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TRADING BLOCS:

Pro or Con for Agriculture?

by Carol Goodloe and Terri Raney

➤ Over the past year, the United States and Canada, who have already formed a free trade agreement (the CFTA), have begun negotiations with Mexico to create a North America Free Trade Area (NAFTA). The European Community (EC) is pushing ahead with plans to harmonize its internal market by January 1, 1993, and joined with the 7 countries of the European Free Trade Association in October 1991 to create the European Economic Area. Australia and New Zealand have further integrated the ties between their economies under the Closer Economic Relations (CER) agreement. Many Latin American countries are aggressively pursuing regional economic integration, with an eye on eventually forming free trade areas with the United States. In January of this year, the 6-member Association of Southeast Asian Nations (ASEAN), until now a primarily political grouping, announced their intention to form a free trade area.

At the same time, the Uruguay Round being conducted under the auspices of the General Agreement on Tariffs and Trade (GATT) has experienced great difficulties and delays. It nearly collapsed in December 1990 largely over the question of agriculture and was stalled most of 1991 and into 1992. Such developments lead to this question, "Do regional trading arrangements have a positive effect on liberalizing the trading environment for agricultural products?" Some experts and observers respond yes; others say no. Here Goodloe will summarize the pro arguments and Raney will counter with the con, leaving you to reach your own conclusion.

Reasons to Move Ahead with Regional Trading Blocs:

Despite the benefits to the world economy that have resulted from the multilateral process embodied under the GATT, many countries are exploring the alternative avenue of regional, preferential trading arrangements. The GATT itself sanctions free trade areas (FTA's) and customs unions under Article XXIV. There are many reasons why countries are choosing this route and their choices should be condoned.

- Free trade zealots sometimes forget that preferential trading arrangements can benefit the countries involved. Murray Kemp and Henry Wan show that customs unions can leave the welfare of non-members unchanged but improve the welfare of members. They argue that "an incentive to form and enlarge customs unions persists until the world becomes one big customs union, that is, until world free trade prevails." We should view FTAs as an alternative path toward global free trade, a stepping stone rather than a threat.

- The very success of the GATT in lowering tariffs may have contributed to the growing use of nontariff barriers (NTBs)—something with which the GATT struggled. Regional groups of countries with similar practices and concerns may be better able to deal effectively with NTBs and the complex issues associated with them, as well as trade in services, intellectual property rights, investment, and, yes, even agriculture.

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- A regional group may not only move faster than the GATT, but achieve greater liberalization than is possible in the GATT. The Canadian Free Trade Area (CFTA) with the United States and the Closer Economic Relations (CER) agreement between Australia and New Zealand went beyond current GATT arrangements for reducing tariffs and broke new ground in addressing some NTBs. In this regard, regional trading arrangements can show GATT the way. As Rudiger Dornbusch says, "... multilateralism moves at the pace of the slowest. Regional integration can open economies further and faster. It should be given free rein."

- Regional arrangements can force economies to become more efficient. By opening the borders to regional trading partners, a country can reduce protectionism and, at the same time, secure access to other markets.

- Regional arrangements also allow countries to lock in reforms of domestic policies. For example, permitting increased access to a regional trading partner may be politically acceptable while extending access to all exporting countries would be politically disruptive.

The last two objectives were major motivations underlying the CER, CFTA, and the proposed North American Free Trade Agreement (NAFTA). Many countries in Latin America are using regional trade agreements to supplement economic reforms. Of course, a multilateral agreement could achieve these same objectives, but the regional approach, given the reasons cited above, has been more successful in the recent past.

Just as the United States insisted on special treatment for agriculture in the GATT, most regional trading arrangements have given agriculture special or exempt status. It is not clear even now that agriculture will be successfully handled in the Uruguay Round. In fact, one could argue that *any* liberalization of agriculture stemming from a regional agreement is a step beyond what previous multilateral trade negotiations have accomplished. There are several clear examples of actual and potential liberalization happening independently of the GATT.

- The CFTA has removed Canada's import licenses on oats and wheat, forcing the Canadian Wheat Board to dismantle its two-price wheat system.

- The CER is pressuring Australia to examine its more protectionist dairy policies vis-a-vis New Zealand.

- The NAFTA negotiations are forcing Mexico to look closely at the ejido system of communal land ownership, a mainstay of many peasant farmers, but a system that has contributed to small, inefficient farms.

- Eastern European countries are also having to reassess their inefficient agricultural policies as they pursue greater economic integration with the rest of Europe.

- By phasing out tariffs over a 10-year period, Canadian processed foods will face more competition from U.S. imports. Such a prospect is forcing Canada to look at its supply management systems which, by setting higher product prices for raw materials, put food processors at a competitive disadvantage.

- A similar process may result from the EC's single market program. If European food processors become more competitive as a result of the EC member countries harmonizing policies, pressure will grow to reform the Common Agricultural Policy that keeps domestic prices high.

These last two situations are examples of "back door" liberalization, where liberalizing trade in other sectors such as processed food products indirectly puts pressure on agricultural policies that keep commodity prices high. Such a process may prove more effective in reforming agricultural policies than the grueling exercise that has been going on for 5 years in Geneva.

The choice facing policy makers is neither a pure, multilateral system of unrestricted trade nor a closed system of self-contained blocs. The first has and will never exist, and the demise of the Sovi-

et-led COMECON shows how undesirable and unworkable is the second. But regional economic integration is just what the doctor ordered to spur moribund, protected economies to greater openness and efficiency. Even if the liberalization of the agricultural sector lags behind other sectors in a regional trading arrangement, it too will eventually feel pressure to liberalize.

Reasons to Avoid Regional Trading Blocs:

Regional trading blocs are just what the world doesn't need more of right now. The multilateral trading system embodied in the GATT is at risk as the Uruguay Round struggles toward a conclusion. In the decades since economic nationalism brought the world to the brink of disaster in the Great Depression and the Second World War, GATT rules have fostered a period of unprecedented trade openness, economic growth, and yes, peace. GATT still provides the best way to work toward global free trade, and free trade is still the arrangement that brings the greatest economic benefit to the greatest number of people.

GATT rules should be strengthened not jettisoned simply because multilateral negotiations are difficult or slow. The Uruguay Round is the most ambitious set of multilateral talks ever attempted under the GATT. By broadening the agenda to include nontariff barriers, agriculture, services, and intellectual property rights among others, negotiators assured themselves a rocky road. Even if the final agreement is less comprehensive than originally hoped, the GATT should not be faulted for attempting to bring these complex sectors under rational trading rules.

As we have seen, countries may give many reasons for choosing the trade bloc route but there are better reasons to avoid such a choice.

- Viner's 1950 observation bears repeating because it remains valid. Preferential trading arrangements may distort trade flows in ways that reduce the economic welfare of the participants and of those excluded. With the proliferation of blocs, trade diversion becomes more likely, especially as groupings expand beyond "natural" trading partners based on geography and complementary production patterns. A U.S./Canada/Mexico agreement may make sense when regional trade is already a high proportion of total trade, but what is the economic logic behind a U.S.-Israel or Mexico-Chile agreement?

- Thirty years of experience with the Common Agriculture Policy (CAP) in Europe are proof of how easily a "Free Trade Area" can be hijacked by political considerations. If a camel is a horse designed by committee, then the European Community is a "Free Trade Area" midwived by politicians. Admittedly, there is the theoretical possibility of creating benign or even beneficial preferential trading blocs. However, the political process in which such blocs are constructed is too easily captured by protectionist special interest groups.

- Trading blocs dangerously distract political leaders from the more important task of multilateral liberalization. We are told that trading blocs can be an interim step along the road to multilateral liberalization, but politicians who believe that FTAs are an acceptable fall-back position may feel less incentive to reach politically difficult multilateral agreements. The Uruguay Round was stalled for much of 1991 largely because the Europeans considered a deeper and wider EC to be a reasonable alternative to a GATT agreement.

- Trading blocs undermine the bedrock GATT principle of non-discrimination. The current proliferation of discriminatory regimes opens the door for other violations of GATT rules because it fosters disdain for the institution and the principles it represents.

- Trading blocs erode a second GATT principle of non-exclusion. GATT privileges are generally available to any country that is willing to accept its disciplines. FTA's are rarely open to all who

would join, as is illustrated by Turkey's long siege to enter the EC. Excluded countries may be shut out of a large share of world trade or be forced to form blocs of their own. Fear of an emerging "Fortress Europe" was a major impetus to American negotiations with Canada and Mexico. The ASEAN countries in turn have begun talks on forming an Asian bloc to counter the European and the emerging North American blocs. How will conflicts between large, exclusive, powerful blocs be resolved?

- The current push for regional agreements may be a recipe for economic disaster by creating a "hub-and-spoke" system. For example, in the western hemisphere there are or will soon be agreements between the U.S. and Canada; the U.S., Canada, and Mexico; Mexico and Chile; and Argentina, Brazil, Paraguay, and Uruguay (Mercosur). The Andean Pact, the Central American Common Market, and the Caribbean nations in Caricom are trying to revitalize themselves. Many of these groups want to create free trade areas with the United States. Will there truly be one agreement with one set of rules to which everybody agrees to, or will the result be a U.S. hub with numerous, conflicting spokes attached?

- Trading blocs ensure job security for international trade economists and for customs agents, but do little for the general economy. Proliferating tariff schedules and byzantine rules of origin impose administrative costs and complexity that inhibit the growth of trade. What is the national origin of a taco bought in Canada, seasoned with salsa processed in Texas, which was made from tomatoes grown in Mexico? Trading bloc arrangements require administrators and inspectors to answer these kinds of absurd questions.

Regional trading arrangements are especially unsuitable for agricultural trade. With the exception of the EC's highly distorting Common Agricultural Policy, agriculture has basically been excluded from regional trading arrangements. In most regional agreements, the agricultural sector has not benefited from across-the-board reductions in tariffs or nontariff barriers. In the few cases where agriculture was included in the agreement, the treatment of agricultural products has either been piecemeal (U.S.-Canada) or not especially relevant to world agricultural trade (CER). Consequently, such regional deals will not solve the pressing problems evident in world agriculture.

My colleague argues that countries can use an FTA to help lock-in domestic reforms. It is more accurate to say that politicians who want to reform their economies will use any external pressure available to them at the time, and those who want to avoid reform will do so unless that external pressure is extreme. Mexico, for example, used the GATT as a tool to lock-in domestic reforms, while the EC used the CAP to avoid reforming its agricultural sector. Thus, the world's most successful free trade area is increasingly a closed system with respect to agriculture. The Eastern European countries which have so recently thrown off the shackles of communism are already queuing up to join the EC. Rather than locking-in their domestic reforms, they are adopting inefficient CAP-like policies. The GATT is the only institution that can exert the kind of external pressure needed to force the EC, and the world, to reform agriculture.

For More Information

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