2

PERTS and PESTS: A Comparison of the Political Economy of Agricultural Policy in the U.S. and European Community in the Uruguay Round of Multilateral Trade Negotiations

by

Glenn C. W. Ames**

Paper presented at:

European Community Studies Association
Second International Conference
"The Challenge of A New European Architecture:
Implications for the European Community's
Internal and External Agendas"

George Mason University, Fairfax, Virginia
May 22-24, 1991

**Department of Agricultural Economics, 315 Conner Hall, University of Georgia, Athens, Georgia 30602 USA

PERTS and PESTS: A Comparison of the Political Economy of Agricultural Policy in the U.S. and European Community in the Uruguay Round of Multilateral Trade Negotiations

Glenn C. W. Ames
University of Georgia, Athens, Georgia, U.S.A.

Abstract

Session: G4 <u>The CAP and the Uruguay Round</u>

Rational farm policy generates a portfolio of programs that provide public goods such as new agricultural and environmental technology (PERTS) or redistribute and transfer wealth from one social group to another (PESTS). PERTS may reduce producers' welfare, because technology increases the supply of farm products, resulting in a decline of farm income. Farmers, acting as a coalition, may seek compensation through the enactment of PESTS, or wealth-transferring policies. By manipulation of both PERTS and PESTS in domestic and trade policy, governments maximize support from social groups. The U.S. proposal in the Uruguay Round of Multilateral Trade Negotiations directly attacks a multitude of PESTS in the trade policy arena. Producers' organizations on both sides of the Atlantic have challenged the U.S. proposal because of their potential welfare loss. However, governmental manipulation of PESTS during the Uruguay Round has not generated the anticipated support for reform. The multilateral trade negotiations are at risk due to the negotiators' inability to resolve conflicts over welfare-enhancing and welfare-transferring policies in the farm sector.

Keywords: Political Economy, Agricultural Trade Policy, Multilateral Trade Negotiations

PERTS and PESTS: A Comparison of the Political Economy of Agricultural Policy in the U.S. and European Community in the Uruguay Round of Multilateral Trade Negotiations

Introduction

Although agricultural trade policy reform constitutes only a small part of the Uruguay Round of Multilateral Trade Negotiations under the aspicies of the GATT, it has become a serious stumbling block to concluding a trade agreement. Farmers and producer associations are reluctant to give up border protection on agricultural commodities, reform internal support policies, or eliminate export subsidies. Solutions to this impasse are grounded in the complex systems of agricultural policies designed to support farm income in the developed countries.

The paper will be divided into four parts. A brief outline of a model depicting the political economy of agricultural policy-making will be used to introduce the issue of agricultural protectionism and its place in the Uruguay Round of GATT. The status of support policies during the Uruguay Round of GATT negotiations will be summarized as a reflection of the respective governments' actions during the Multilateral Trade Negotiations (MTN). Next a summary of selected farm organizations' support or opposition to the GATT proposals for trade reform will be presented. Finally, I will conclude by speculating about the role of welfare enhancing and transferring policies in the post-Uruguay Round of GATT negotiations.

Joint Policy Approach to Public Policy Development

Political scientists and economists have developed models of political economy and policy formulation that may help explain the stalemate in the GATT negotiations. Rausser and Foster (1990) constructed a model of the political economy of agricultural policies involving two interest groups, producers and consumers, operating within the objectives and decision rules of the government. In their model of political economy, governments seek to maximize support from social groups through a combination of social-welfare-increasing and welfare-transferring policies. Current food and agricultural policies represent short-term equilibria in the political/economic markets for social-welfare policies (Rausser and Foster 1990, p. 642). Their model of political economy appears very appropriate to analyze the impasse in the Uruguay Round of Multilateral Trade Negotiations.

In their analytical framework, PESTs are policies designed to redistribute wealth from one social group to another, while PERTs are policies that reduce transaction costs in the private sector by correcting market failures or providing public goods; e.g., environmental and conservation programs, new technology, research, and extension. PERTs are neutral with respect to their distributional effects. That is, large or small farmers have access to the same technology. The aggregate effect of these public goods on agriculture may be an increase in both producers' and consumers' welfare. However, the market effect of this PERT may reduce producers' welfare as new technology shifts the supply of farm products, resulting in a decline in producer prices and farm income.

> Specifically, [society's] total wealth increases ... but, due to an inelastic demand, the distribution of benefits changes to the detriment of producers. Producers acting as a coalition may obstruct the implementation of the public good or PERT unless they are compensated in some form. One form of compensation is to introduce a PEST which transfers some wealth resulting from the new PERT equilibrium to producers. This transfer of wealth, the PEST, may actually be a means of securing the welfare-increasing policy even though it may appear as an inefficient rent-seeking based policy (Rausser and Foster 1990, p. 641).

Food and fiber "... policies are in place, in part, because they serve the interest of those with relative political power and influence. The rational process generates a portfolio or mixture of PERT and PEST policies. . . governments seek to maximize support from different social groups through the judicious combination of both PERT and PEST policies" (Rausser and Foster 1990, p. 642). These policies are available to the government to maximize its support through manipulation of consumer and producer welfare. For a mathematical presentation of this manipulation process, the reader should refer directly to Rausser and Foster.

In a policy portfolio model, government is recognized as a dynamic institution with its own agenda in addition to its role as a locus of distributional struggles (De Janvry and Sadoulet, 1989, pp. 245-6). The lobbying effort by producers, consumers, taxpayers or other political groups in response to changes in their welfare can be the catalyst that the government needs to change transfer mechanisms to more economically efficient combinations of policies. Governments as the contracting parties in the Uruguay Round of MTN, certainly have their own agenda for the negotiations. The U.S. is a prime example with its "free trade" agenda being supported and opposed by various agricultural, commercial or taxpayer lobbies.

The taxpayer cost of agricultural support in the U.S. and EC has become one catalyst for GATT proposals to reform internal support measures. Governments have responded with various proposals for reform, some coming from within the governments themselves. Farm lobbyists have responded with support or opposition to the MTN depending upon perceived welfare gains or losses from a change in agricultural protection.

Agricultural Protectionism

Agricultural protectionism has its origin in government's response to agriculture's declining share of the national economy. During periods of economic growth, agriculture's share of economic activity declines, since the income elasticity of demand for food is less than that for nonfood items (Anderson 1987). Moreover, agricultural productivity growth results in a downward pressure on commodity prices, farm income, and employment relative to the nonfarm sector. To avoid agriculture's declining share of economic activity, government policy ". . . requires either a strong bias in productivity growth towards the farm sector . . . and/or a heavy distortion of incentives towards agriculture" (Anderson 1987, p. 195). These incentives consist of a broad portfolio of PERTs and PESTs that have become increasingly expensive in the 1980s. The U.S. and the EC have vigorously pursued price policies designed to arrest agriculture's declining share of employment, exports, and income. Their policies have resulted in runaway budgetary costs, imbalances in world agricultural markets, and an escalation of trade conflicts among major trading partners.

U.S. agricultural policies have their roots in the Depression of the 1930s (Hathaway 1987). The decline in farm prices brought the federal government into agricultural markets to support farm income through price supports, acreage restrictions, and deficiency payments. These policy mechanisms still provide the basis for agricultural support in the 1990s.

The EC's agricultural policies have similar objectives as those in other industrialized economies. The Treaty of Rome, which set up the European Community, explicitly mandated a common agricultural policy with the specific objectives to (1) increase farm productivity, (2) ensure a fair living standard for farmers, (3) stabilize agricultural markets, and (4) guarantee stable food supplies at reasonable prices to consumers (European Communities-Commission 1987, Article 39, pp. 155-156). The EC has developed a widely-known system of internal price supports, border protection, food stocks, and export subsidies to achieve its objectives. "Together with rapid technological progress in agriculture, . . . [the Common Agricultural Policy] has stimulated EC food production well beyond self-sufficiency in many commodities, creating expensive surpluses and distorting international commodity markets" (Moyer and Josling 1990, p. 25). Thus, the EC entered the Uruguay Round of Multilateral Trade Negotiations faced with internal pressures to curtail the high cost of the CAP and conflicts with its trading partners over market access and subsidized competition in world markets.

The fact that both the U.S. and EC have distorted incentives towards agriculture, which depresses the real international price of food as subsidized surpluses are placed in the world market, only adds to the likelihood of agriculture declining in undistorted economies (Anderson 1987, p. 195). Certainly the Cairns group in the GATT negotiations views the actions of both the U.S. and EC as detrimental to its welfare. Subsidized exports from the U.S. and EC displace exports from other countries and reduce their export earnings. Thus, secure and enhanced market access for farm products and elimination of export subsidies have become primary objectives of the Uruguay Round of Multilateral Trade Negotiations. However, some powerful commodity groups in both trading blocs oppose dismantling of the welfare enhancing and transferring policies that could be a possible outcome of a subsequent GATT agreement. The basis of that opposition lies in the structure of the political economy of agricultural policy making in industrialized countries.

Since governments seek to maximize their support for PERTs or PESTs through the manipulation of consumer and producer welfare, the implicit assumption of U.S. policy makers was that consumers would support the reduction in welfare-enhancing agricultural PESTs contained in the U.S.'s GATT proposals in exchange for gains in trade for investments and services and better protection for intellectual property values (Schott 1990, p. 11). Thus, political support for a reduction of PESTs in the U.S. and European Community will determine whether the Uruguay Round of GATT negotiations is successful in reducing producer welfare in one arena in exchange for gains in another.

U.S. price supports are set in the farm bill, which allows the Secretary of Agriculture to "adjust" support prices and participation criteria according to market conditions, the level of stock accumulation or political agendas. Thus, farm organizations have been critical of any proposed changes in the commodity programs that might reduce the entitlements for program participants, especially within the realm of trade negotiations.

Agricultural Support Policies in the Uruguay Round of MTN

The status of agricultural support policies during the Uruguay Round of GATT negotiations indicates governmental manipulation of the system of domestic farm PESTs relative to the Uruguay Round of Multilateral Trade Negotiations. Both the U.S. and EC responded to farm policy crises during the 1980s. The farm financial crisis of 1982-83 in the U.S. preceded the start of the Uruguay Round of MTN, while the budget crisis in the Community coincided with the initiation of the GATT negotiations. The passage of 1990 farm bill and the establishment of the budget stabilizer package of February, 1988, in the Community were influenced by the ongoing GATT negotiations. The changes in domestic support policies in the U.S. and EC were only measures of short-term welfare changes while the potential outcome of the GATT negotiations represents long-term shifts in consumer, producer and taxpayer gains and losses. Nevertheless, the short-term changes in PERTs and PESTs have been utilized in the GATT negotiations as bargaining positions toward long-term solutions in world agricultural trade.

There have been very few substantive changes in the *structure* of agricultural support policies since the Uruguay Round of MTN began in 1986. Rather, incremental changes in support prices and policies characterized U.S. farm policy in the 1980s. The Food Security Act of 1985 authorized the Secretary of Agriculture to lower U.S. support prices to internationally competitive levels and to undertake export subsidy programs to counter unfair trade practices of competing nations. The Food, Agriculture, Conservation and Trade Act of 1990 continues the market-oriented approach and aggressive export assistance programs contained in the previous farm bill. In the European Community, the budget crisis in 1987/88 led to a partial short-term solution to the financial problem of the CAP. However, neither trading bloc has changed the fundamental structure of its internal support, border protection and export subsidy policies. The structure of welfare enhancing and transferring policies in the U.S. and EC essentially remains in tact.

Inertia and incrementalism characterize the process of agricultural policy reform. Moyer and Josling (1990) argue that "The major farm policies survive because of the particular sets of institutions involved in the setting of the policy and the structure of the decision framework in which they operate, as well as the pressures from interest groups" (p. 203). The public choice paradigm explains the resistance to reforms in the EC and the

U.S. and predicts that individuals, in this case farm organizations, are likely to commit resources to influence the policy process in direct proportion to the degree to which their interests are at stake (Moyer and Josling 1990, p. 206). "Price support policies in both the EC and USA create large rents and financial interests for farmers, which they have a strong interest in mobilizing to protect" (Moyer and Josling 1991, p. 206). Certainly, resources have been marshalled by farm organizations in the EC and US to protect the PESTs in their respective systems. Thus, price supports remain relatively high, border protection remains in place, and export subsidies are widely used to dispose of surpluses.

The continuation of a high level of price supports in the EC can partially be explained by the actions of pressure groups which would be disadvantaged by price cuts. The annual price proposal provide a focus for pressure from farm organizations. The Commission's 1991 proposal for price cuts and subsequent response by farm organizations indicates that changes are not easily made (Agra Europe, March 1, 1991, P/6).

The Common Agricultural Policy Crisis of 1990 and Trade Issues

The European Community is caught in a web of problems and conflicting institutional proposals and positions in its agricultural support programs, all of which influence its position and proposals in the Uruguay Round of Multilateral Trade Negotiations. These include an unresolved price support package for 1991/92, conflicting interpretations of the 1988 ceiling on farm spending, the Agriculture Commission's CAP reform initiative, and the Community's GATT position itself. Each of these proposals impacts the set of PERTs and PESTs that enhance and transfer welfare to the Community's 9.4 million persons employed in agriculture (Herlihy and Weiss 1990, p. 88).

In the mid 1980s, the cost of farm support triggered the process of CAP reform. The February, 1988, European Council supply management agreement to limit CAP spending, establish production quotas, limit support price increases, and penalize overproduction with coresponsibility levies, was only a short-term measure and did not address the fundamental cause of the budget crisis. The Commission's 1991/92 farm price package repeats the same framework of a short-term solution to another budget crisis.

The structure of the Community support policies contribute directly to the budget dilemma. In 1990, 54% of EC CAP expenditures were allocated to intervention activities, 32% to export refunds, 7% to structural guidance, and 7% to other market support activities. Community spending on agricultural price and income support climbed steadily during the 1980s, reaching a peak of 28.9 bn ECU in 1988, as domestic production responded to high support prices. Thus, intervention activities and export refunds accounted for more than 80% of CAP expenditures. Surplus commodities were either disposed of on world markets or placed in storage. The budget stabilizer agreement came into force in 1988 as the heads of government imposed a ceiling on Community spending for agriculture. Thus, CAP expenditures were estimated at 30 bn ECU or $36.255 bn in 1990. In 1991, the ceiling of 32.511 bn ECU may be reached unless constraints hold farm support spending in check.

By using intervention purchases to support prices, storage costs rise and disposal costs through export refunds become excessive (9.56 bn ECU in 1990 or 32% of the EAGGF budget). The Commission has had to use several policy mechanisms -- mainly intervention price cuts, a reduction in production quotas, and penalties for over-quota production -- to keep support costs under the ceiling of 32.511 bn ECU in 1991. These measures translate into lower farm income, as COPA/COGECA representatives have observed and communicated to the Commission and Council.

The ceiling on farm support spending is a source of disagreement in the Community and this has placed the Commission's price proposals into "semi-paralysis" until the guideline issue is resolved. The agriculture and finance ministers have failed to resolve the issue of whether the addition of the GDR to the Community justified an increase in the ceiling on CAP spending (Agra Europe April 12, 1991,p. P/1). Certainly, the cost of coping with extending the CAP to the former east German agricultural sector has added costs (1.3 - 2 bn ECU) to the EAGGF budget, but the primary problem remains the inability to control intervention expenditures on cereals, beef, dairy, sheepmeat and oilseed regimes.

Intervention stocks rose drastically in 1990. The dairy sector was partially responsible for this situation, more than one-fifth of all Community skimmed milk powder production was sold into intervention, while 15% of all butter production went into public stocks in 1990. Consumption of butter in the Community continues to decline, hence the gap between production and consumption widens. Subsidized butter disposal simply adds costs to the system. The volume of cereal intervention stocks rose to 17.867 million tons in March 1991 after several years of modest decline. Oilseed stocks also rose in 1990. Beef intervention stocks rose to record levels of 710,000 mt (Agra Europe April 12, 1991, p. E/5). The intervention mechanism adds budgetary costs through purchase, storage and subsidized disposal through the use of export refunds. When surpluses are placed on the world market, the EC comes into direct competition with the U.S. and other exporters which continues to be a source of trade conflicts.

In late January, the EC Commission approved a "Reflections Paper" proposing reforms in the Common Agricultural Policy. These reforms would cut welfare transfer payments (PESTs) to farmers through reductions in price supports, production quotas, increased set-asides and provide decoupled income aid to small farmers (Council of the European Communities, Feb. 1, 1991). The reforms would also split the agricultural sector into small and large farms. Farmers with up to 30 hectares would be compensated through direct income payments for reductions in support prices as well as a waiver on set-aside requirements. Larger farmers would participate in direct income payments according to a sliding scale by farm size (Gardiner and Nishiura p. 20).

EC farm organizations attacked the proposal because it undermined the price policy as the primary means of income support for farmers (Agence Internationale D'Information Pour LaPresse, Jan. 23, 1991, p. 14). Farm organizations also wanted more emphasis on social-structural measures to maintain family farmers and preserve the environment. Thus, the reform proposal became a sort of "dark cloud" over the subsequent 1990/91 annual price package debate. The emphasis on CAP reform was delayed until after short-term measures were incorporated into the price proposals to solve the budget crisis for the current year. Even the CAP reform proposals contained in the "Reflections Paper" appear constrained by the Community's GATT proposal.

Mr. David Roberts, the Commission's deputy-director general for agriculture, argues that it is incorrect to lay the blame for the current budgetary crisis on the 1988 stabilizers policy. He states that "When the heads of government agreed [to] budget discipline and the stabilizers, they signalled clearly that the problem of *imbalance between growing agricultural productivity and static demand* [italics added] could no longer be resolved by ever growing exports at ever increasing budgetary costs. The stabilizers package was, however, incomplete because it did not explicitly confront the problem of [the gap between] growing productivity and static demand" (Agra Europe, March 1, 1991, p. P/3). Thus, the EC Commission's proposal for radical reform in the CAP placed additional limits on the supply side. It also shifted the CAP focus to social objectives such as maintaining the rural environment. "Set-asides and direct income aids would help to protect the incomes of cereals producers" (Agra Europe, January 25, 1991, pp. E/1 - E/2).

The Commission subsequently issued its 1991/92 farm price package proposal "sharp cuts" in farm support prices (Agra Europe, March 1, 1991, p. E/1; Commission of the European Communities, March 1, 1991). The earlier Mac Sharry reform package was abandoned in favor of a simple continuation of existing arrangements and political manipulations directed toward an increase in the budget guideline for 1991 to finance the extra expenditure which will be incurred this year.

The Commission's 1991/92 farm price proposal contains cuts in the nominal support prices for beef, milk and cereals, a 3% increase in the cereals coresponsibility levy (CRL), a 2% reduction in milk quotas, a 5% cut in the sugar intervention price, and a substantial reduction in the EC support for the tobacco regime (Agra Europe March 1, 1991, p. E/1). The Commissioner described the price package as "a roll-over exercise ... pending the detailed proposals later in the year for a more fundamental reform of the CAP" (p. E/1). This years' price package follows the 1990/91 freeze in ECU amounts for most intervention prices. In the view of Community-wide farm and cooperative associations (COPA/COGECA), the price proposals represented a renewed threat to farm incomes in 1991.

Despite the rise in nominal farm prices, due to concessions in the intervention system and agrimonetary measures, farm income fell on the average, 4.5% in 1990 after having risen by 11.2% in 1989 (Agra Europe, March 22, 1991, p. E/3) and producers are concerned about further cuts in their welfare. EC farm organizations argued that "the fact that budgetary expenditure under the Guarantee Section of EAGGF will exceed the guideline of 32.511 bn ECU in 1991, the Commission's main argument of such a severe cut in market prices and support, is the result of exceptional factors which have nothing to do with the CAP," (Agra Europe, March 1, 1991, p. P/6). These exceptional factors include an increase in imports from Eastern Europe, the loss of export markets in the Middle East due to the Gulf Crisis, low world market prices, and the decline in the value of the dollar. Nevertheless, these factors have partially contributed to higher intervention stocks and increased export subsidy costs for the CAP.

Agricultural Support Under the CAP in the 1990s

Moyer and Josling's hypothesis that inertia and incrementalism characterize the difficulty in making farm policy responsive to budget pressures due to outmoded institutional objectives, policy instruments and incentives appears appropriate for analyzing the EC's situation in 1991. "In the EC, the persistence of outdated policy instruments, such as the use of intervention buying under conditions of chronic surplus, seems largely a function of the glacial pace of decision-making within the Community" (Moyer and Josling 1990, p 203). The need for broad consensus to change EC Regulations and the slow process of moving a proposal from "technical analysis to political reality" contributes to policy inertia and incrementalism. The voting procedure has already been used to block an increase in the EAGGF spending guideline -- ministers of the United Kingdom and the Netherlands argued that agricultural expenditures should be cut to fit within the spending limits, resulting in a 10-2 vote in the Council (Agra Europe April 12, 1991, p. P/1). The 1991/92 annual price proposals and review cannot proceed on any serious basis without a decision on the guideline. Since neither the agricultural nor the finance ministers could reach an agreement on the spending guideline, a decision must await the EC heads of government summit in Luxembourg scheduled for late June.

The delays in the decision-making process on the spending guideline and the annual price proposal have broad implications for the Commission's CAP reform initiative. A fiscally conservative agreement on spending limits could lead to cuts in intervention prices and production quotas, higher set-asides, and larger producer levies as contained in the Commission's "Reflections Paper."

Despite a number of pressing financial and political problems in the European Community in regard to the agricultural sector, "enormous inertia" constrain change in the policy process (Moyer and Josling 1990, p. 205). The basic commodity price support mechanisms are deeply ingrained in the system. Price supports are difficult to change without serious disruption of producer expectations and farm planning. Moreover, the annual price package proposal provides a focus for political pressure from the farm lobbies. Farm organizations lobby national and community leaders to maintain the system of PESTs that enhances their welfare. Moreover, the agricultural ministers are held accountable for their decisions by their member state farm lobbies and constituents.

In the EC, the agricultural reform process requires a time-consuming, consensus building process. Responsibility is essentially divided between the Commission, which proposes legislation on price supports and reform measures, and the Council of Ministers, which decides on the merit of the Commission's proposals. The reforms of February, 1988, have closely connected the agricultural price policy and budgetary processes, culminating in the stalemate of 1991. The conflict over interpretation of the spending ceiling must be settled before a decision can be taken on support prices. If a narrow interpretation of the ceiling prevails, then price supports may be lowered to keep budget costs within the constraint. An expansion of the ceiling to account for the additional costs of supporting agriculture in the former GDR region will allow for less restrictive price and quota policies for the 1991/92. However, settling the spending ceiling issue will not solve the budgetary problem in the long-run.

The EC commodity programs create entitlements whose costs are not easy to predict. Since intervention buying and export refunds account for 80% or more of CAP expenditures, world market conditions create a random element in the budget planning process. When world market prices decline due to abundant supplies, export refund costs rise. Furthermore, when other exporters like the U.S. use export subsidies in third country markets, the Community incurs additional costs to match these subsidies. Thus, there is strong resistance to exposing Community agriculture to world market fluctuations.

The EC's GATT proposal (Agra Europe October 5, 1990, pp. P/1-P/3), has been characterized as one "... designed to accommodate the CAP mechanisms while offering some reduction in absolute levels of support and protection" (Normile 1990, p. 83). While the EC's proposal offers some reduction in absolute levels of support and protection, the dual pricing system remains the cornerstone of the EC's GATT proposal. Export subsidies also remain in the proposal. Even the EC's tariffication proposal would only allow a partial transmission of world commodity prices to EC producers and consumers.

U.S. Trade Negotiations and The 1990 Farm Bill

Interia and incrementalism also characterized U.S. farm policy. Budget deficits have been the driving force behind much of the policy-making process. Professor Harold F. Breimyer (1991) has characterized the new farm law, consisting of two basic pieces of legislation, the Food, Agriculture, Conservation and Trade Act of 1990 (FACTA90) and the Agricultural Reconciliation Act of 1990 (ARA90), as "more of the same" (p. 1), since it extends many of the basic provisions of the Food Security Act of 1985 (FSA85) into the 1990s. The 1990 farm bill continues the earlier price support reduction concepts and mandates spending reductions of $13.6 bn from the federal farm program budgets from 1991 through 1995 (Sanders 1990, p. 1).

Key provisions of the FSA85 are retained in the 1990 farm bill; Moyer and Josling would term this condinuation as a form of policy inertia. These provisions include a comparatively low commodity loan-rate price policy intended to stimulate exports and complex environmental provisions that are linked closely with commodity price supports. The FSA85 was designed to expand markets for program commodities, especially in the export market. The FSA85 held commodity loan rates relatively low, becoming implicit subsidies for domestic use and exports. Trade provisions in the 1990 farm bill continued export market development through the Export Enhancement Program ($425 mil.) and the Targeted Export Assistance program ($75 mil.).

While the FSA85 contained provisions to cut farm support prices and limit government spending, the 1990 farm bill froze nominal target prices at 1990 levels through 1995. Direct deficiency payments will be constrained by reducing the amount of program acres eligible for payments. However, flexibility in planting on base program acres not eligible for deficiency payments will increase the uncertainty in expected output for non-program crops. The 1990 farm bill will reduce government costs, given the limitations on program acreage and other constraints. Real farm income will certainly be affected since inflation will reduce the real value of target prices and loan rates. Furthermore, assessments on dairy, peanuts, honey, wool, sugar and tobacco will further reduce effective support rates.

Moyer and Josling (1990) argue that policy complexity itself promotes inertia and incrementalism (p. 207). The 1990 farm bill is a prime example. The Wall Street Journal has characterized the 2,000 page document as "the longest, most complex piece of U.S. agricultural legislation ever adopted." For example, determining the actual base acreage for program crops involves a complex formula starting with a producer's base acreage eligible for deficiency payments, and then subtracting three different acreage reduction provisions (Sanders 1990, pp. 1-2). While there were incremental changes in farm legislation between 1985 and 1990, the basic PESTs that have protected producers' welfare remain essentially intact. Policies providing large rents and financial benefits for farmers remain in the legislation, albeit at a reduced level for the next five years. Thus, opposition to GATT proposals for reduced internal support, border protection, and export subsidies is predictable. Farmers have lost transfer payments through domestic legislation and the uncertainty of additional gains or losses through multilateral trade negotiations would create opposition that has already been cited. Those commodity groups that perceive benefits from trade negotiations provide qualified support for the U.S.'s position.

In summary, the U.S. has increased the complexity of its farm program by creating producer options, price support formulas tied to market conditions, and more rigid environmental regulations. Deregulation resulting from multilateral trade negotiations would threaten the rents that result from this complex policy. Gains from increased efficiency would be distributed throughout society, with no individual group gaining enough to justify political action to dismantle the system. In all likelihood, incremental changes at the margin will prevail in U.S. farm policy over the next decade.

U.S. Farm Organizations and GATT Negotiations

U.S. farm organizations have expressed their support for, or opposition to, the Uruguay Round of Multilateral Trade Negotiations depending upon their perceived gains or losses from a GATT agreement. They have also been divided over support for Congressional legislation authorizing the President to engage in trade negotiations, the so called "fast-track" legislation. A GATT agreement approved under the fast-track framework, which must be approved in its entirety without amendment, could leave producer groups without protection -- the PESTs that they have enjoyed in the past. Thus, the objectives of the GATT negotiations to bring about an enhanced and secure trading environment threatens the elaborate system of internal price supports, border protection, export subsidies, and nontariff barriers that have been used to support farm income and employment since the 1930s.

Dairy, peanut and sugar producers in the U.S., are concerned about the potential loss of border protection if Section 22 of the Agricultural Adjustment Act (7 U.S.C. 624), reenacted with amendments by the Agricultural Marketing Agreement Act of 1937, is negotiated away as part of the enhanced market access agreement in the Uruguay Round of MTN. Section 22 allows import quotas on dairy products, peanuts, cotton, and sugar. Price supports combined with import protection and government purchase of surplus production are the primary farm income support mechanisms in these sectors. Enhanced market access in the GATT threatens these PESTs. In addition, the elimination of export subsidies would also mean that surplus stocks could not be disposed on the international market. Surplus stocks would have to clear the market through commercial channels. Consequently, producer associations have marshalled lobbying efforts to maintain their welfare enhancing farm policies.

Protection for Dairy Producers

A review of some policy statements by producer groups clearly indicates how important PESTs are to farm organizations. The National Milk Producers Federation (NMPF) is a commodity organization representing most of the dairy marketing cooperatives in the U.S. and their dairy farmer members. The Federation characterizes the agricultural sector as having "... a structural predisposition to economic instability, characterized by tendencies toward overproduction, inelastic demand, low and unstable prices, resulting in disruptive marketing conditions to the detriment of agricultural producers" (Camerlo 1991, p. 2). The federal dairy price support program purchases primary dairy products -- butter, nonfat dry milk and cheese -- which will not clear the commercial market at the stated support prices. Section 22 allows import quotas where imports would interfere with the operation of any domestic agricultural program. U.S. dairy import quotas protect the dairy industry from subsidized imports. Cheese imports into the U.S. from Canada, the EC and the European Free Trade Association have benefitted from export subsidies ranging from 12% to 54% of the U.S. wholesale price (Camerlo 1991, p. 3). Thus, the NMPF views the potential loss of Section 22 with alarm (p. 4).

The NMPF argues that "Virtually all other countries with significant dairy industries ... maintain dairy policies that include domestic price supports and measures to restrict import access as a means of providing stability for their dairy sectors and ensuring adequate supplies of milk and dairy products for their domestic markets" (Camerlo 1991, p. 5). The NMPF concludes that these other countries -- the EC, Canada, Japan, South Korea -- have not agreed to significantly liberalized access to agricultural markets during the Uruguay Round of MTN. The NMPF opposes extension of the congressional fast-tract implementing procedures under which the Section 22 waiver would be given up as part on any GATT agreement.

The NMPF's policy Statement on trade negotiations are as follows:

> The Federation urges the United States Trade Representative and the Secretary of Agriculture, in the Uruguay Round of Multilateral trade negotiations, to negotiate no trade agreement that either increases the quantity of any dairy product that can be imported into the United States under currently existing quotas, or removes such quotas from any dairy product, or that makes any modification to the waiver for Section 22 of the Agricultural Adjustment Act approved by the Contracting Parties to the General Agreement on Tariffs and Trade (NMPF 1990 Policy, p. 5).

In addition the NMPF supports potential changes in U.S. trade restrictions that would establish quota limits on imports of milk derivatives -- casein, caseinate, lactalbrunin and whey protein concentrates -- and to change their tariff classification to the higher human foods and animal feeds classification rather than continue their current, lower industrial tariff level.

National Association of Wheat Growers

U.S. farm organizations' opposition to other trading blocks price supports, trade barriers or export subsidies often depends on which problem area has the largest direct impact on farm income. Export subsidies are transparent and easily identified with a loss of sales, stock accumulation, and declining market prices. When the cost of program support rises, legislators may impose higher set-aside requirements and reduce price supports, both actions would lower farm income. Thus, farm organizations are very sensitive to the actions of their competitors because of the implied loss of producer welfare.

A "swift and fair resolution of the export subsidy issue" is the National Association of Wheat Growers' highest priority in the Uruguay Round of Multilateral Trade Negotiations. The U.S. exports approximately 48% of its wheat production, accounting for 32% of the world's wheat exports. The bulk of U.S. wheat exports enter the world market as commercial sales, but part of the production is sold with the help of export subsidies (bonuses) under the Export Enhancement Program. Competition for wheat exports in third country markets puts the U.S. in direct competition with the European Community.

In February, 1991, the EC out-subsidized the U.S. in wheat sales to the Soviet Union. The EC's export subsidy or restitution of $161/mt was 263% higher than the U.S. enhancement bonus of $44.31/mt. The U.S. subsidy represented 60% of the ultimate sale price ($73.75/mt) while the EC's export restitution was 214% higher than its sale price to the same destination (National Association of Wheat Growers). These insidious trade practices are seen as a prime cause of low U.S. farm prices and declining world market share, according to the National Wheat Growers Association.

The National Association of Wheat Growers partially accepts the use of "aggregate measure of support" for reducing internal policies that distort trade. However, the Association argues that price supports that are tied to set-aside or supply management schemes do not distort trade (National Association of Wheat Growers). The Association emphatically states that it would not accept any GATT "... agreement that does not provide U.S. wheat farmers with a viable and workable 'safety-net' against the vicissitudes of the world market." The Association wants protection against low commodity prices in any GATT agreement and elimination of export subsidies, essentially a splitting of the PESTs for U.S. wheat farmers. The National Association of Wheat Growers supports the extension of the fast-tract negotiating authority but reserves "the right to reject a final agreement if it disadvantages U.S. farmers."

Other Farm Organization Positions

The American Farm Bureau Federation supports the Uruguay Round of GATT negotiations and its leaders provide advice on the negotiations through the private sector advisory committees. The Bureau's position is that trade reform should eliminate or reduce export subsidies, allow non-trade distorting income support for the agricultural sector, enhance market opportunities, and eliminate sanitary standards that restrict trade (nontariff barriers). The two key areas for GATT reform, from the Bureau's point of view, are export subsidies and import barriers, major PEST in the present system.

The American Farm Bureau Federation's guarded support of the GATT negotiations reflects a broader industry base than a single commodity organization like the National Milk Producers Federation. The Farm Bureau supports "...the concept embodied in the U.S. proposal that all trade-distorting government subsidies be subjected to progressive and substantial reductions worldwide . . . . . Failure to achieve substantial and progressive reductions in equally important foreign trade barriers and subsidies would result in continuing [the Farm Bureau's] ... support for ... the retention of Section 22 of the Agricultural Adjustment Act, as amended" (American Farm Bureau Federation). In general, American farm organizations find it very difficult to surrender the portfolio of PESTs, through multilateral trade negotiations, that have supported farm income objectives since the Great Depression of the 1930s.

On the otherside of the policy spectrum, food processing, manufacturing, and retail organizations generally support the President's "fast-tract" negotiating authority in the GATT negotiations. Food processors would benefit from lower internal price supports, lower import barriers, and clarification of sanitary regulations. Retail organizations would generally benefit from a more open trading system and a wider product range. These benefits to private firms certainly will not be enough to overcome the objections of the farm lobby to GATT reforms.

CONCLUSIONS AND IMPLICATIONS

The pressures for reform of the Common Agricultural Policy and the implications of the GATT negotiations for agricultural policies may lead to incremental changes in the portfolio of PESTs and PERTs that supports agriculture in both the EC and U.S. Despite the pressure to maintain the welfare-transferring policies in the Community, shifts in the social welfare-increasing policies in the Community toward structural guidance and environmental programs will require a different mix of social welfare transferring policies. The portfolio of PESTs will change as agriculture adjusts to different social objectives. These include extensive agriculture, rural development in less-favored regions, environmental protection, and other activities.

> "Simply put, reforming food and farm policies implies changing the forces conditioning government behavior .... The reform of agricultural policies must come through changes in the means of compensating groups who would otherwise be losers or through institutional changes in the relative costs of political activity by groups paying the compensation" (Rausser and Foster 1990, p. 651).

The demand for farm policy reform is an increasing function of the degree of social waste generated by the wealth transfer programs (p. 651). Clearly, the cost of farm support in the U.S. and EC has become excessive. In the U.S. the budget agreement of 1990 targeted cuts of $13.6 billion in farm programs over five years. Moreover, the projected costs in the European Community for 1991/92 have reached the 1988 spending ceiling agreement. Certainly, social waste has been the driving force behind legislative decisions to reduce farm support spending. The question arises about what guidance does the model provide for solutions to the funding crisis and GATT negotiations.

Agricultural reforms may be developed by demonstrating the feasibility of alternative, more efficient programs of wealth transfer or by lowering the costs associated with making those paying the compensation more sensitive to government decisions (Rausser and Foster 1990, p. 651). In the first case, less distorting lump-sum transfers would be the optimal means of allocating society's welfare. This becomes a benchmark for welfare transfers rather than an actual PEST.

The structure of the bargaining process changes slowly. Governments and interest groups operating in an arena of constant political technology generally will not bring about reform. The U.S. GATT proposal assumed that once the cost of agricultural support became known, consumer groups would generate enough political pressure to reduce the farm sector's welfare transferring policies. However, the transparency analysis of the estimates of consumer and producer subsidy equivalents (CSEs and PSEs) has not led to vocal consumer lobbies pushing for drastic changes in farm support policies. External political forces may play a critical role in the reform process. Exporting countries affected by importers' farm policies and border protection measures may initiate changes in these support policies through bilateral or multilateral agreements, but they have to be willing to pay the cost of such agreements.

> External groups (even entire nations), who would gain coincidentally with the strengthened political power of internal groups, must therefore carry part of the responsibility of beginning the reform process; and they must be prepared to share in the direct expense of increasing pro-reform activities (Rausser and Foster 1990, p. 652).

The Uruguay Round of Multilateral Trade Negotiations is just such an external entity that is providing a catalyst for reform in the agricultural support policies of the U.S. and European Community. EC farm lobbyists have recognized that the Commission's reform proposals for drastic cuts in price supports, production quotas, and new environmental payments to promote less intensive farming have received a certain stimulus from the GATT negotiations. Certain U.S. commodity groups have also been threatened by the loss of their border protection measures and other PESTs. If the GATT negotiations are successful, both sides will have to "pay" a certain cost by giving up some their PESTs in exchange for gains in agriculture and other areas. Certainly, the portfolio of PERTs and PESTs will not disappear after the Uruguay Round of GATT, but the mixture of policies will change.

The agricultural sector experiences a lag between the discovery and adoption of new technology. Modified PESTs may be required to encourage the adoption of new farming practices like extensive farming or rural development in the less favored areas of the community. The rapid development of new biotechnologies will require increased attention from policy makers in the 1990s.

> The continued development of these technologies will necessitate and will depend upon increased government involvement in providing appropriate regulation, establishing guidelines to determine property rights, monitoring the transfer of technologies, and providing public support for necessary research activities. (Rausser 1990, p. 85).

Nevertheless, it is important that the welfare transferring policies be less distorting than under the continuation of the current system. Likewise, the U.S. will experience substantial pressure to change its policy portfolio. The U.S. will have to give up some of its border protection and support mechanisms in return for wider access to world markets. It must be ready to develop the means to compensate those commodity groups directly affected by the loss of their rent seeking policies. The European Community has proposed some possible alternatives but the U.S. lags behind in the policy arena.

What will the likely structure of agriculture be in the European Community after the Uruguay Round of MTN? A British farmer's comments on declining farm profitability due to cuts in EC price supports, rising input costs, and imports from Eastern Europe may provide a clue to the futures of European farming. "'The EC's answer seems to be a system of conservation related direct income aids to small farmers, in return for which they would presumably walk around in flat caps sucking straws and preserving the character of the countryside. Bigger farmers ... are assumed to be efficient enough not to need such cash handouts'" (Hudson Institute quoted from the London Financial Times). Ultimately, the agricultural sector of Western Europe may be split into two sectors, one for the tourists and another for agribusiness.

References

Agence Internationale D'Information Pour La Presse. "COPA Criticizes the European Commission's Guidelines for the Reform of the CAP and Insists on Rebalancing Protection in Regard to Third Countries." Europe. No. 5415, Jan. 23, 1991, p. 14.

Agra Europe. No. 1367, December 8, 1989. "Intervention Stocks Declining for Most Products but Concern Over Maize, Alcohol and Tobacco."

Agra Europe. No. 1409, October 5, 1990. "How Commission Tariffication Proposals Will Work." pp. P/1-P/3.

Agra Europe. No. 1424. January 25, 1991. "Ec Farm Ministers Give Cool Reception to CAP Reform Plans." pp. E/1-E/2.

_________. No. 1429, March 1, 1991. "Farm Unions Attack 'Draconian' Cuts in Farm Supports." pp. P/5-P/6.

_________. No. 1429, March 1, 1991. "EC Commission Adopts 1991/92 Farm Price Package." p. E/1.

_________. No. 1429. March 1, 1991. "Agreement on Need for CAP Reform - But not How to Achieve it." p. P/3.

_________. No. 1432, March 22, 1991. "Community Farm Incomes Down by 4.5% in 1990." p. E/3.

_________. No. 1435. April 12, 1991. "EC Ministers Heading for Climb Down on CAP Reform." pp. P1/P2.

_________. No. 1435, April 12, 1991. "Cereals Intervention Stocks Returning to Levels of Mid-1980s." p. E/5.

Allen, K. and B.J. Elliot. "The Current Debate and Economic Rationale for U.S. Agricultural Policy." *U.S. Agriculture in a Global Setting: An Agenda for the Future,* M.A. Tutwiler Ed., Resources for the Future, Washington, DC, 1988.

American Farm Bureau Federation. "Farm Bureau's Position on Section 22 in the GATT Uruguay Round of Trade Negotiations." Park Ridge, Illinois, USA, no date.

American Soybean Association. "EC Proposal for Rebalancing." Unpublished position statement. Washington, DC (No Date).

Anderson, K. "On Why Agriculture Declines with Economic Growth." Agricultural Economics, 1(1987):195-207.

Breimyer, Harold F. "The New Five Year Farm Law." Economic & Policy Information for Missouri Agriculture. 34 No. 2 (Feb. 1991):1-4.

Camerlo, James P. "Testimony of James P. (Tom) Camerlo President National Milk Producers Federation before the Sub-Committee on Department Operations, Research, and Foreign Agriculture of the Committee on Agriculture U.S. House of Representatives regarding the Uruguay Round of Multilateral Trade Negotiations Under the General Agreement on Tariffs and Trade, February 28, 1991, Washington, D.C." Arlington, V.A.: National Milk Producers Federation, 1991.

Commission of the European Communities. "Commission Proposals on the Prices for Agricultural Products and on Related Measures (1991-/92). Com(91) 72 final - Vol. 1, Brussels, Belgium, March 1, 1991.

Council of the European Communities. "The Development and Future of the CAP - Reflections Paper of the CAP." Press Release, Brussels, Belgium, February 1, 1991.

De Janvry A. and E. Sadoulet. "Alternative Approaches to the Political Economy of Agricultural Policies: Convergence of Analytics, Divergence of Implications." in Agriculture and Government in an Interdependent World: Proceedings of the Twentieth International Conference of Agricultural Economists, A. Maunder and A. Valdes, Eds., Dartmouth Publishing Company, Brookfield, Vermont, 1989, pp. 245-246.

European Communities - Commission, Tr^[ties Establishing the European Communities (ECSC, EEC, EAEC) - Single European Act - Other Basic Instruments, Abridged edition, Office for Official Publications of the European Communities, Luxembourg, 1987.

European Communities - The Council, "Comprehensive Community Proposal on the Long-Term Objective of the Multilateral Negotiations on Agriculture." (Provisional text), Adopted by the Council of Ministers, Brussels, Belgium, December 19, 1989, p. 6.

Gallagher, P. "The Grain Sector of the European Community: Policy Formation, Price Determination, and Implications for Trade." American Journal of Agricultural Economics, 70(1988):767-778.

Gardiner, Walter H. and Katherine C. Nishiura. "EC Policy: Reform or Tinker?" Agricultural Outlook AO-173 (April 1991):19-21.

Hathaway, D.E. Agriculture and the GATT: Rewriting the Rules, Institute for International Economics, Washington, DC, 1987.

Herlihy, Michael T. "Profiles of Agriculture in the United States and European Community." Western Europe Agriculture and Trade Report. RS-90-4 ATAD, ERS, Washington, D.C.: U.S. Dept. of Agriculture, Nov. 1990.

Hudson Institute. "Myth of the Month: The EC will Never Change Its Common Agricultural Policy." News from the Center for Global Food Issues. April 1991, p. 2.

Moyer, H.W. and T.E. Josling. Agricultural Policy Reform: Politics and Process in the EC and the USA, Iowa State University Press, Ames, Iowa, 1990, p. 31.

National Milk Producers Federation. "NMPF 1990 Policy." Arlington, V.A.: National Milk Producers Federation, 1990.

National Association of Wheat Growers. "Extension of Fast-Track for GATT." Washington, D.C." National Association of Wheat Grower, 1991.

Rausser, G.C. "Political Economic Markets: PERTs and PESTs in Food Agriculture." American Journal of Agricultural Economics. 64(1982):821-833.

Rausser, Gordon C. "The Political Economy of Agriculture in the United States." in The Political Economy of Agricultural Trade and Policy, H.J. Michelmann, J.C. Stabler, and G.G. Storey, Eds., Westview Press, Boulder, Co., 1990.

Rausser, G.C. and W.E. Foster. "Political Preference Functions and Public Policy Reform." American Journal of Agricultural Economics, 72(1990):641-652.

Sanders, Larry D. "A Summary of the 1990 Farm Bill." Agricultural Policy and Economic Issues. 5 No. 10 (Nov. 1990):1-4.

Sanderson, Fred H. Ed. Protectionism in the Industrialized World. Wasington, D.C.: Resources for the Future, 1990.

Schott, Jeffrey J. "Uruguay Round: What can be Achieved?" In Completing the Uruguay Round: A Results-Oriented Approach to the GATT Trade Negotiations. Washington, D.C.: Institute for International Economics, Sept. 1990.

Spear, J. "Without Export Subsidies, Agriculture Faces 'Severe' Change." Feedstuffs, 61(1989).

Tarditi, Secondo; Kenneth J. Thomson; Pierpaolo Pierani; and Elisabetta Croci-Angelini. Eds. Agricultural Trade Liberalization and the European Community. Oxford, U.K.: Clarendon Press, 1991.

"U.S. Proposal for Reforming Agricultural Trade," Public Affairs Office, United States Mission to the European Communities, Brussels, Belgium, October 25, 1989.