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Next Steps in Agricultural Trade Policy Reform

Further Steps in Domestic Reform

Domestic policy reform clearly opened the way for regional and multinational trade policy changes. But in the European Union and the United States (among other countries), were recent farm policy reforms permanent or just the latest twist in the endless saga of these programs? If the policy changes were a short-term expedient masquerading as reform, then these two countries will revert to type as soon as possible. In 10 years' time, will these policies look like an evolution of the reformed policies, or will they resemble the policies of the early and mid-1980s? Are they the latest variant of the old entitlement approach to farm programs (not based on need but on participation) or the first glimpse of a "new age" policy that takes the government out of making farming decisions, shifts payments to people rather than hectares, and buys out the political obligation to commodity and farm groups?

The Permanence of Reform in Developed Countries

In the case of the United States, there is still some doubt about the longevity of the reform, because the underlying legislation, the 1949 Agriculture Act, is still on the books. Failure to enact new legislation in the year 2003 will cause the policy to revert to that permanent legislation. This threat (since the 1949 act would create an expensive chaos) has been

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the stimulus for the timely passage of past farm bills, but it is not clear how credible the threat continues to be. It is likely that a compromise bill could be put together whenever needed. The failure to repeal the old legislation in 1996 was important, and an opportunity to clear the political decks was missed. That there has to be new legislation is an important advantage to those that will argue for the revival of traditional farm programs. The commission that will recommend the appropriate role for government in agricultural markets in 2003 will have to propose something. It will be difficult to dodge the issue.

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

CAP reform is also likely to be permanent, but for different reasons. Both internal and external forces will keep the policy from backsliding. Internally, the benefits of a lower cereal price are evident to the livestock sector, and the renewed use of domestic grain in animal feed has made market management easier. Externally, the GATT agreement and the schedules of export subsidies incorporated into the European Union's bindings are an effective brake on any significant recidivism. And if the European Union is to welcome new members in the first decade of the new century, the policy needs to be able to accommodate such changes. The enlargement of the union will leave no room for the type of policies that the EC6, the EC9, and the EC12 pursued for many years. A union of 20 or more will neither be able to afford the expenditure nor be able to justify the economic costs. Of course, the CAP could be rescued by a "green wall" around the existing member countries, with border taxes on goods coming from the new members that preserve higher prices for the existing members. But the political implications of this solution are worrisome. The message would be sent that the agricultural sector in the existing members is valued highly but not that in the new members. Any semblance of equity would be lost if the agricultural exports of Hungary and Poland cannot sell freely in Germany after accession. In other words, political reality will require the CAP to change to allow for enlargement, which will in turn lock in the second round of reforms.

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The instruments used in the reformed policies of the United States and the European Union give another indication of whether the reforms are permanent. If the policy reforms are to become permanent, there has to be an agreeable set of instruments that address the continued problems of the rural economy. Without such instruments, the removal of price supports depends on favorable (i.e., firm) world prices. The armory of weapons for dealing with rural employment, farm income levels, and social stability is extensive. Unfortunately, most of it is untested or tried only on a small scale. The fate of decoupled payments over time is uncertain. Will they become truly portable, attached only to the individual that was first the recipient? That may have some implications for land prices and raise some interesting landlord-tenant problems. Will they become salable? If the payments are portable assets, there is no reason why they should not be sold to others, presumably at a discount that reflects the credibility of the commitment to future payments. If they did become portable and salable, the impact on the rural economy could be significant, because investment would shift from agriculture to other areas. Will the payments become truly green, tied to environmental farming practices? This is certainly the way the European Union is heading, but whether farm interests will object to the layer of supervision necessary to make significant payments in a fair and effective way is unclear. Will farm income stability be dealt with by other instruments? Crop insurance is likely to be one such instrument. But farmers in the United States are experimenting with a variety of monetary instruments that offset risk, such as options-based contracts. The sale terms of farm products could over time evolve to include more such contracts. Income insurance and tax equalization schemes can prevent the major swings in income that often beset the farm sector.

A third way to phrase the "permanence" question is to ask whether the new policies are compatible with regional trade agreements and market integration in the Americas and Europe. If they are, then that reinforces their legitimacy and significantly increases their chances of permanently replacing the old price-support policies. NAFTA has made a start in pointing the way to a single agricultural market in North America, and Mercosur is pursuing the same path in South America. The 1996 Farm Bill contributes to this process by reducing government price support. There might even be a free market in cereals and oilseeds and perhaps beef in the next few years. Nevertheless, there will be frictions over sugar, fruits, vegetables, and dairy products. In these areas, the Farm Bill makes only a hesitant step toward regional market integration.

In the case of the European Union, there is little doubt that the MacSharry reform made the economic integration of the European economies—west, central, and east—markedly easier. By lowering the price level and compensating with direct payments, the market probably will not have to be kept segmented between east and west. That is not to say that there will not be problems of further integration of agricultural mar-

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kets. There will always be those in the existing European Union that object to the importation of goods from the new members. After all, French farmers still protest against agricultural imports from Spain, Italy, and the United Kingdom on the smallest pretext. But the political imperative to allow the Central European countries access to western markets will over time allow the economic benefits of specialization and trade within the enlarged European Union.

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

Is the FAIR Act, then, the policy change that makes a liberal global trade system possible for agriculture? It could be, if the US negotiating position in the 1999 round of the WTO is strengthened and if meanwhile it has not availed to export subsidies. The European Union could be isolated in the WTO if it does not respond by further modifying the CAP. The blue box in which the United States and the European Union agreed to shelter their deficiency payments and compensation payments from reduction and challenge will now by occupied only by the European Union. Hence, the pressure to get rid of this anomaly will be irresistible. The new round will include pressure to continue export subsidy reduction, to improve market access, and to achieve further reduction in AMS. There are reasons to hope that on this occasion the necessary shift in EU policy to bring the union into conformity and strengthen its bargaining position will take place without the six years of contention and confrontation that characterized the Uruguay Round negotiations.

Prospects for Further Reform in Asia

It is central to the arguments for further agricultural trade reform that domestic policy in Asia is at a critical juncture. The developing countries

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in the region are currently reducing the taxation of the agricultural sector through macroeconomic and trade policy reforms. Marketing and distribution systems are being deregulated and privatized. But there is considerable pressure to protect agriculture against the success of the more dynamic sectors of the economy, rather than encourage the rural sector to be among the leading sectors. A major shift in economic and political philosophy has overturned the long history of exploiting the agricultural sector. The greater danger now is that the agricultural sector be given undue protection, distorting the economy in the other direction, taxing the nonagricultural economy through a regressive levy on foodstuffs and employing the countries' natural resources in a way that does not add to national income.

The advanced industrial countries in Asia that have already experienced a period of high price supports (Japan, South Korea, and Taiwan) have not yet undergone the same transformation in agricultural policy as have the countries in the Americas. Direct payments are a much smaller part of farm support. But will these Asian countries follow suit or take a different path? One key to this lies with the future of Japanese policy. Japan has a reputation, well deserved, for having one of the most protective agricultural policies in the world. Only Switzerland comes close to the degree of protection afforded by Japanese policies. And yet these policies are of relatively recent origin, stemming from the 1960s. A bold move toward decoupling income payments from commodity output would imply that the country is prepared to allow imports to compete with domestic output, even if that meant that existing farmers were to be indemnified against income loss. The message that imports are a legitimate source of food for consumers and that a country best guarantees its food supply with a healthy economy and an integrated trade system, rather than with high-cost staples, would have considerable impact on emerging countries in the region.

Japan would also send a strong message to its Asian neighbors by continuing the deregulation of the wholesale and distribution channels and allowing private firms to import all agricultural goods. Obviously, countries may well differ in what role government plays in the agricultural and food system. But its role is rarely to subjugate private marketing in the name of administrative control of domestic prices. Modern food systems are far too complex for such administration by a government agency. Japan has taken so long to free up its distribution system not because the country needs the paternalism of state-distributed food but because powerful interest groups were making money and exercising control through the parastatal mechanism. If the trend toward deregulation and privatization in Japan were to continue, other countries in the region might also join the train and phase out the parastatal agencies that still permeate the agricultural and food sectors of a majority of Asian countries.

If Japan, South Korea, and Taiwan move to free up imports, shifting the burden of support to targeted payments from the tax base and at the same

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time encouraging private trading of basic foodstuffs, then the developing countries of the region will have new markets to penetrate if they can meet quality standards. China and Thailand have already begun to exploit these opportunities. Japanese and South Korean investors in turn could invest in the growing agricultural and food-processing sectors in the developing countries, as could US and EU companies. Conversely, maintenance of tight control over internal food markets and a lack of willingness to open markets will discourage others in the region from developing competitive farm sectors.

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

The Regional Path to Freer Agricultural Trade

The growth of regional trade pacts that started in the mid-1980s has posed many problems for the global trade system. Even now, the interaction between the regional and the multilateral trade liberalization process is one of the most important structural issues facing the WTO. It was initially feared that the spread of regional trade pacts would threaten the multilateral system. At the low point of the GATT negotiations, in 1991, it seemed that the world trading system was moving toward one of trade

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blocs. The usual scenario projected a European bloc, based on an expanded European Community; an American bloc, built on NAFTA; and an Asian bloc, with Japan as the key economy (International Monetary Fund [IMF] 1991). The three-bloc scenario concerned many economists and trade diplomats who thought that such talk might jeopardize the Uruguay Round by holding out the prospect of an alternative to the GATT system. One negative feature of such blocs was their presumed propensity to exclude or discriminate against trade or investment flows from each other (i.e., trade diversion). Trade wars could easily erupt under such circumstances, to the particular disadvantage of the smaller countries within the blocs. Countries outside the blocs would presumably hasten to be included, to at least get some shelter from the trade hostilities.

Success in the Uruguay Round has eased the fears on this score, because the strengthened multilateral system represented by the WTO offers some defense against the warring continental blocs. Despite the risks associated with setting up regional preferences, the consensus now appears to be that no great damage has yet been done. Most of the recent regional trade agreements, in particular those conceived under "open regionalism," conform with the WTO requirement that they cover most traded commodities and do not involve an increase in tariffs against nonmembers.[1] Because most of them have been formed in conjunction with liberalization of external trade, they might reasonably be expected to promote efficiency rather than shelter inefficiency. However, concerns remain that the proliferation of such agreements can impede liberalization and that technical devices such as "rules of origin" can be captured for protectionist purposes.

If the liberal purpose of open regional agreements is acceptable, then those agreements can be complementary to multilateral liberalization and become an alternative path to a similar end. The question is not one of choosing between the two but making the best use of each. The relationship between regional and global trade negotiations can therefore be linked with the question of the scope of the negotiations. Three different levels can be identified: unilateral trade policy decisions (where any negotiations are internal to the country making the change), regional talks (including bilateral and other group arrangements), and multilateral negotiations (in the WTO or other such body). The negotiations can either cover a subsector or commodity, a sector or industry, or more than one product. The matrix of nine negotiating level and scope combinations is shown in table 15. At one extreme are unilateral decisions on trade policy (such as the height of the tariff), which can be implemented quickly but may lack political support at home, because none of the exporting inter-

1. "Open regionalism" has come to mean some combination of low external protection and open membership that in addition meets the demands of the WTO, namely conformity with Article XXIV of the GATT (Bergsten 1997c).

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Table 15 Matrix of negotiating options

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

ests that will stand to gain are made party to the decision. At the other extreme, multisector global negotiations allow the maximum possibility for trade-offs and deals and include gainers as well as losers; however, these negotiations seem to take forever to complete and may in some cases hold back progress in policy reform as countries try not to "give away" trade barriers without getting something in return.[2] Trade strategists must decide what role regional and other intermediate levels of negotiation should have, and what the scope and coverage of those talks should be.[3]

2. Robert Paarlberg (1997) has made a convincing case that such negative impacts on domestic policy reform can take place. However, calculation of "credit" for reform taken unilaterally since the Uruguay Round should be possible, and such a calculation would reduce the temptation to avoid needed domestic policy change.

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

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Regional commodity or subsector agreements have often been used to grant preferences to specific developing countries and, as discussed above, have become less acceptable (and less useful) as the global economy becomes more integrated. Global commodity agreements were usually illiberal in intent and infeasible in operation. The heirs to this tradition are zero-for-zero agreements in particular commodity areas that get progress where broader sectoral pacts are impossible. While better than schemes that keep prices artificially high, such narrow schemes distort markets and may let other sectors off the hook by reducing the pressure to liberalize. In agriculture as a whole, single-commodity trade policy talks are somewhat unlikely to be fruitful except in special circumstances.[4] Broader, sectoral negotiations that cover groups of products also promise to further trade liberalization. These are sometimes discussed first at the regional level and then offered to other WTO members for their participation (as was the case with the recent Information Technology Agreement). An agricultural sector initiative of this type might be worthwhile, but it would have to be easier to persuade, say, reluctant European importers to join an agricultural trade pact negotiated by an Asia Pacific regional group dominated by exporters than to have the same debate between the same parties in the WTO. The choice between regional and multilateral trade approaches usually refers to negotiations with a multisector or economywide scope. The merits of the regional trade path depend on the balance between the positive effects of trade creation, through the reduced protection in the import-competing sectors, and the negative effects of trade diversion, as higher-cost partner goods muscle out efficient third-country suppliers. If the degree of external protection is low, the trade diversion is likely to be small. If the low-cost suppliers can join the regional bloc, then trade diversion will also be reduced. Regional trade agreements are not static institutions, nor are they passive participants in world trade. Few have kept the same membership for long, and all have evolved as a result of internal and external dynamics. One such external force began to emerge piecemeal in the early 1990s. This was a new set of trade pacts that could be called network arrangements, which link free trade areas by means of treaties among the blocs. The best-known case was the European Economic Area (EEA), between the European Union and the EFTA, which granted free movement of goods, services, labor, and capital between the two blocs. The structure was intended as an alternative to EU membership for the EFTA countries, at a time when they had foreign policy objections to join-

4. One such circumstance might be a coordinated push from the private sector in a range of countries for free trade in a particular product. This could occur in the case of oilseeds. But how nonparticipants in the agreement are treated becomes crucial. If not expanded on an MFN basis, the zero-for-zero becomes discriminatory.

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ing the union.[5] Another variation on the same theme is the Latin American Integration Association (ALADI), a framework agreement that is a descendant of the original Latin American Free Trade Association (LAFTA). Regional groups, subject to common rules, are encouraged within ALADI. But in addition, individual member states can enter into economic cooperation agreements with each other and give limited preferences for imports from other members.

The major architectural innovation of the mid-1990s was to transform these networks into trade agreements that span continents. This new breed of supraregional agreements, such as APEC and the FTAA, are different from traditional regional trade blocs, because they have overlapping membership and join rather than isolate continents. A country can be a member of more than one such agreement. They can include both countries and existing trade agreements as components. This new trade structure, if it survives, will no doubt undergo further development. The New Transatlantic Agenda, at present concerned with such issues as mutual recognition of standards and testing, could become a precursor to a more formal agreement between the United States, Canada, and the European Union. The European Union and Asia will no doubt find it in their interest to conclude agreements of their own to avoid the implications of the pivotal position of the United States, just as the European Union and Mercosur have been actively discussing such an agreement.[6] These supraregional agreements go some way to meeting the objections of trade economists to the narrower regional blocs. They are large enough to include low-cost suppliers of most products; they can absorb new members easily; and so far, each has bent over backward to be compliant with the WTO. In this sense, they are examples of open regionalism.

The new type of supraregional trade architecture is particularly interesting from the perspective of international trade in agricultural goods. It is unlikely that a three-bloc world—Europe, the Americas, and Asia—would have dealt effectively with the issues of world trade in agricultural products. The blocs were bound to have taken very different views on such trade, and interbloc tensions would have prevailed. A European bloc was no more likely to have yielded to an American bloc on agricultural trade liberalization than such a bloc was likely to have yielded in the WTO. Similarly, it was not clear that an Asian bloc that included Japan, but not the United States and Canada, would suddenly have become more willing to liberalize trade in farm products. Historical ten-

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

6. The free trade agreement between Mercosur and the European Union is expected to be signed in 1999. The extent to which agricultural goods are included is an obvious sticking point in these talks.

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sions would have been preserved in the interface between the continental blocs.

By contrast, the supraregional processes that span the regional blocs will not be able so easily to dodge the issue of agriculture. The problems of agricultural trade will tend to be internalized by the nature of the processes. The United States, for example, could become a member of at least three trade pacts (the Americas, Asia Pacific, and transatlantic) that together cover all the major markets for its goods. The pressure to include agriculture would come from the lack of political support for any agreement that excluded a major sector of US exports. The way that it is included would also liberalize agricultural trade on world markets, because other exporters would quickly have to conform to avoid losing out on the major markets of the world.

Supraregionalism and Agriculture

Is there an even more ambitious role for the supraregional trade pacts that could be exploited by the multilateral process? Set against the scenario of unfulfilled promise of agricultural trade liberalization at the multilateral level, the regional initiatives have begun to look like useful building blocks for the future of the trade system. By the year 2005, there should be virtually no agricultural trade barriers left between the United States and Mexico, though Canada will have to catch up with that schedule by steeply reducing tariffs for some high-tariff agricultural commodities on intra-NAFTA trade. The same would be true in Latin America, Central America, and the Caribbean if current timetables for liberalization are followed. The rather optimistic plans for the FTAA by 2005 include removing agricultural trade barriers. If several of the countries of Central Europe became members of the European Union around the year 2002, and if the same "instant accession" arrangements negotiated with the recent EFTA countries were followed, there would be an agricultural free trade zone of perhaps 21 countries in Europe by that time. Including the Euro-Med agreements with the countries of North Africa and the Europe Agreements for the other Central and Eastern European countries, the free or mostly free trade zone could include over 30 countries.

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

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afforded Asian countries. Nor will it accept a disadvantage in Asian markets relative to goods from the United States. Therefore, a transatlantic trade agreement seems to be a likely outcome of progress in APEC, if Europe does not somehow participate directly in the APEC-inspired liberalization process. An Asia-European Union trade agreement also seems inevitable at some stage (a series of meetings has already begun though not with an explicit free trade agenda), again unless the European Union were to join the APEC process. Between them, these agreements would have to incorporate free agricultural trade between the United States, Asia, and the European Union, however improbable this may seem at the moment.

There is, therefore, the possibility that the pace of liberalization of agricultural trade may be set by these regional agreements and processes. A liberal trade system may come about more quickly if agriculture is incorporated in the timetable of the regional agreements and supraregional blocs and not in traditional WTO negotiations. Most present intercontinental agricultural trade flows will be internalized within these supraregional pacts. Moreover, the pacts are likely to deal with agricultural trade issues in similar ways, so as to avoid the proliferation of different trade rules for countries that are participants in more than one pact, such as the United States.

Supraregional trade agreements do not make importers more willing to open up their markets. However, the political calculus might change enough for some serious liberalization to occur in agricultural markets as a result of such blocs. The United States, for instance, would be in a stronger position to suggest major changes in farm product access in Asian countries if the prize were membership in a supraregional bloc. Removal of export subsidies on agricultural products may be possible in the context of a transatlantic deal with the European Union.[7] Even domestic subsidies may be forced to conform with subsidy and competition rules within the supraregional agreements. In all these cases, the threat is of exclusion, and the cost of such exclusion will be high. Despite some obvious dangers in this emerging trade architecture, it seems to offer a parallel and perhaps speedier path to free agricultural trade within a generation. In short, supraregional blocs may be just the institutional structures needed to tackle agricultural trade and protectionism.

The FTAA and Agriculture

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

7. For a discussion of this possibility, see the chapter by Josling in Stokes (1996).

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

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

Integrating the Eastern European Agricultural Market

The European Union's most difficult challenge in the next decade is to figure out how to absorb up to 10 more countries from Central and Eastern Europe.[8] These countries have low incomes at present—on average those incomes are only 11 percent of the EU15 average. But they have good potential for steady economic growth and their consumers have high expectations. Workers in these countries are potentially mobile and will undoubtedly go looking for jobs throughout the union if none is available at home. The population in these 10 countries is about 29 percent that of

8. Ten countries now have Association Agreements that are intended to lead to membership. The Czech Republic, Hungary, Poland, Slovenia, and Estonia are considered to be the most ready for membership and might enter by 2002. Slovakia, Bulgaria, Romania, Latvia, and Lithuania are considered less likely to be prepared and might be ready by 2005 at the earliest. Cyprus has been promised entry negotiations as soon as the constitution of that divided country is settled. Malta has for now decided against negotiating for membership. Turkey provides the biggest problem for the European Union from the point of view of possible accession. It has had an Association Agreement for more than 30 years and now has a customs union agreement (that excludes much of agriculture). Although it has requested full membership, it is still a long shot, and several EU members would oppose it.

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the EU15. Thus, the challenge is to generate enough economic growth in these economies that they become a source of employment, a magnet for both domestic and foreign investment, and a buoyant market for goods from the EU15.

As integration takes place, EU15 producers will press for relief from imports from the Central and Eastern Europe. Sensitive imports into the European Union—including steel, textiles, and agricultural goods—are already controlled by quotas under the Europe Agreements.[9] Everyone agrees that the markets must eventually be opened. It is the timing and sequencing that is at issue. Too rapid an opening in advance of membership could provoke a backlash that would delay accession. Too slow a move to an open market increases the disillusion already felt in Central Europe about the willingness of the European Union to take any political and economic risks for the sake of securing democracy and establishing security.

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

The convergence of the countries of Central and Eastern Europe toward the level of economic and political stability necessary for membership is proceeding apace, and it will be difficult to postpone enlargement much beyond the first few years of the next decade. This puts their accession roughly at the same time as the next trade round and indicates that there is at most five years to adjust current policies to meet the of accession. The challenge has been recognized by the European Commission in its "Agenda 2000" report. At the very least, a large jump in budget costs is possible if structural grants and subsidies based on hectares and number of livestock are extended to the new countries. These countries would increase the agricultural capacity of the union considerably. Whether the new entrants will be major exporters of farm products within the next five years depends upon a number of conditions, including their own recovery from the traumas of changing political and economic systems and the

9. Prospective members are also apprehensive about joining the European Union. They fear that competition from the west will demolish entire industries in their countries.

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policies they chose in the interim. If the projections of substantial surplus production are realized, as seems likely, then the cost to the budget of enlargement could be crippling to the European Union.[10] But can the political system respond in advance to avoid the problems or will change have to wait for crisis?

Several tasks must be accomplished before the Central and Eastern European countries can join the European Union without causing too much disruption. First, the EU15 must be convinced of the positive side of the accession of a number of countries that have high skill levels and adequate natural resources. Trade with such countries will be mutually beneficial and strengthen the European Union internationally. This is also true of the agricultural sector. If the European Union sees the accession as a chance to adapt and take advantage of the expanded resource base, all countries will win. The present negative view stems from the difficulties in managing the protected market along with the feeling that the competition for budget funds is a zero-sum game. Discussion of agriculture on a continental basis could alleviate some of the natural concerns about increased competition for markets and funds.

Merging the agricultural sectors of the old and the new members can start well before entry. The Europe Agreements provide a framework for the convergence of the economies in general and of trade policies in particular. Agricultural policy should be included more fully in these agreements, not to protect the present EU producers but to allow a rapid integration of the agricultural sectors of Europe. To this end, the Europe Agreements need to accelerate the liberalization of quotas on imports from Central and Eastern Europe and to improve the administration of those quotas so that they do not give so much of the benefits to the importers. The European Union is already using the market-access guarantees negotiated in the Uruguay Round to increase imports from Central and Eastern Europe. A quick move to trade unrestricted by quantitative barriers should be the goal. Price differences that reflect different levels of external support could then be tackled as a part of policy harmonization.

The tasks before the union in preparing for entry are not too daunting, if the logic of the 1992 MacSharry reform is applied and if this reform has been continued along the lines suggested in Agenda 2000. Cereal prices for the expanded European Union need not differ from the future reduced level for the current members. A relatively light intervention system, at a low price and coupled with a set of bound tariffs (and a maximum applied duty rate) for imports, should support the wider European market. If in the next few years the new members have chosen prices at or below the EU level, and if that level is close to world market prices, then their

10. See Tangermann and Josling (1994) for a detailed argument as to why the Central and Eastern European countries are likely to become major exporters of many agricultural commodities.

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incorporation should not cause problems. Exports could increase, but only minor subsidies would be needed to price them down to world market price levels and, hence, onto world markets. Problems are more likely if one of these conditions does not hold. If CAP reform stalls before that time and, hence, the European Union has cereal prices way above those in other major producing areas, the extension of these high prices to the countries of Central and Eastern Europe could generate considerable export quantities that could only be restrained by supply control or sold with expanded subsidies. This would prove both financially expensive and also diplomatically difficult, because the European Union would have to bargain for additional export subsidy allowances.[11] Other exporters are likely to complain if EU expansion increases subsidized exports, because this would be a sure sign of trade diversion rather than trade creation from the process of enlargement.

The European Commission appears to be leaning toward the notion of a transition period for the harmonization of agricultural prices.[12] The argument seems to be based on the experience with the southern enlargement in 1986, where relatively smooth transition periods allowed the very different price levels of the applicants to harmonize with those of the CAP. This, however, leads to the question of whether the analogy is closer to the Portuguese transition, a ten-year period designed to allow Portugal to adapt to Europe, or the Spanish case, a seven-year period for the European Community to prepare for Spanish competition. In any case, since the time the European Union was established with its borderless internal market, the costs of maintaining different prices has increased sharply. The better model might be the recent accession of the three EFTA countries. Prices were harmonized from the date of accession, but payments were made to compensate the farmers whose prices declined. The problem with this analogy is that if the Central and Eastern European countries were to get current EU15 prices, the expansion of production, the hardship for consumers, and the budget cost for the European Union would be too great to bear. Hence, if the CAP is not changed by that time, the choice will be between a slow transition and a costly division of the market or a fast transition and more uneconomic agricultural surpluses. The Europeans should work toward convergence and the creation of an integrated agriculture sector as swiftly as possible. This is why a continued reform of the CAP is necessary for enlargement.

11. The Central and Eastern European countries declared some export subsidies in their GATT schedules, which must therefore be reduced. These could be aggregated with the subsidy allowances for the European Union. They would not, however, cover the likely expansion of exports eligible for subsidy if these EU applicants expanded output (and reduced consumption) because of higher prices. See Tangermann and Josling (1994, appendix II).

12. This is the solution that the European Commission suggests for those commodities that still have price gaps (European Commission 1995).

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Agriculture and the Transatlantic Agenda

One of the most important tasks for the transatlantic partnership may be to define and improve commercial relationships between the United States and the European Union. The European Union has revived this issue because it is concerned that the United States is drifting into isolationism or an obsession with Asia. There was considerable discussion in the early 1990s on the need for a new transatlantic treaty to keep the United States engaged in Europe. This treaty, by common agreement, would have an economic component. What this economic component could be is less clear. Some argued at the time for a Transatlantic Free Trade Area (TAFTA), but governments did not seem to be willing to go this far.[13] Instead, at the end of 1995 the European Union and the United States signed a joint declaration for a New Transatlantic Agenda, including an Action Plan on economic as well as security issues. The issue has opened up again, with Frost's proposal for a North Atlantic Economic Community (NATEC), the economic counterpart to the North Atlantic Treaty Organization (NATO).[14] This would apply the APEC approach to regional trade agreements and encourage others to join in the liberalization to avoid the introduction of preferences.

Could such an agreement include anything meaningful on agricultural trade? In agriculture, any discussion of US-EU relations carries with it the fear of failure and frustration, born of the experience with the Uruguay Round and the previous 20 years of tension. However, the opportunity should not be lost for an improvement in trade relations in such an important area. Indeed, if domestic policy trends continue in both the United States and the European Union, there could be an opportunity for dramatic change in trade relations in agriculture. For example, they might agree to mutually forswear the use of export subsidies in those markets where they compete, reform domestic policies so that they are consistent with the green box category of decoupled support, and develop quality and health standards and agree to recognize of each other's sanitary and phytosanitary measures. However, the United States and European Union must avoid the establishment of new trade preferences across the Atlantic, unless they are part of full free trade agreement that has only low levels of external protection.

Agriculture would obviously be a possible sticking point in such discussions. But difficult trade issues must be faced rather than avoided if the transatlantic agenda is to be credible. A bilateral pact that puts a mora-

13. Presumably, the enthusiasm for TAFTA will rise if APEC achieves trade liberalization within the Asia Pacific region to the exclusion of Europe and fall if it does not. The European Union is unlikely to accept less favored access into the US market than that enjoyed by Japan.

14. See Frost (1997) and also Stokes (1996).

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torium on the use of export subsidies, for instance, would boost transatlantic trade relations and be acceptable to other countries. Rather than raise fears about trade diversion and corrosive bilateralism, the rest of the world would welcome such a pact because it would contribute to peace and stability on world markets. The recent US period of high prices was perhaps the best time for such a pact to have been agreed on.

Does the combination of the MacSharry reform in the European Union and the FAIR Act in the United States promise to reduce significantly the tensions across the Atlantic in agricultural matters? In the long run, there is little doubt that decoupling farm support payments from output will reduce the tensions between the United States and the European Union. However, the benefit may not be felt at once. Indeed, for a time there may actually be an increase in transatlantic tension. The pressure is now on the European Union to make the next move in policy reform. The commissioner for agriculture is reported to have said that he looks forward to a time when EU agriculture is internationally competitive without the aid of export subsidies. Such an eventuality would be hastened by a continuation of the policy reform of 1992. If "MacSharry II" were to bring EU prices to world levels, international agriculture relations could improve markedly. Transatlantic relations may also depend on whether the United States has permanently ended agricultural commodity support. Will the next administration increase the safety net? Will the United States revert to the old legislation when the current bill expires? If so, then there will be resistance to negotiating away farm support instruments. Congress may also not allow the United States to lose market share to the European Union. Export subsidies have been authorized, though that does not ensure that the funds will be appropriated. They may be kept as a weapon for the conduct of trade wars long after their usefulness as a cost-effective domestic market-management tool (if it ever was) has disappeared. Under these circumstances, the prospects for peace look dim. But if the FAIR Act really is a major shift away from government involvement in farm markets, then the possibility of a different US-EU relationship is not so far-fetched. The outcome may in part depend on world price developments. High prices would lead to less tension and less tendency to revert to the old policies. Low prices could be followed by increasing pressure to go back to commodity market support.

Agriculture in the APEC Process

The potential role of APEC in agricultural trade reform cannot be denied. By setting a date by which free trade is to be achieved and by specifically rejecting the attempts of some members to exclude agriculture from the commitment, APEC has raised its sights beyond that of the WTO. When APEC was first discussed, few would have thought it likely that any

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meaningful agreement could have been negotiated in the area of agriculture. Therefore, two questions arise: How did such a commitment come to be made and what will actually happen?

The decision to move to free trade and investment among APEC members by 2010 for the developed and 2020 for the developing countries is historic. If it remains on track, it will represent the triumph of collective courage by heads of government over the politics of protection. Presumably, having decided to go above the heads of special interests and ministries on the industrial side, it required little more reach to include agriculture. But the way that the free trade goal is to be reached is even more unusual. The process relies heavily on coordinated unilateral action (the APEC Individual Action Plans) rather than the bilateral negotiations (multilateralized afterward) of the WTO. How does the inclusion of agriculture fit in with this process? It implies, in effect, that each APEC country will have to bring to the table plans for the unilateral liberalization of agriculture. So far, commitments under the APEC umbrella have not gone far beyond an acceleration of Uruguay Round obligations and agreement on sectoral liberalization plans. APEC identified the food sector, along with oilseeds and oil products, as one of the 15 areas where the voluntary program of liberalization was to be pursued. This at least suggests some continued willingness to move into sensitive waters.

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

The Way Forward in Multilateral Talks

It would be difficult to find anyone outside the ranks of the inveterate trade policy buffs with much enthusiasm for yet another round of trade talks. Still fewer would relish the idea of further negotiations on agriculture. The long drawn-out process of the Uruguay Round, seven years

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from start to finish, was not one that many wish to repeat.[15] But further negotiations are on the way, and agriculture will be among the topics discussed. The agenda is already being formed and the issues discussed. It is not too soon to identify which aspects of the international trade system for agricultural products still need fixing and how to best go about fixing them. Now is a particularly good time to be thinking about these issues, before attitudes are hardened and options foreclosed.

The Next Round of WTO Negotiations on Agriculture

The Uruguay Round established the next steps for multilateral trade liberalization in agriculture. The URAA (in Article 20) called for talks to begin no later than 1999 (the last year of the implementation of the scheduled reductions in protection, at least for developed countries) on further reform of agricultural trade. The agreement confirms "the long-term objective of substantial, progressive reductions in support and protection resulting in fundamental reform" (WTO 1995b, 55). The WTO ministers' meeting in Singapore in December 1996 confirmed the timetable and recognized the need to firm up the agenda and begin analyzing alternatives. Countries will decide on the agenda within the next year or so, initially by informal contact among the major actors. To this end, an informal body known as the Analysis and Information Exchange Group has been set up within the WTO Agriculture Committee.

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

The most important task of the next round will be to take the next step toward a world market undistorted by high import barriers and government subsidies. This task was begun in the Uruguay Round, and the

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

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mechanisms are largely in place. However, removing the first 20 percentage points of a tariff or subsidy was relatively easy. The challenge comes when high-cost farmers begin to sell their enterprises. But there will also be anguish when reductions begin to cut into profits of those that feel themselves to be competitive. Though the ultimate test of competitiveness is survival in the marketplace, those whose livelihood is at stake will resist that test. The range of protection exposed by tariffication makes clear that trade liberalization has far to go. The next round will not in itself achieve the competitive environment that will make the best use of the world's agricultural resources. But it must make a significant move in that direction, or it will have failed to continue the process started with the Uruguay Round.

Improving Market Access

Tariffication has made agricultural trade significantly more transparent. The level of protection long hidden by nontariff barriers is now visible. And this level of protection is high relative to the trade barriers in manufactures. It is as if the agricultural sector still has pre-Kennedy Round tariff protection. How can this discrepancy be eliminated quickly? How can tariffs of 100, 200, or even 300 percent be brought to levels found in most other areas of trade (5 to 15 percent) or to zero if free trade is in the cards? This looks to be a tall order: it implies a period of significant tariff cuts that extend well beyond the time frame of the next round.[16]

One way to engineer this reduction of trade barriers in a shorter time frame is to negotiate a major across-the-board tariff reduction, perhaps aiming for a 50 percent cut in all tariffs over a five-year period. This would, however, still leave some high tariffs. Alternatively, agricultural tariffs could be reduced on a formula basis, with higher tariffs being reduced at a greater rate. This method, the "Swiss Formula," was used to reduce tariffs on industrial goods in the Tokyo Round. This could be a faster and fairer way to the same end, because it would squeeze much of the "water" out of the high tariffs (and remove the element of "dirty tariffication") in the first stage.[17]

16. Tangermann (1997) has suggested using the same base that was established in the Uruguay Round for the next set of tariff cuts. A further 36 percent cut from the same base would imply a 72 percent cut over the two "reform" periods. In this way, the continuity of the process would be emphasized and the same percentage cut would have greater impact.

17. The "water" in a tariff is the unused protection when no imports can sell at the tariff inclusive price. The "dirty" element in the agricultural tariffs refers to the use of price gaps between domestic and world markets, which overstate the existing protection at the time of tariffication, leading to larger-than-necessary tariffs. Tariff bindings were also often set well above the actual tariff in operation, giving an element of discretion to governments, which one might call "policy water." Thus, a reduction in the high tariff rates removes the water, cleans up the tariff, and removes the discretionary element of ceiling bindings.

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Such a formula would also reduce the variance of tariffs among products, which increased during the last round.[18] The URAA provided for a simple unweighted average reduction of 36 percent, with a minimum cut of 15 percent for each tariff line. Many countries cut tariffs on sensitive commodities by the minimum and made larger percentage cuts on other items. As an alternative approach to the problem of tariff dispersion, countries could agree on a maximum tariff to which all higher tariffs would have to be reduced over an agreed on period. This could be combined with an across-the-board cut that gives a general reduction and a rate consolidation.

To remove some of the "policy water," a different approach could be considered. The gap between bound and actual rates could be eliminated. Bindings could be reduced to no more than the maximum applied tariff in an agreed on historical period (e.g., 1993 to 1998, if the negotiations were conducted in 1999).[19] This would lock in at least some agricultural trade reform. It would not, of course, remove the element of protection introduced through "dirty tariffication," and there could still be "water" in the tariffs as currently applied. It would only remove the discretionary element of protection that countries were able to build into the Uruguay Round tariff bindings for their own flexibility. This would, however, increase considerably the credibility of the liberalization process. It would put a limit to the spread of "price band" systems of variable protection that several Latin American countries have adopted to stabilize domestic prices.

A somewhat different approach to the issue of tariff reduction has been successful in other areas of trade, such as information technology. This approach is to negotiate zero-for-zero agreements that would eliminate tariffs completely on particular goods.[20] Clearly, there are advantages as well as disadvantages to such an approach. Political sensitivities restraining liberalization in some products such as dairy and sugar would not hold up a move to competitive markets in others such as oilseeds and pigmeat. Trade would expand in the latter markets if protection were reduced. However, the benefit of this trade creation from the point of view of both the importing country and the world as a whole would be offset by the costs of trade diversion, because zero-tariff items would replace the lower-cost but higher-priced goods still subject to tariffs.[21] The zero-for-zero approach rests in part on the notion that the isolation of

18. This was the case, for example, in the European Union, Japan, and the United States (Tangermann 1995).

19. There would, of course, be a danger of announcing such a scheme in advance. Countries might choose to raise tariffs to their bound levels to avoid the cut.

20. This approach is discussed more fully in Miner et al. (1996).

21. The European Union, which negotiated easy access to oilseeds in the Dillon Round, knows well the problem of "unbalanced" protection.

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highly protected markets will force them eventually to come in line. Unfortunately, this strategy might let sensitive commodities off the hook unless the sector-by-sector reductions were in a framework that ensured no long-term exclusions.

Another way to tackle the high tariffs that resulted from tariffication is to expand the guaranteed market access that forms a part of the provisions of the URAA. Removing the TRQs, as discussed above, may not be an attractive option for the exporting countries. Expanding them, however, is one simple way of reducing their importance and lessening the impact of the high "above quota" tariffs. Doubling the minimum access quantities, for instance, would make irrelevant many of the high-bound tariffs for imports above the quota. If TRQs were increased by 1 percent of domestic consumption every year for five years, much of their negative effect would be removed. In most markets, the quotas would become nonbinding before the five-year period ended. In effect, tariffication would have taken place at the level of the reduced tariff applicable to the TRQ. The main political objection to this could be that the "within quota" tariffs were generally left to the discretion of the importing country to fix at levels that would attract the guaranteed access quantity. This implies that some form of renegotiation on these tariffs might have to take place.[22]

Removing Export Subsidies

Subsidizing agricultural exports has been sanctioned by the Uruguay Round, albeit in a reduced form. Countries that import agricultural products have gained in economic terms from the subsidies. But even among these countries, the disturbance of the domestic market has often caused problems. In the next round of negotiations, it will be difficult to persuade countries that export agricultural goods with little or no subsidy to allow countries such as the European Union and the United States to continue their market-distorting practices. A further push to rein in these subsidies is likely to be high on the agenda of the Cairns Group of agricultural exporters.

The elimination of export subsidies would have significant advantages. The prerequisites for dispensing with export subsidies are a renewed confidence in world markets that have firmer and more stable price levels for the major products and reduced dependence on intervention buying in domestic policies. The former depends on how successful the URAA is in increasing trade and reducing protection. As for domestic programs, it is possible that practice and sentiment in the United States and the Euro-

22. This also offers a possibility to start such tariffs for within-quota trade at a reasonable level in relation to other goods. For example, all within-quota tariffs could be bound at 20 percent and not reduced until they became the operative tariff for the bulk of agricultural trade.

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pean Union will have moved away from the use of market support policies to other instruments by the turn of the century. If that were the case, it could be politically easier to curb the use of export subsidies by the time of the new round. A new set of negotiations could, for example, set a target to phase out export subsidies by 2005. If such a move were successful, export subsidies for agricultural products would have been relegated to an inglorious place in trade policy history.

Curbing Export Taxes

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

Therefore, importers such as Japan may lead a movement to constrain the ability of exporters to restrict supplies. After all, restraints on exports are no less inconsistent with an open trade system than restraints on imports. Export taxes should be included under the same qualifications as quantitative restrictions. The argument has already surfaced in connection with the Food Security Declaration appended to the URAA, "The Ministerial Decision on Measures Concerning the Possible Negative Effects of the Reform Program on Least-Developed and Net Food-Importing Developing Countries." It seems inconsistent to leave in place the possibility of export taxes and quantitative restrictions that have an immediate and harmful impact on developing-country food importers.

New Instruments for Domestic Support

It is one of the ironies of the Uruguay Round that although the most important conceptual breakthrough was that countries accepted that domestic policies were a legitimate concern of trade talks, the actual disciplines imposed on those policies were rather weak. Therefore, in the next round, should attempts to constrain domestic policies be strengthened or abandoned? In one sense, the issue is less crucial than in 1986. Most developed countries have modified their domestic agricultural

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programs in recent years to improve targeting and reduce the output-increasing nature of farm-income supports. Consequently, the AMS constraints are not binding in most cases. However, this does not mean that the constraints on domestic support have been ineffective. The role of the agreement in supporting this domestic reform process should not be underestimated. The reinstrumentation of domestic support programs, away from those that most impede trade, has begun. But the AMS constraint on domestic policy puts useful pressure on countries to continue this process. Making policies compatible with the green box guards against challenges from trading partners and means that the policy transfer is not counted toward the AMS. This suggests that the AMS constraint should be tightened to avoid the temptation of backsliding and to promote further reforms. The present reforms are in general less secure and easier to reverse than trade rules.[23] This tightening would make the green box much more effective. Because such policies are exempt from AMS and avoid challenge by other countries, there is a powerful case for making domestic policies conform with the green box criteria.

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

The Politics of the Next Round

Further reform is possible if recent trends in domestic, regional, and multilateral policies toward agriculture are moving down the same path. But such arguments for further action on agricultural trade reform will not carry much weight if the political signals are wrong. This implies that internal political opinion in at least some of the major participants must

23. The reform of the CAP is not yet permanent, and the 1996 US Farm Bill only lasts for the next seven years, at which time Congress may decide that direct decoupled payments are not enough to support rural incomes.

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favor entering into another round of trade talks on agriculture. In the past, the United States has been the driving force for putting agriculture on the agenda, backed up by Canada and the smaller agricultural exporters. The European Union and Japan have reluctantly agreed to the agenda despite vocal domestic opposition and have dragged their feet once talks have begun. However, this hesitation is costly in terms of the negotiations as a whole. Can the dynamics for the next round be changed?

The best hope for change lies with the European Union. Until now, the agricultural stance of the European Union has hung like an albatross around the neck of its trade negotiators. The agricultural issue is still going to be problematic for the union and could still limit its position on other matters. But the European Union as a major exporter has an interest in expanding markets. Trade wars fought with export subsidies are not in the interest of the union as a whole: they are an unfortunate and costly side effect of the old CAP, with its rigid intervention at high prices and no other way of reducing stocks. Indeed, the European Union has a strong interest in promoting freer agricultural trade, including the removal of export subsidies. Continued CAP reform along the lines started in 1992 will allow for a more constructive position on agricultural trade liberalization than was taken in the Uruguay Round. The negotiations scheduled for 1999 to continue the process of trade reform in this area will test the ability of the union to resist protectionism in favor of openness in agricultural markets. These issues will help to determine the politics of the next set of WTO talks. The European Union could continue to run interference for the protectionist elements in East Asia, taking the brunt of the pressure from the United States and others to liberalize markets. Or, the union could pressure Asia to open agricultural markets and help the export prospects for the newly competitive agriculture of the enlarged union. This would isolate those governments that have until now resisted international efforts to modify their domestic policies and would almost certainly lead to further trade liberalization.

This transformation of the European Union, from a reluctant partner in multilateral trade liberalization in agricultural products to a leader in the process, will require a consistent and credible strategy. The Uruguay Round has made such a task somewhat easier. Essentially, the only import barriers are bound tariffs, though sometimes at a high level, and export subsidies are declining according to the agreed on schedules. The battles of the Uruguay Round have been fought—and lost. The European Union could now decide that its destiny is as a competitive exporter of high-quality agricultural and food products and, therefore, that it is in its interest to reduce tariff barriers as quickly as possible and to phase out export subsidies. It could take the high ground of the negotiations by putting forward a date for the end of export subsidies, perhaps the most unpopular of all trade policy instruments in agriculture and the cause of much disruption in world markets. And it could offer to end the use of the blue

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box. Now that the United States has enacted the 1996 Farm Bill, which makes the former deficiency payments available to farmers without any need to produce commodities (i.e., they are completely decoupled and, thus, presumably can be put in the green box of acceptable subsidies), the European Union is alone in needing the blue box protection against reduction commitments and challenges by trade partners.

What will be the role of the United States in the next round of talks on agriculture? Will the United States take the lead in suggesting the path toward reform? Clearly, the outcome of the debate over fast-track negotiating authority will influence the answer to this question. Without fast-track negotiating authority, and with a Congress wary about further attempts to liberalize trade, it is not easy to see a leadership role in the next round. But even with fast track, certain hard decisions have to be made. The United States will need to offer to others some incentives to allow them to strike a deal on agriculture. The European Union may want some continuation of the Peace Clause, to avoid continuous WTO challenges of the day-to-day operations of the CAP. Asian countries may hold out for assurances against the use of export embargoes. But most of all, the United States is going to have to grant better access for some of the commodities that have so far not been opened up to imports. These include sugar, dairy products, peanuts, and citrus fruits. Open markets also imply transparent health regulations, allowing such imports as poultry into the market subject to meeting the same conditions as imposed on domestic supplies. The process of opening up US markets to NAFTA partners has already begun. The putative date for an agreement on free trade in the Western Hemisphere is only seven years away. The administration has consistently supported the APEC objective of free trade and investment, and this objective is scheduled to be achieved within 12 years.

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

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