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Curbing Agricultural Exceptionalism: The EU's Response To External Challenge:

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From the launch of GATT in 1948, through to the Uruguay Round of GATT negotiations, the niceties of international trade rules had little impact on the design and implementation of EU farm policies. GATT was built on consensus, but powerful economic actors (such as the EU) were to a large extent able to implement farm policies that best suited their perceived needs. This agricultural exceptionalism (a term used by political scientists) had been promoted by the US in the 1940s and 1950s, but was cultivated by the EU (and others) in the 1960s and 1970s. However, dating from the Punta del Este declaration of 1986 launching the Uruguay Round, agricultural exceptionalism has been under pressure and the Uruguay Round Agreement on Agriculture of 1994 (the URAA) did, to some extent, curb agricultural exceptionalism and continues so doing through the WTO dispute settlement body.

In this paper we analyse the extent to which agricultural exceptionalism has been curbed, explore why it was curbed and finally explore the implication of this for EU policy-making. We argue that in particular two major changes in GATT institutions enabled actors, dissatisfied with the agricultural exceptionalism institutionalised in GATT 1947, to curb it. The Uruguay Round represented a significant break with the past. First it was a 'single undertaking' in which progress on other dossiers was contingent upon an outcome on agriculture deemed satisfactory to other GATT signatories. Having signed-up to a single undertaking, the EU was 'forced' to make concessions on agriculture if the

Uruguay Round was to be concluded. Thus we subscribe to the view that the MacSharry reform of 1992, which ushered-in a major change in EU farm policy, was in large part prompted by the need to assuage its partners in the Uruguay Round negotiations.

Secondly, in implementing the agreements, the GATT system was based on consensus (tempered by power diplomacy), whereas the WTO ushered in a rules-based system of international trade. The determination of new WTO rules (for example in the Doha Round) is still based upon consensus, but once the rules are in place a quasi-judicial system applies (the dispute settlement process). 'Soft' law has been replaced by 'hard', or harder, law. Under the new quasi-judicial dispute settlement procedure, countries are expected to bring their policies into conformity with WTO rules (or face retaliatory trade sanctions). During 2005 two seminal rulings were confirmed: one condemning many aspects of the US support regime for upland cotton (and by analogy other US farm support regimes), and another condemning the EU's export subsidy provisions for sugar. In November 2005 the EU's Council of Ministers reached a political agreement on a reform of the sugar regime, allowing the EU, more or less, to meet the deadline of 22 May 2006 of bringing its policies into conformity with WTO commitments.

The format of the paper is as follows. In Section II we introduce the concept of agricultural exceptionalism in the GATT/WTO legal system. In Section III we outline the EU's commitment to the Uruguay Round as a *single undertaking* and show how this led to the MacSharry reforms of 1992. In Section IV we explain why the WTO's Dispute Settlement mechanisms impose new restraints on EU farm policy; and we conclude in Section V.

(background notes)

1. The presentation is premised on the belief that the EU is a committed member of the WTO community, wanting to see a successful outcome to the Doha Round, and willing to make changes to the CAP to accommodate WTO rules and Dispute Settlement Body (DSB) rulings. For example:

- the recently proposed reform of the fruit and vegetables regime is said to be formulated '*taking into account the need for WTO compatibility*; consistency with the reformed CAP, first and second pillar and conformity with the financial perspectives' (European Commission, 2007: 3; emphasis added).
- the EU has imposed a cut of more than 2 million tonnes in its sugar quota for 2007/08 (about 12% of total quota) to remain within WTO export subsidy constraints (*Agra Europe*, 23 February 2007: EP/2).

2. This presentation focuses on the WTO, and does so from a British perspective (which certainly is *not* reflected in all the other 26 Member States!). Other issues that might be raised include: the CAP after Jacques Chirac; Mariann Fischer Boel's ambitions for the 'health check' in 2008, and her vision for the CAP post-2013; the UK's ambition for a radical review of EU funding in 2008/09 (based on the decisions of the December 2005 meeting of the European Council); etc.

3. A Doha Agreement will involve some further constraints on farm support, under the 3 pillars (market access, domestic support, export competition) established in the Uruguay Round *Agreement on Agriculture* (URAA). A Doha failure will probably involve the EU in more litigation. In the presentation we consider some implications for the CAP under six headings: the 3 pillars, each considered with a Doha agreement ('success') and a Doha 'failure' in mind. To this is added some consideration of a failure to agree WTO compatible *Economic Partnership Agreements* with the ACP states before the end of 2007. The presentation rests on the trade negotiator's perspective that a Doha 'success' involves the EU granting 'concessions' (in the form of enhanced market openings, a reduction in subsidised production, etc.) rather than the economist's dictum that a unilateral reduction in trade barriers would be welfare enhancing.

4. *Doha Success: Domestic Support*. Most analysts are agreed that the EU will have little difficulty in achieving any likely reductions in amber and blue box support. This is because of the decoupling brought about in the Single Payment Scheme (SPS) by the Fischler and subsequent reforms, and the likely 'simplifications' to be introduced by the 2008 'health check'. Area and headage payments, once in the blue box, are presumed to have shifted to the green box; and much amber box support –on olive oil, cotton, sugar, dairy, etc.– should have switched too. However:

- this does depend on the SPS falling within the green box. The proposed reforms to the fruit and vegetables regime, making land on which fruit and vegetables are grown eligible for SPS payments, is clearly designed to overcome the problem the US encountered over *Upland Cotton*; but payments are still made to farmers, annually, on the basis of the land at their disposal, and cross compliance applies, raising the question of whether the scheme does fully meet the criteria of paragraph 6 of the green box (see Swinbank and Tranter, 2005).

- the EU's contention that the SPS is a *decoupled* payment would not be enhanced in any DSB case by recent statements from senior members of the EU's policy community suggesting they *do* impact on production (see for example *Agra Europe*'s report on the European Parliament's opposition to a 20% voluntary rate of modulation, because of fear of distortion of competition between the Member States; 9 March 2007: EP/1-2).

5. Product-specific limits could be problematic in some instances, for example for sugar and fruits and vegetables. However the original UR calculation for the latter was a rather strange construct, which could be made to dwindle if enough imagination were brought to bear.

6. A successful outcome would 'lock-in' the policy reforms, and would restrict the EU's ability to use subsidies to promote bio-fuels.

7. *Doha Failure: Domestic Support*. If there is no Doha outcome the EU will have scope through the amber and blue boxes to back-track on the reforms agreed to-date (although there are no current indications that this is likely); there will be little pressure to complete the dairy, sugar and other reforms (though see below on export competition); and an expensive bio-energy programme would become feasible.

8. The EU's critics would doubtless seek to show that some EU domestic subsidies are *Prohibited Subsidies* under Part II of the *Agreement on Subsidies and Countervailing Measures* (SCM Agreement): in particular that, in reality, they are illegal export subsidies (i.e. not provided for in the URAA or the EU's schedule of export subsidy commitments) or that they are 'contingent … upon the use of domestic over imported goods'. The European Commission's proposal to decouple the processing aids paid on certain fruits and vegetables might be seen as an attempt to forestall such an attack. I pass on the question of *Actionable Subsidies* under Part III of the SCM Agreement, or those potentially subject to *Countervailing Measures* under Part V (but see Steinberg and Josling, 2003).

9. *Doha Success: Export Competition*. One outcome of the 2005 Hong Kong Ministerial was an agreement to phase out export subsidies by '2013' in the context of an overall agreement. In effect, all export subsidies would become *Prohibited Subsidies* under Part II of the SCM Agreement. Where market price support still forms an important component of the CAP, this is not a trivial matter as the recent need to impose a quota reduction on sugar producers demonstrates. The Commissioner has, after all,

indicated she would like to see the abolition of milk quotas after 2015. Export surpluses of commodities might have disappeared by 2013, but processed products containing milk fat and sugar will presumably still be exported. It is interesting to note that the Commission in its *Monitoring Agri-trade Policy* briefs makes a virtue of the fact that 'the share of commodities in EU agricultural exports has dropped to just 8% of their total value', with a corresponding increase in semi-processed and processed exports (European Commission, 2006: 6). This might cause some of the EU's trade partners to query the export 'refund' arrangements on processed products. Post-2013 the EU's food industries will not willingly pay high raw material prices for agricultural raw materials if they are denied access to export 'refunds' on processed goods, and they are likely to lobby for the elimination of the remaining elements of market price support.

10. *Doha Failure: Export Competition*. If there is no outcome to the Doha Round, the existing export subsidy constraints should not prove too problematic for the enlarged EU in most sectors, though clearly sugar remains a problem: indeed the EU could in a number of instances increase its subsidised exports. There is no reason to believe the EU would be willing to eliminate its remaining export subsidies, unless this formed part of a WTO agreement (although it is planning to do so for fruit and vegetables). The EU's partners are no doubt scrutinising its policies to see whether they can identify any more subsidy programmes that could be shown to be prohibited subsidies: export subsidies on processed products *might* be such a case if it could be shown that GATT Article XVI prevailed over the URAA (Swinbank, 2006).

11. *Doha Success: Market Access*. The most difficult part of the negotiation for the EU relates to market access. It is agreed that there will be four tiers or bands within which tariffs will be cut: the EU has proposed that the top band should include all tariff lines with an *ad valorem* equivalent (AVE) of 90% and above, and be subject to a linear reduction of 60%.[1] The EU's critics want a much more ambitious formula. To-date the EU has been unwilling to go beyond a 60% cut on tariffs of more than 90%, or reduce the 90% threshold, at least in public; but it has offered to increase its overall percentage reduction in tariffs by selectively offering *bigger* cuts on selected products in lower bands. *Agra Europe* (2 February 2007: EP/1) suggests that the Commissioner, Peter Mandelson has indicated a willingness to increase its average offer by 10 percentage points over its initial 39% proposal.

12. Messerlin (2006) reminded us that the tariff lines covered by the URAA cover semi- and processed products, not just agricultural products, and suggested the EU could up its offer by promising to make higher percentage cuts on these. The tariff on soybeans for example is 0% whereas that on soybean flour 4.5%; that on cocoa beans 0% and that on cocoa paste 9.6%: scope here for two tariff cuts of 100% without impacting on EU farmers. Selective reductions of this sort could also reduce tariff escalation (though of course it might also eliminate tariff preference margins as well).

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[1] The decision to adopt this banded approach will result in discontinuities. For example, if the EU's proposed figures are adopted, a 90% tariff would be cut by 60% to 36%, whereas one of 89% would be cut by 50% to produce a new rate of 44.5%.

13. However, such adjustments will not satisfy the EU's trading partners seeking improved market access on sugar, beef, dairy, fruit and vegetables, etc. An outcome satisfactory to them would almost certainly involve market penetration, and some undercutting of CAP price support. Closely aligned with this is the issue of *Sensitive Products*: how many tariff lines can they cover, what abatement on the normal tariff cut can apply, etc.? Furthermore, will the existing Special Safeguard Provisions of the URAA be carried over into the new agreement, and if so will the trigger prices be reviewed?

14. *Doha Failure: Market Access*. If there is no Doha agreement, there is absolutely nothing to suggest that the EU would unilaterally reduce its tariffs on agricultural products, despite the advocacy of economists. Its trading partners must be re-examining its schedules and trade practices. Ecuador is in the process of launching a new challenge on bananas (*Agra Europe*, 2 March 2007: EP/3). For fruit and vegetables the EU still maintains a minimum entry price system (Swinbank and Ritson, 1995), even though footnote 1 to the URAA suggests that 'quantitative import restrictions, variable import levies, *minimum import prices*, discretionary import licensing, non-tariff measures maintained through state-trading enterprises, voluntary export restraints, and similar border measures other than ordinary customs duties' should have been subject to tariffication, and are now illegal (emphasis added).

15. An inability to complete the Economic Partnership Agreements (EPAs) before the Cotonou waiver expires at the end of 2007, could give Brazil and others plenty of scope to attack the sugar regime if the EU attempts to maintain country-specific tariff rate quotas (TRQs) for the ACP States; and the EU's banana policy would crumble as well. Crafting a new sugar policy within the framework of WTO-compatible EPAs, and its Everything but Arms (EBA) policy for the least-developed countries, is a major challenge with which the EU (it would appear) has still to grapple.

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