefits countries other than those who liberalise. This situation suggests that the optimal provision of this public good is unlikely to occur in a decentralised international system. The international trade game is akin to a prisoner's dilemma *situation*.

The prospects for agricultural trade liberalisation would *be* gloomy if the political balance *in all countries was* in favour of *agricultural protection to the same extent*. This is not the case, however, as *some developed and developing countries export certain* temperate-zone commodities on to world markets on a nearly competitive basis. These countries have trade interests in the liberalisation *of the trade in these* commodities. As governments pursue mercantilist *objectives* as well as seeking to placate special interests, *an incentive for collective action at the international level therefore exists, which will reinforce the trend, suggested by the public finance approach, towards less trade distortionary support instruments.*

This incentive may not be sufficient, however, to trigger action since the negotiation process, *is based on* the Most Favoured Nation (MFN) *principle* that the benefit of a concession made by any country *must be* extended to all other contracting parties. In a multilateral framework, trade concessions also become public goods When a large number of countries is involved, the incentive for any one of them to make concessions is reduced by the prospect of having to share with all countries the benefit of the reciprocal concessions granted in return. This is another free-rider problem in the agricultural trade game, more likely to result in status quo than in a trade liberalisation when the negotiations deal with a large number of small countries.

The proliferation of Free Trade Areas (FTA), bilateral trade agreements and trade blocs *may be seen as* attempts to circumvent this externality problem *created by the MFN principle. The existence of big players in the international trade game helps to safeguard the principle of multilateral trade agreements on which the GATT is based.* This may appear as a paradox at first glance, but it is consistent with Olson's remark that collective action is more likely to occur in heterogeneous groups with some players having high stakes in a successful organisation of the group to develop power. Group organisation is more likely to happen when some big players can take the role of catalysts in collective action, because sufficiently large gains give them an incentive to move and because their relative size allows them to express credible threats to force other reluctant players to move as well. If all parties in the trade negotiations were of equal size and unable to affect the terms of trade of anyone, no single country would have the incentive to initiate a costly negotiating process. It seems that US and other large *agricultural* exporters *have* such a incentive in the Uruguay Round. It is doubtful that agriculture would have played such a big role in the Round without these national interests in *agricultural trade* liberalisation. Moreover, the use of the multilateral framework of the GATT rather than purely bilateral deals will force smaller *importing* countries (subject to "credible threats") to comply with the agreement settled by the big players, thus further reinforcing the gains accruing to the big players from higher world prices.

To summarise, although the economic costs of agricultural policies in industrial countries can now be reduced by introducing new instruments, all countries involved in the Uruguay Round have to find a delicate balance between the domestic pressures to keep some support for their most protected farm industries and the objectives of capturing the benefits of freer trade in the commodities they export on a more competitive basis. This makes it difficult for most countries to take positions for all their farm activities, consistent with broad principles. It also explains the ambiguity of the negotiating strategies of many countries and the limited prospects to reach an agreement close to the initial ambitions of the Punta del Este declaration.

3-AGRICULTURE IN THE URUGUAY ROUND: BETWEEN POLITICAL ECONOMY AND TRADE CONFLICTS

The current Round of GATT negotiations was launched in 1986 in Punta del Este, Uruguay, with the explicit intention that the negotiations should aim at a greater liberalisation of agricultural trade. The Ministerial Declaration stated that all agricultural policies, including domestic measures, import barriers and export subsidies, were subject to discussion.

a. The Punta Del Este Ministerial Declaration : an ambitious programme

In the seven previous Rounds, the notion that "agriculture is different" was generally accepted. Therefore, agriculture was never really brought under the general GATT rules, it was granted exceptions from the general principles of the Agreement and some countries were allowed specific derogations. Several of these exceptions and derogations were incorporated in the GATT at the insistence of the US. Import quotas (Article XI) and export subsidies (Article XVI) were tolerated, under some general conditions, for agricultural products. In 1955, the US obtained a waiver of its GATT obligations under Section 22 of the Agricultural Adjustment Act of 1933. Variable levies were tolerated in the EC.

Agriculture was largely left out, not of the successive GATT negotiations[2], but of the GATT commitments, because of the pre-eminence of domestic issues over trade objectives in agricultural policies of most contracting parties. A particular opportunity was missed in the Kennedy Round when the EC proposed to introduce a ceiling for its self-sufficiency ratio for important products and to bind the "montant de soutien", which would have constrained the level of price support and hence, of border protection. However, the US rejected the offer that it might have been wise to accept[3].

Real commitments were nevertheless made in the successive Rounds of negotiations. Some of them seemed rather limited at the time but have since become serious issues in agricultural trade relations. The zero binding tariff on oilseeds and non-grain feeds in the Dillon Round, and on grain substitutes (corn gluten feed) in the Kennedy Round, has both constrained the development of the CAP and given a leverage to other countries in the current negotiations.

The announced objective of the Uruguay Round, as stated in the Punta del Este Declaration, was no less than to achieve greater liberalisation of agricultural trade by, 1) improving market access (i.e., reducing import barriers), 2) "improving the competitive environment by increasing discipline on the use of all direct and indirect subsidies and other measures affecting directly or indirectly agricultural trade, including the reduction of their negative effects and dealing with their causes" (FOCUS, October 1986, p. 4), and 3)

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[2] Until the Uruguay Round, domestic agricultural policies were regarded as non-negotiable (Hine et al., 1989).

[3] As pointed out by Warley (1989, p. 308) and Josling et al. (1990, p. 295).

reducing adverse trade effects of sanitary and phytosanitary regulations.

Although all countries agreed to bring agriculture further under the general GATT rules, itwas clear from the start that the degrees of enthusiasm varied. It remains to be seen how far this Round of negotiations can go in achieving a programme with ambitions which quickly turned out to create problems for nearly all countries in some sectors and in nearly all sectors for some countries.

b. Initial offers of contracting parties and main compromises[4]

The first proposal tabled by the US argued for the complete elimination of farm programmes by the year 2000 (the "zero" option). The Cairns Group agreed with the long-term objectives of the US, but allowed for more flexibility. The EC's (and also Japan's) response was a flat rejection of the call for complete elimination of farm programmes. The EC proposed a negotiation process in two stages : short-term actions to stabilise the most seriously imbalanced markets (cereals, sugar, and dairy products) and, in a second stage, reduction of support levels based on the decrease of an Aggregate Measure of Support (AMS).

The wide gap between these early positions led to the failure of the mid-term review meeting in December 1988 in Montreal. Nevertheless, at the April 1989 session, the contracting parties agreed to propose commitments before the end of 1990 on short-term measures and long-run reforms, and set a time schedule for their implementation. This agreement was possible essentially because the US adopted (temporarily) a more flexible position by abandoning the idea of a complete elimination of export subsidies and by accepting a discussion on short-run measures without a precise accord on long-run objectives.

In October 1989, the US issued its revised proposal for a long-run reform which dealt with four topics : import access, export competition, internal support, and sanitary and phytosanitary regulations. This proposal was particularly demanding for the EC as

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[4]For an excellent overview of initial positions of the various contracting parties, see Hine et al. (1990).

export subsidies were supposed to be eliminated over five years, while internal support and border protection could be phased out over ten years. The US proposal tabled in October 1990 was somewhat less radical calling "only" for a 90% reduction in export subsidies and a 75% both over 10 years, of internal support measures. The US confirmed its will to negotiate simultaneously and explicitly in the three areas : market access, export competition and internal support.

In its proposal of November 1990, the Community repeated that AMS reductions would result automatically in decreases in the need for export subsidies and, hence, that it was not necessary to make specific commitments in the area of export subsidies. The Community offered to reduce the AMS by 30% between 1986 and 1995 and agreed to some form of conversion of its border measures into tariffs. However, this concession was contingent on the acceptance by other contracting parties of the principle of "rebalancing", i.e., the fixation of tariffs on EC imports of oilseeds and non-grain feeds[5]. In other words, the EC agreed to make binding commitments on AMS reduction and tariffication, but *did not want* to negotiate specific CAP instruments.

The meeting in Brussels in December 1990 failed to conclude the talks despite the ultimate tentative of the Swedish Minister of Agriculture, Matt Hellström. The Swedish compromise followed the negotiation logic of the US and the Cairns Group by proposing specific commitments in the areas of internal support, export competition and import access. None of the parties was able to accept the Swedish compromise in its entirety. For the US and the Cairns Group countries, the reductions of internal support and export subsidies were deemed insufficient the EC, Korea and Japan rejected it as a basis for negotiations, the EC mainly due to the proposed reductions of export subsidies. However,at the time of the Brussels conference the first proposals for the CAP reform, which involve a switch from price to income support, were formulated, and, at the beginning of 1991, the EC implicitly agreed, for the first time, to discuss explicit reductions of export subsidies.

Most of 1991 was spent on expert discussions which were helpful in clarifying issues and options, and at the end of that year, the General Director of the GATT, Arthur

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[5] McCorriston (1993) provides an assessment of this proposal, focusing on rebalancing EC protection for grains.

Dunkel, presented a new compromise. Although it was not accepted in its entirety by the different parties, this compromise was at the core of the talks during 1992 and provided the basis for the successful meeting in Washington in *November* 1992, where the EC Commission and the US found a bilateral deal.

The Dunkel compromise (or Draft Final Act) dealt with export competition, domestic support, *market access and sanitary and phytosanitary measures.* It recommended, over the period 1993-99, i) a 36% cut *in export subsidies* in budgetary *terms* combined with a 24% reduction in the subsidised export volume, ii) *for domestic support,* a 20% reduction *in AMS, and* iii) *with respect to market access,* tariffication of border measures, a 36% reduction of these *and existing* tariffs, and a *guaranteed* minimum import access of 5%. The major reform of the Common Agricultural Policy proposed by the EC Commission in July 1991 (CEC, 1991) and adopted in May 1992 (CEC, 1992) set the stage for this bilateral compromise.

The basic features of the Draft Final Act have been kept in the EC-US Washington agreement, except for the cuts in the AMS which are no longer effective because of sector-wide aggregation and of a temporary *exemption* of the new CAP aids *from reductions*. Furthermore, the latter agreement settles the oilseeds dispute, includes a peace clause and mentions, although in vague and not binding terms, the rebalancing issue which had been reduced in importance after the cut in grain prices decided in May 1992.

c. Rationales behind the positions of the contracting parties

The negotiating positions were far apart, mainly because the agricultural sub-sectors of the various contracting parties are characterised by different degrees of competitiveness. All countries pursue free-trade arrangements for their efficient exporting sectors and seek to delay adjustment in the others.

In general, contracting parties of the Uruguay Round may be classified into two categories : the proponents of reform and the proponents of restraint (Hathaway, 1990). The first group led by the US, the Cairns Group (including Canada, but to a lesser extent), and supported by other exporter developing countries, have tangible terms-of-trade gains to expect from a multilateral approach of trade liberalisation. The second group is composed of Japan, the EC, Nordic countries, importer developing countries and also Canada for animal products. These countries do not have obvious trade gains to expect and their governments' position is highly influenced by the political clout of farmers. The EC case is even more complex because of the expression of national interests in the Community decision process. This rationale - trade interests for some countries and domestic political costs for most countries - may be illustrated by some examples in the three main areas of the negotiations.

i) Market access

A major issue in the area of market access has been tariffication, i.e., the conversion of all border instruments into bound tariffs. It makes protection transparent and obvious. It creates a direct link between world and domestic prices in protectionist countries. This procedure has been successfully used by the US in bilateral negotiations with Japan to obtain more open access to Japanese markets in beef and citrus (Blandford, 1990). Success with this approach may explain, in part, the US propensity to use this strategy in the Uruguay Round. Obviously, tariffication would imply an important reform of the EC variable levy system[6]. However, it would also affect other policies and contracting parties such as the Voluntary Export Restraint Agreement on manioc imports into the EC, the waiver in the US (dairy, sugar, ...), import quotas on dairy products, eggs and poultry in Canada, the rice import ban in Japan,... The negotiations on market access also concern the amount and time schedule for reduction in tariffs (including tariffied border instruments) and minimum-access provisions.

In 1988, Japan agreed to partially liberalise its restrictive beef import regime by phasing out beef import quotas over a three-year period. Beef quotas were replaced by a tariff that will equal 50% in 1992. Japan also agreed to remove import quotas on cheese, frozen yoghurt, whipped cream and ice cream. However,, the major obstacle to a real reform of Japanese agriculture is the high price support of rice. Japan has repeatedly used a food-security argument to promote self-sufficiency in that sector. Hence, as regards rice, Japan is strongly reluctant to convert quotas into tariffs and to accept the clause of minimum access.

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[6] Hence, the modified version of tariffication proposed by the EC which would include i) tariffs with a fixed element and a correction factor which takes into account exchange-rate changes and fluctuations in world prices, and ii) rebalancing. The Draft Final Act includes provisions related to item i), but item ii) has been left out.

The 1990 Canadian proposal on market access was at variance from the Cairns Group position (75% reduction over 10 years of tariff equivalents). Canada proposed that quantitative import restrictions continue to be permitted under Article XI:2c, and especially for products under supply control (i.e., dairy and poultry products in Canada). Even "fair" traders have difficulty confronting their own special interest groups.

ii) Export competition

The negotiations on export competition pursue the objective to make more precise and stringent the content of Article XVI of the General Agreement on export subsidies. The EC export restitution system is the main target of the contracting parties with major trade interests.

For a long time the EC has refused to discuss a specific commitment on export subsidies on the grounds that this would automatically result from the decrease in domestic support. Under the old regime the EC would, not accept any commitment to reduce grain exports since would have translated into significant cuts in transfers to farmers without significant trade gains. This is the background for the EC rejection of the different GATT compromises up to 1990, including the so-called De Zeeuw paper which clearly asserts that "the commitments to reduce export assistance shall result in such assistance being reduced effectively more than other forms of support and protection and that these commitments may take the form of commitments to progressively reduce aggregate budgetary outlays on export assistance, per unit export assistance, the total quantity of a product in respect of which export assistance may be provided, or some combination of such commitments" (MTN, 1990). The EC has been isolated on that issue.

Although the US is currently carrying a substantial subsidy programme, its position on export competition reflects the expectations of a major grain exporter from better world prices. The Cairns Group position in this area is also based on the gains that these countries expect from freer trade on grains. Any commitment to reduce subsidised exports and export subsidies, by both the US and the EC, would imply reductions of American and European exports from current levels, higher world prices and hence, a better price competitiveness for the Cairns countries. It is interesting to note, for example, that Australia, although a traditional ally of the US in agricultural trade negotiations, has accused both the EC and the US of dumping their grain surpluses on world markets during the six years of the Round[7].

While Japan tends to support the EC position on market access and internal support, it accepts the US and Cairns position on export competition. Hence, without unnecessary risks to its trade interests, Japan supports a ban on all export subsidies. Nevertheless, given the net-importer position of Japan on all agricultural products except rice, this "liberal" line is not too difficult to follow. A similar reasoning applies to the Nordic countries.

iii) Internal support

All contracting parties accept the principle of a reduction in internal support, but disagree on how to implement this reduction (reference year or years, transition period, degree of reduction, list of measures subject to reduction, agreement on a measure of support, definition of the fixed reference world price, measure of credit, especially for products subject to supply management policies,...). The various contracting parties have accepted to negotiate on the basis of an Aggregate Measure of Support. Hower, further developments in the Round have revealed that all countries, while agreeing on principles, have attempted to minimise the cuts in support. This is clearly illustrated by the Canadian proposal of October 1990 and by the choice in various proposals of the base periods from which reductions are to be measured.

Canada has not been able to follow thoroughly the "hard" line of other Cairns countries calling for "only" a 50% reduction in internal support (on a 1988 base period) and insisting on the credit to be granted for supply control programmes. This case shows again that even "fair" traders have some sensitive points and encounter limits in the principles when they hurt the interest groups of highly protected sectors.

The choice of a 1986-88 base period in the US proposals allows this country to minimise reductions in support (CARD, 1991). In the same way, the choice of a 1986 base period by the EC also reflects its desire to minimise support reduction requirements because it maximises the credit for policy changes achieved in the EC from the beginning of the Round (Westhoff, 1991).

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[7] For example, US grain sales (with the help of the Export Enhancement Programme or EEP) to China, Yemen and Kuwait have been the subjects of complaints from Australia.

Recent developments of the negotiation (i.e., the Washington compromise) exemplify the contrast between the accommodating treatment of AMS reductions[8] and the strict line kept in the areas of import access and export competition. The latter agreement would relieve both the US and the EC from any domestic support cuts further than those implied by the US 1990 agricultural legislation and the 1992 CAP reform, but would in the long run imply fairly drastic constraints on both Community preference and export volumes in the EC (Guyomard et al., 1992). It reflects the necessity to buy international peace with a fairly generous compensation for the domestic sectors forced into adjustment.

4. Focus on the US-EC agricultural conflict

The previous sections made it clear that the possibility for the US and the EC to reach an agreement on agricultural issues will largely determine the outcome of the GATT not only with respect to agriculture, but also with respect to other issues. This justifies a more detailed look on the US-EC agricultural conflict.

As far as agriculture was concerned, the various GATT negotiations were dominated by US-EC disputes. In fact, the major concerns of the US have always been to alleviate or reverse the adverse consequences of CAP principles on US trade in cereals and related feedstuffs. The US tolerated the EC trade policies on grains as long as the EC was not a significant exporter, kept from the temptation of imposing a tax on fats and feed imports and maintained import flows when further enlargements occurred such as in the Spanish agreement on maize. Now that the EC has became a large exporter of grains and has developed a significant oilseeds sector, the difference in policies between the two countries seems unacceptable.

a. Empirical illustration by a quantitative assessment of the US 1989 GATT proposal

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[8] This is a major concession from the US, particularly in view of the results of the oilseeds panel which has rejected *that* compensatory payments *could be disregarded in a GATT context*. But, this concession makes life easier for most countries which *are supporting their farmers*.

The results of quantitative assessments of US and EC proposals tabled in the GATT clearly illustrate the rationale of the negotiating positions of the two main players. The US focusses on trade policies, while the EC tries to square the circle by managing the conflict between the alleviation of the external pressure and the costly domestic adjustments. Let us take the example of the US 1989 proposal.

According to this proposal, internal support measures which have a significant impact on trade would be progressively eliminated over 10 years, import barriers would be tariffied and phased out, also over 10 years, and export subsidies would be eliminated over 5 years. A simulation of the proposal was performed over 5 years (from a 1988 data base) so as to compare the relative pace of the adjustments in both the EC and the US (Guyomard and Mahé, 1991). The proposal was implemented in such a way that farm income loss in the EC would be minimised when export subsidies follow the 5-year elimination schedule. Accordingly, milk production quotas were used to ensure the elimination of exports of dairy products after 5 years, so that price support can follow the less constraining 10-year phasing out schedule. Deficiency payments were not introduced for grains, however, so that the nominal rate of protection must be reduced by 72% over the 5 years of the simulation. In the US, the main policy instruments concerned were deficiency payments (which follow the 10-year schedule) and the Export Enhancement Programme (which follows the 5-year schedule). Finally, the analysis assumed that historical rates of technological change in the two regions would continue into the future.

<u>Insert Table 1</u>

The results (Table 1) suggest that, after 5 years, indirect price cuts in the EC's agricultural sector cause it to attain self-sufficiency in products now in surplus, with significant benefits to consumers and taxpayers (+21 and +12 billion ECU, respectively). Total farm income losses are nevertheless large (over 20 billion ECU). In contrast, the US's agricultural sector suffers much less (farm income falls by 4.6 billion ECU "only") and, of course, the cost of the US programmes decreases sharply (7 billion ECU). Essentially, the US saves budget costs because the target price of grains is reduced and because world prices of grains increase (+11%) as a result of the elimination of EC grain exports. These world price effects would be sufficient for the US to increase its trade balance in grains while EC's trade deteriorates sharply.

In view of these results, it is not surprising that the EC rejected this US proposal as unbalanced. But, more basically, the results reveal the unavoidable conflicts imbedded in the CAP, i.e., the conflicts between farm income, budget cost savings and export policy. They document the fact that a significant CAP reform is likely to be costly to tax-payers if farmers have to be compensated for income losses. They also reveal that a decrease in export subsidies would put a heavy burden of adjustment on the EC agricultural sector as long as price support policies were maintained, hence the EC's reluctance to strike a deal which would discriminate against export subsidies. Finally, they illustrate how US interests are served by such a deal because this country saves enough to compensate its farmers while it draws gains on its external balance.

b. The Political economy of the US-EC agricultural trade game

Several authors have analysed the political economy of EC and US farm policies, either separately (Gardner, 1987) or in parallel (Petit, 1985 ; Meyer and Josling, 1990). Furthermore, Johnson et al. (1990) have tried to evaluate the political weights (i.e., the political influence) implied by the observed behaviour of US and EC policy makers. These measures are then used to provide insights into the types of trade compromises between the US and the EC that are both politically feasible and resource saving. Such weights were estimated assuming that the policies prevailing in the EC and the US in 1986 reflected a Nash equilibrium of an EC-US agricultural trade game. In other words, the political forces discussed in Section 2 were balanced in such a way that neither country would find an alternative policy action that would benefit its respective interest groups given the likely reaction of the other country. The estimated weights of major commodity groups, consumers and tax-payers are presented in Table 2.

Insert Table 2

The results highlight both similarities and differences. Similarities include the large weights of sugar and dairy producers in the two countries, and the small power of the pork and poultry commodity group. Consumers have less political power in the EC than in the US in relation to tax payers (who are the reference group), so that budget indicators are likely to matter more in the US than in the EC. Beef and dairy producers also carry more weight in the EC than in the US, and the same is true for grain producers.

What do these weights say about feasible compromises between the US and the EC in the Uruguay Round ?

A game (i.e., alternative trade policy positions ranked from the status quo to progressively freer trade) was simulated on the basis of 1988 data, where the weights were used to calculate the outcome of various degrees of liberalisation on the political objective function of US and EC policy makers. The policies included i) a continuation of present policy instruments but at different levels (game 1), ii) a compensation to the groups with the highest weights, i.e., with the highest political influence (game 2), and iii) a change in world markets (environment) resulting from a liberalisation of policies in other OECD countries (game 3). Three possible strategies were then allowed, namely a) status quo (sq), b) ban on producer and export subsidies (ber), c) partial free trade (pft), and d) free trade (ft)[9]. The implications to politically acceptable trade compromises are shown in Table 3.

Insert Table 3

The results from the game 1 simulation suggest that, given the balance of political influence reported in Table 2 and the policy instruments in place in 1988, neither country could find a policy action that would benefit its interest groups better than the status quo, given the likely reaction of the other country. In other words, these simulations illustrate the well-known fact that, in spite of potential economic gains from deregulation, the political influence of commodity groups are able to stop the reform process.

The question analysed in game 2 is : if compensation could be made to the most influential groups that lose from reform in each country, might the two countries agree on

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[9] For precise definitions of strategies, see Johnson et al., 1990.

some level of reform ? The results suggest an affirmative answer, although they indicate that only partial liberalisation would result because budget savings from reform is only sufficient to compensate more powerful losers. Consequently, freer trade is likely but completely free trade is not.

The implication of this empirical analysis is not too surprising in light of the discussion thus far. Still, even these rather limiting possibilities for reform rest on a critical assumption that is known as dynamic inconsistency (Persson and Tabellini, 1990). The essence of the issue is that the optimum policy for government may be different before and after the private sector has responded. That is, for example, a government may promise to make decoupled payments if farmers agree to forgo the old policy instruments. But, once farmers give up the old policy for decoupled payments, a government may not have an incentive to maintain these payments. Anticipating this to happen, farmers may be reluctant to give up the old policy even if the decoupled payments are lucrative. Now, the government, anticipating this behaviour, only announces time-consistent policies, i.e., policies that, while socially sub-optimal, have a small likelihood for reversal. These policies are then credible in the eyes of farmers. Finally, as mentioned, the question of administrative efficiency and information costs remains. That is, can administratively efficient policy instruments that decouple payments at low administrative costs be found ? Section 2 argued that this is increasingly the case in industrial countries.

Finally, the simulation of game 3 sought to provide insights into whether liberalisation by the rest of the OECD would increase the willingness of the US and the EC to reform. The results suggest that reform in other OECD countries would induce the US to reform partially even if the EC did not reform. These results are consistent with the US action to seek bilateral agreements outside of the GATT, such as the free trade agreement with Canada and currently NAFTA (North American Free Trade Agreement). Effectively, the economic gains to the US from bilateral treaties tend to internalise gains at levels that exceed political costs. Concessions made under the GATT mean that economic gains of reform must be shared by all whereas bilateral agreements internalise a larger share of these economic gains. Whether this circumvention of the GATT as an international institution will strengthen or weaken it deserves considerably more study.

In summary, the fact that only partial liberalisation looks feasible is consistent with the view that, in spite of the initial zero option tabled in the first US GATT proposal, neither country is likely to be able to carry out a complete elimination of its own farm programmes, particularly in the sugar and dairy sectors. The US Congress has proved to be less enthusiastic than the Administration when it comes to the benefits expected from the GATT round. Hence, full-fledged deregulation of the US agricultural sector seems out of reach. The tactic of US negotiators in the Uruquay Round to set the targets at an unrealistic level, not only in the beginning but up to the final stage of the negotiation, can be then interpreted either as a way to dramatise the need for reform in order to obtain a more preferred trade compromise, and/or as a strategy to accomplish through the GATT process domestic policy reform that could otherwise not be obtained through domestic political means alone.

In the EC as well, where the CAP reform was viewed as unavoidable in nearly all circles in spite of wide discrepancies between Member States, a complete elimination of support programmes may not be envisaged. Hence, the mid-way nature of the Mac Sharry project of July 1991 and of the CAP reform of May 1992 since they relieve external pressure without uprooting the Market Common Organisations, particularly in the sensitive dairy and sugar sectors which are protected from scrutiny by production quotas.

5. Conclusion

In sum, organised collective action within countries forces the negotiators to yield on domestic support to minimise political costs, whereas collective action on the international scene has been led by the evident interest of the more competitive exporters in maximising gains from freer trade. The decreasing role of the AMS in the negotiations appears as a necessity to sell a GATT agreement to the more powerful producer groups. This is obviously true for the EC, but also for most other countries, including the US, since all have some non-competitive sectors whereby cuts in income support are politically hard to achieve. So, the progressive tolerance by the US to exclude the "new" CAP compensatory payments from the AMS is consistent with its own difficulties in reforming the sugar and dairy sectors. The crucial necessity for the EC to get compensatory payments *exempted from reduction* gives leverage to the US for obtaining binding *commitments with regard to* trade*flows*, and more particularly *with respect to* subsidised exports. This is consistent with the political economy approach to the negotiation since countries with clear trade interests form an organised constituency which support a stricter discipline of trade barriers and export subsidies along the antidumping philosophy of the GATT.

The active role of the US in this Round on agricultural issues can then probably be best understood by its relative size and by the potential of immediate and sizeable gains from trade liberalisation on grains that would exceed the adverse political losses in other subsectors. It is clear that agriculture would not have played such a role without clear trade interests of the US and the Cairns countries in the cash crop sector and related feedstuffs. The more defensive attitude of the EC in the Uruguay Round may be explained by the relatively stronger political influence, compared to the US, of farmer groups : hence, the stated EC position on short-run political costs and on adverse trade effects of multilateral reforms for some Member States. Nevertheless, technological advances have made the principles of the "old" CAP increasingly inadequate, even to attain domestic policy objectives. The shift to a permanent net export position in most temperate-zone products, with the budgetary and trade-conflict consequences, have made action necessary, particularly in the cash-crop sector where interdependencies with other countries are the greatest.

The strongly binding constraints which have survived the negotiations down to the Washington compromise are the export-subsidy cuts, while domestic-support reductions, and even market-access *provisions have been much diluted.*

As far as agriculture is concerned, the Uruguay Round has increasingly given the irresistible impression of "déja vu". After much debate on broad principles and ambitious plans, the setting has turned into a deal between the two big players that focuses on the solution to the immediate trade dispute: international competition in cash crops.

It now seems likely that the Uruguay Round will be completed with an agreement which, for agriculture, will not differ much from the Dunkel and Washington compromises. The commitments made may not, in the short term, impose any very binding constraints on the CAP, which is in a process of change anyway due to the emergence of a number of other constraints. A framework has, however, been established in the form of AMS, tariffication and restraints on subsidised export, which may be used in future rounds to impose such constraints. This may turn out to be the more important achievement of the prolonged agricultural trade negotiation in the Uruguay Round than the actual commitments. For the EC to become an exporter carried a price which EC farmers eventually would have to pay. The day of reckoning may not have arrived yet, but it is not that far off.

Table 1. Impact of the US October 1989 GATT proposal (in billion ECU).

	European Community			United States		
	initial (year 1)	final (year 5)	change	initial (year 1)	final (year 5)	change
Net farm income	82.5	60.8	-21.7	67.0	62.3	-4.6
Budget costs	16.1	3.9	-12.2	16.0	8.9	-7.1
Consumer surplus	-	-	+20.9	-	-	+1.6
Trade balance	-18.9	-31.9	-13.0	+8.5	+8.8	+0.3

Source : Guyomard and Mahé, 1991.

Table 2. Political-goal function weights and ranking of interest groups in the EC and the US (based on 1986 data).

	United States		European Community	
	Rank	Weight	Rank	Weight
Sugar	1	1.56	1	1.57
Dairy	2	1.29	2	1.46
Animal feeds	3	1.23	3	1.32
Grains	4	1.15	3	1.34
Budget	5	1.00	6	1.00
Beef	6	0.92	4	1.32
Consumers	7	0.87	8	0.83
Pork & Poultry	8	0.85	7	0.95

Source : Johnson, Roe and Mahé, 1990.

Table 3. Possible agreement between the EC and the US under three strategies.

US\EC	sq	ber	pft	ft
sq	game 1 (current instruments)	-	-	-
ber	-	game 2 (decoupled payments)	-	-
pft	game 3 (OECD liberalisation)	-	-	-
ft	-	-	-	-

Source : Johnson, Roe and Mahé, 1990.

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