# Staff Papers Series

Staff Paper P90-67

November 1990

ILLUSION AND REALITY IN

INTERNATIONAL AGRICULTURAL TRADE NEGOTIATIONS

by

C. Ford Runge

**Department of Agricultural and Applied Economics**

University of Minnesota
Institute of Agriculture, Forestry and Home Economics
St. Paul, Minnesota 55108

# ILLUSION AND REALITY IN
# INTERNATIONAL AGRICULTURAL TRADE NEGOTIATIONS

C. Ford Runge
University of Minnesota

November 2, 1990

# Illusion and Reality in International Agricultural Trade Negotiations*

C. Ford Runge**

The United States (US) and the European Community (EC) have been the principal antagonists throughout the Uruguay Round of multilateral trade negotiations. Beginning in December, 1986 at Punta del Este, continuing without relief through the mid-term ministerial meeting in Montreal in December 1988, and up to the supposed 1990 finale in Brussels, the US and EC have found little common ground.[1]

An important reason for this failure lies in the faulty premises under which both the US and EC launched and conducted much of their negotiations. These premises created the illusion that the negotiation in agriculture was

---

*A paper to be presented to a conference on "The World Field Crops Economy: Scope and Limits of Liberalization of Agricultural Policies," Paris, France, December 4, 1990. Financial support from the Northwest Area Foundation, St. Paul, Minnesota and a travel grant from A. Chominot are gratefully acknowledged. My thanks to Willard W. Cochrane for comments on an earlier version.

**Currently Associate Professor and Director, Center for International Food and Agricultural Policy, University of Minnesota, 332 Classroom Office Building, St. Paul, Minnesota 55108. Formerly Special Assistant to the U.S. Ambassador to the General Agreement on Tariffs and Trade, Geneva, Switzerland, 1987-88. The opinions expressed are those of the author, and carry no official or government endorsement.

---

[1]An account of the negotiations leading up the Montreal meeting is provided in Carlisle Ford Runge, "The Assault on Agricultural Protectionism," Foreign Affairs (Fall, 1988): 133-150. The negotiation during 1989 is discussed in "Agricultural Trade in the Uruguay Round: Into Final Battle," in Increasing Understanding of Public Problems and Policies - 1989, Farm Foundation, Oak Brook, Illinois, 1990. The period 1989-1990 is discussed in "Prospects for the Uruguay Round in Agriculture," in The Political Economy of Agricultural Trade and Policy: Toward a New Order for Europe and North America, Westview Press, Boulder, CO, forthcoming, 1991.

a zero-sum-game for the US and EC, even if a positive sum outcome was possible for the rest of the world. This illusion reinforced the impression that no common interest united the two, and disguised the reality, which is that both the US and EC would gain from movements in the direction of more open markets and reduced levels of agricultural support. The actual, and realistic, characterization of US and EC bargaining is not a zero-sum-game, but a game of mixed motives, in which there is indeed common ground. Earlier recognition of this fact would have led to much greater progress, and substantially larger benefits from the Uruguay Round to the rest of the world.

Faulty Premises

The premises which fostered the illusion that the US and EC were locked in a zero-sum-game were largely the creations of domestic politics on both sides of the Atlantic. In the US, the premise was that world trade in agriculture must eventually be free and that to demand anything less than the total elimination of all trade-distorting policies would be to surrender the high ground of the negotiation. This premise caused the US to insist until past the midpoint of the round that unless "elimination" entered the language of agreement in agriculture, there would not be one.

The curious feature of this premise was that it was acceptable to US interests at both ends of the political spectrum. To Reagan conservatives, such an unreconstructed free trade position had an ideological tone consistent with their anti-government bias. To supporters of farm programs and protectionist Democrats, on the other hand, the position seemed so unlikely to occur that it provided a kind of refuge from realistic acknowledgment that farm programs were badly in need of reform. These protagonists of the traditional farm price and income support programs in truth wanted no part of any program reform.

The faulty premise that free trade must someday come to agriculture also was grounded in the ethos of American business. In the American mind, the way in which business is done is to set a hard and fast end, and then to move to it by appropriate means. "Elimination" of trade-distorting subsidies was such a worthy end, and it became a sort of holy grail, obviating many more important modalities in the process of negotiation. In contrast, in the European mind (or at least the Continental), the <u>process</u> of negotiation <u>is</u> the end, and no <u>a priori</u> goals can be realistically determined. One arrives at a position in time, but the process determines the endpoint, rather than the endpoint determining the process. By adopting the premise that "elimination" should be the ultimate desideratum of policy, the US limited its negotiating flexibility. While the "double zero" option (so-called because of the proposed elimination of both border measures and distorting internal subsidies) created an early tactical advantage for the US, this advantage was largely the result of surprise. As the surprise that the US might radically alter its course wore off, the tactical advantage faded, and the US proposal came to appear almost utopian.

After the December, 1988 Montreal meeting broke up over the "elimination" issue, a rough and ready agreement to pursue "substantial progressive reductions" in agricultural support was reached in April, 1989 in Geneva. Prime ministers meeting at the Houston Summit in July, 1990, reaffirmed a more flexible framework for negotiation built around the "de Zeeuw text." This framework, authored by the chairman of the Negotiating

Group on Agriculture, appeared in late June. The text outlined a possible agreement to reform market access through "tariffication" of nontariff barriers, the reduction of export subsidies and the restraint of domestic support through application of an aggregate measurement unit. The de Zeeuw text incorporated the idea that agricultural supports could be categorized into "red light," "green light" and "yellow light" policies, with differential schedules for change over time, and provided for interpretations of what must and must not be eliminated and over what period of time. In October, 1990, the US had come off of "elimination" altogether, calling instead for 90 percent reductions in border measures and 75 percent reductions in total agricultural supports. While clearly intended to signal a willingness to negotiate, by this point too little time remained to fully explore how such reductions might be achieved. And to those Europeans who had all along branded the US premise as "unrealistic," the concession that 9/10ths of elimination, or 3/4ths, would be acceptable did little to satisfy.

Having criticized the premise underlying the US negotiating approach, and its tendency to foster the illusion that anything less than "elimination" would be a loss to US interests, it is time to give the EC its due. EC negotiating strategy was premised on the conviction that the Common Agricultural Policy (CAP) was the centerpiece of community, and to weaken it would be to tear at the fabric of both the solidarity of the Community and the rural culture of Europe. I believe this premise is faulty, in at least three ways. First, the increasing economic and social integration of Europe will occur and is occurring, with or without the CAP. In part, this is a result of monetary union and the provisions of the

Single European Act. Economic integration was occurring anyway, and is simply acknowledged and speeded along by these actions in Brussels. This integration and harmonization, especially in terms of monetary union, does not depend on the CAP for its energy or inertia. Indeed, the CAP has kept many farm assets and much capital from migrating to its highest and best uses in various parts of the Community. It has done this by capitalizing its benefits into land and asset values in situ, discouraging off-farm migration of labor, and institutionalizing exchange rate adjustments for community price policies.

Second, the CAP has proven to be a far greater source of community discord that solidarity, especially since 1986. Its budgetary demands on scarce EC resources are well known. The very fact that the agriculture ministers cannot agree amongst themselves on price policies or GATT positions provides clear evidence that the CAP stands in the way of many gains from both internal and external trade reforms. These obstacles are particularly apparent in connection with exchange rates, and the tension between a European Monetary System, on the one hand, and the monetary compensatory amounts (MCA's) used to adjust CAP prices for exchange rates on the other. I predict that as the Community's economies become more integrated, the CAP will decline in importance, and will wither away due to internal Community pressures even if it is never "eliminated."

Third, the role of the CAP in preserving traditional rural culture is a hoax, perpetrated by large farmers and their political supporters, who have reaped the lion's share of the benefits of the CAP, saving only the crumbs for the rural poor. It is the rich farming regions of the Paris basin, and Norfolk, and the Po Valley, that have benefitted from the CAP, not the poor of Haute Savoie, nor the North English border counties, nor the South of Italy. The ultimate irony is that like American farm programs, the CAP has made the rich richer, but has left poorer, traditional farmers alone, causing Europe's farm sector to look more and more like the most oversupported, overcapitalized parts of US agriculture. In the name of preserving European rural life, the CAP has led to the Americanization of European agriculture.

The faulty premise that the CAP must be preserved at all costs has fostered the illusion that any concessions to the US would begin a process of deterioration in the vitality of both CAP and Community. This premise allows its arch-defenders to hide from the fact that the CAP is <u>already</u> withering away, and will continue to do so, for reasons <u>internal</u> to the politics of the EC. By raising the spectre that the CAP might be "eliminated" from without, these defenders of wealthy landowners could better hold the line in the name of European "peasants" against a larger Community which had begun to appreciate the hoax for what it was.

Before going on to analyze the reality of agricultural trade reform, it may be useful to summarize. The faulty premise of the US has been that total elimination of trade distorting policies is possible, which has fostered the illusion that anything less is a net loss. The faulty premise of the EC has been that the CAP should be the Maginot line of Community, even though its guns are turned in the wrong direction. This has fostered the illusion that reforming the CAP is a concession to Uncle Sam, rather than something well worth doing for internal reasons.

To these faults in the individual premises held by the US and EC I would also add a faulty shared premise: that "progress" in negotiation can be "measured" through a metric of reform: the Producer Subsidy Equivalent (PSE) and its cousin, the Aggregate Measure of Support (AMS). While no one can object to measurement per se, the illusion fostered by these measures is that they can substitute for the political will to make needed changes in policy. They are virtually tools of illusion, because they allow any action to be measured in a way most congenial to the effected parties.[2] In a larger sense, the excessive attention given to these technical measures excused too many bureaucrats and economists from explaining in non-technical language to affected farmers and the larger public why the negotiation is important. They also reinforced the zero-sum impression by indicating to most farmers only one thing: what they have to lose from trade reform.[3]

## A Tale of Mystery

In his classic analysis of negotiating strategy, Thomas Schelling recalls a vignette from Conon Doyle's Sherlock Holmes.[4] The reader of these mysteries may recall the famous case of Holmes and his nemesis Moriarty traveling aboard separate trains, neither in touch with the other, each having to choose whether to get off at the next station. Consider three kinds of payoff for this game of strategy. In the first case, Holmes

---

[2]See Thomas W. Hertel, "PSEs and the Mix of Measures to Support Farm Incomes," The World Economy, 12:1 (March 1989): 17-27; and Thomas W. Hertel, "Negotiating Reductions in Agricultural Support: Implications of Technology and Factor Mobility," American Journal of Agricultural Economics (August, 1989): 559-573.

[3]I am indebted to Terry Roe for forcefully emphasizing this point to me.

[4]Thomas Schelling, The Strategy of Conflict, Cambridge: Harvard University Press, 1962.

wins a prize if they get off at different stations, and Moriarty wins if they get off at the same station. This is what is now often called a "zero-sum-game," in the sense that preferences over outcomes are perfectly correlated inversely. In the second case, Holmes and Moriarty will both be rewarded if they succeed in getting off at the same station, whatever that station may be. This is a "pure coordination game," in which the preferences of the players are perfectly correlated positively. The third case would show Holmes and Moriarty both being rewarded to get off at the same station, but Holmes gaining more if both he and Moriarty get off at one particular station, and Moriarty gaining more if both he and Holmes get off at another particular station, with both losing if they got off at different stations. This is the usual "non-zero-sum game" that typifies bargaining situations: both players want to make a deal, but not the same one, yet both lose if a deal is not made.

The negotiating positions of the US and EC in agriculture are not, as I have argued, perfectly correlated inversely, despite the illusion that they might be. For the EC to be seen as saboteurs of the Uruguay Round is not a preferred outcome. Nor, obviously, are US and EC policies simply in need of coordination, regardless of the particular station of agreement. Both the US and EC have an interest in reducing the budget pressures posed by agricultural spending, but for a variety of political reasons, the US prefers one package of reforms, and the EC another. Most importantly, both the US and EC will lose if the Uruguay Round falls apart, primarily due to losses outside of agriculture. There are sufficient elements to make some sort of a deal possible, so long as the framework within which it is made is flexible enough, yet still commits each to important new domestic and

GATT disciplines. To accomplish such a deal would have major positive effects on the rest of the world. While these "public benefits" of US/EC agreement are often cited, it is the internal incentives to reform domestic agricultural policies that will ultimately rule the outcome.[5]

The Evidence

As evidence in support of my contention that the elements of a deal exist, I would point to three common reasons for agricultural reform in both the US and EC. This is not to say that a deal will be made, only that it could be made. These are budget pressures, distributional issues, and the non-agricultural impacts of failure. After reviewing these in turn, I will briefly suggest how such a deal might be accomplished.

## Budget Costs

The budgetary costs of the CAP are well documented and discussed.[6] Since the early 1970s, the CAP accounted for between 60 and 75 percent of EC expenditures. As this budget pressure continues, the demands on the Community from German unification, integration, and possible expansion will also grow, making expenditures on the roughly 4 percent of the Community counted as farmers more difficult to justify. Agriculture accounts for only 3.9 percent of total gross domestic product in the Community, and perhaps as much as 8 percent of employment, although this figure is probably high, and includes many part-time farmers, forestry workers and

---

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

[6]Harald von Witzke and C. Ford Runge, "Institutional Choice in the Common Agricultural Policy and European Community Enlargement," American Journal of Political Science 34(1990): 254-268.

other non-farm rural workers.[7]

In the US, the budget deficit also requires little elaboration. In line with the recently completed budget compromise, the 1990 Farm Bill will reduce total support payments to farmers by $13.6 billion, or from $54.4 billion to $40.8 billion over 1991-96. These reductions will amount to cuts of roughly 15 percent or more in many programs, the most seriously affected of which will be wheat.[8] While these cuts have been entirely driven by domestic budget requirements, this will not prevent US negotiators from claiming credit at the Brussels ministerial meeting in December 1990. In fact, the direction of the 1990 farm bill is generally in line with the US negotiating position in GATT: a movement toward greater planting flexibility and lower levels of domestic support, or what might be called "incremental decoupling."

What is noteworthy is that in both the US and EC, the pressure to reduce spending on agriculture arises primarily from <u>domestic</u> sources, suggesting that a GATT virtue can be made of domestic political necessity if an appropriate formula for continued budget restraint can be agreed to in Brussels. This formula must, however, be based on principles of more liberal, rather than more protectionist, policies.[9]

---

[7]EC Commission, <u>Agricultural Situation in the Community: 1989</u>, Brussels, 1990.

[8]<u>AgWeek</u>, October 22, 1990, p. 6.

[9]Budget restraints alone do not imply adjustments that are more liberal in trade terms. A recent report from <u>Agra Europe</u> emphasizes that while "all of the Community's so-called reform measures in the agriculture sector are budget driven", this budgetary pressure had led in the main "to measures that are more protectionist and less efficient." An example is the dairy quota policy. See "Political Change and the Future of the CAP," <u>Agra Europe Special Report No. 54</u>, London, 1990, p. 8.

## Distributional Issues

A second reason for agricultural reform arises from the distributional inequity of current agricultural policies in both the US and EC. It offends the moral sensibilities of citizens that a few wealthy farmers should reap so many of the benefits of agricultural subsidies. This moral offense is translated into political demands for reform. The US Department of Agriculture reported that the top 18 percent of US farm producers in 1987 received 90 percent of direct payments, representing $32,367 per farm.[10]

The sentiment of the public over these payments was well-expressed by a lead editorial in the New York Times, entitled "Fat Farmers at the Public Trough."[11] It read in part, "the grim reality is that present farm policy destabilizes output, encourages overuse of chemicals and other soil-damaging practices and favors large farms at the expense of family farms."

In the EC, the reaction to paying wealthy farmers to produce chronic surpluses has been more muted, in part because many smaller farmers also receive payments. However, because payments are based on units of production, the largest producers continue to garner the lion's share of benefits. Harald von Witzke, one of the few EC economists honestly to address this issue, has calculated that in Germany, 60 percent of all CAP price supports go to 20 percent of the richest farmers.[12]

---

[10] J. D. Shaffer and G. W. Whittaker, "Average Farm Incomes: They're Highest Among Farmers Receiving the Largest Direct Government Payments," Choices (Second Quarter, 1990): 30-31.

[11] New York Times, July 13, 1990, p. A-12.

[12] Harald von Witzke, "Prices, Common Agricultural Price Policy, and Personal Distribution of Income in West German Agriculture," European Review of Agricultural Economists 6(1979): 61-80.

The inequity of benefits distribution is also apparent between the countries of the Community, where the poorest countries are not always the main beneficiaries of the CAP. Ulrich Koester estimated that in the 1970s, the inter-country distributional effects were not in accordance with general principles of fairness and redistribution.[13] In part in response, monetary compensatory amounts (MCA's) or "green money", was used to adjust these benefits according to the relative strength of national currencies, a partial proxy for national income and wealth. In many cases, the result has been to exacerbate distributional inequity, and to undermine the CAP as a force for integration by "re-nationalizing" agricultural price policy through the back door of "green" exchange rates.

The "green" or agrimonetary exchange rates, which now dominate most price policy discussions under the CAP, are antithetical to larger monetary union and economic integration in the Community. As a result, the CAP now stands as an obstacle to further European integration, rather than a symbol of it. As the recent report of the AgriEurope group noted:

> What is certain is that by the mid-1990s, the Community will have established a much closer monetary union, also involving economic policy coordination which will have produced a much closer relationship between the currencies of the Community. This is likely to have reduced the current, often wide, variations between the values of EC currencies, and thus to have removed the need for constant readjustment of agrimonetary exchange rates of individual member states [MCA's]. It will increasingly be seen that the use of agricultural exchange rates (green money) will have become irrelevant and unnecessary.[14]

---

[13]Ulrich Koester, "The Redistributional Effects of the Common Agricultural Policy, European Review of Agricultural Economics 4(1977): 321-345. See also, Alan Buckwell, et al., The Costs of the Common Agricultural Policy, London, Croom-Helm, 1982.

[14]"Political Change and the Future of the CAP," AgraEurope Special Report No. 54, London, 1990, p. 24.

In both the US and EC, opportunities to reform agricultural policies can be driven by a political insistence on more equitable distribution of benefits. Be reorienting these programs to broader based goals of environmental quality, rural development and employment, and away from the support of large commercial farmers (and the farm sectors of the wealthiest nations) the incentive to expand production regardless of market forces can be reduced. This is an oblique, but important, way in which reductions in both internal subsidies and border measures can be justified to internal political constituencies.[15]

## Non-Agricultural Impacts of Failure

If the agricultural negotiations fail in December, 1990, it is likely that the entire Uruguay Round will fail too. Thus, a third in the mixed motives of the parties must be to calculate the larger lost opportunities resulting from continued stalemate in agriculture. In quantitative terms, these losses are difficult to estimate exactly, but the package of possible reforms in all 15 negotiating areas is probably worth trillions of dollars in world trade. While the talks might be extended beyond the December ministerial meeting, the US has imposed a deadline of June 1, 1990 for "fast-track implementing authority," before which the President must notify Congress with 90 days notice for the agreement to be approved. Hence, March 1, 1991 appears to be the latest effective date for an agreement, unless special provisions of the 1988 Trade Act are invoked to extend this authority.

---

[15] Willard W. Cochrane and C. Ford Runge, Restructuring Farm Policy: Toward A National Agenda, forthcoming, 1991.

Failure would reverberate well beyond GATT. Both the US Congress and EC Council of Ministers would be likely to slide toward greater protectionism, hardening opposition to multilateral solutions and hastening the development of regional trading blocs. This will not be interpreted favorably in world financial markets, and would help to deepen and expand global recession into a full-scale trade contraction and depression. Failure will also spill over to affect the pace of reform in the Soviet Union and Eastern Europe, and economic development in less developed countries, as contracting markets and reduced market access make economic reforms and growth less possible.[16] It is thus of incalculable significance whether the Uruguay Round succeeds, and the linchpin is agriculture.

The linkages to other sectors of the negotiation are recognized in political circles in both the US and EC. In the EC, particular importance is attached, even with the agrifood sector, to trade-related intellectual property rights (TRIPS). EC industrialists have been working for months to try to "decouple" TRIPS from agriculture, as insurance against failure in the Uruguay Round, yet still want to use GATT as a vehicle to assure minimum standards against counterfeiting and passing-off of food and drink products.[17] In the US, the financial services sector has invested substantial resources in the Uruguay Round, and can be counted on to lean

---

[16] C. Fred Bergsten, "From Cold War to Trade War?" International Economic Insights 1:1(July/August, 1990). These points are also made forcefully in C. Michael Aho, "U.S. Trade Policy at a Critical Juncture," Council on Foreign Relations, 1990.

[17] Eurofood, October, 1990, p. 2.

heavily on agriculture for some sort of accommodation.[18]

In short, the costs of failure in the Uruguay Round as a whole to various non-agricultural constituencies in the US and EC weigh heavily on agriculture, and create powerful motives to find an agreement. Whether these cross-cutting pressures will be sufficient, or whether agriculture, abetted by other protected sectors such as textiles, will help to block agreement, will only be known in time. But a powerful motive for agreement is given by the costs of failure on both sides of the Atlantic.

## Conclusion: Is Realism Consistent with Reform?

All negotiators prefer to think of themselves as "realists", but trade reform by definition involves altering current reality. Do budget pressures, distributional issues and the nonagricultural impacts of failure add up to sufficient motives, internal to both the US and EC, to alter the reality of current domestic policies, and to reform trade policy in the Uruguay Round? Perhaps, but not without "new thinking." The essential question for both the US and EC is whether each can find what Bredahl calls "internationally acceptable safety net programs."[19] In this case, the reduced form of this question is whether the US and EC can find safety net programs that are acceptable to each other. Such programs will not eliminate domestic and trade policy distortions, but will reduce them,

---

[18]For an excellent review of the linkages across all 15 negotiating areas, see Jeffrey J. Schott (ed.), Completing the Uruguay Round: A Results-Oriented Approach to the GATT Trade Negotiations, Washington, D.C., Institute for International Economics, 1990.

[19]Maury E. Bredahl, "Internationally Acceptable Safety Net Programs," a paper presented to the conference "The World Field Crops Economy: Scope and Limits of the Liberalization of Agricultural Policies," Paris, France, December 4-5, 1990.

hopefully, substantially. They will do so by lowering the total budgetary resources devoted to price supports and border protection for commercial farmers. Hence the US premise of "elimination" can be (and has been) discarded. This has caused both ideological conservatives and particularly protectionist Democrats in Congress to charge that the US has "unilaterally disarmed." A reform package of this kind is threatening to agricultural interests in Congress since it would actually attempt to reform domestic programs and border measures without eliminating them. The 1990 farm bill is a small step in this direction, at least insofar as it reduces domestic supports and increases planting flexibility.

A shift to a safety-net income approach also implies a broader-based attempt to refocus government policy on rural development and employment, environmental quality, and market integration, rather than on paying relatively few commercial producers on the basis of their output. This would lead to a new and different mission for the CAP, built primarily around distributional issues. Such issues would be how to integrate low income areas into a growing Community, and how to increase rural environmental quality and off-farm rural employment, rather than how to continue producer production incentives. As production incentives to commercial farmers are reduced and EC resources are refocused on these broader objectives, the need for surplus disposal mechanisms (e.g., export restrictions) will also be reduced.

The premise of an inviolable CAP must thus also be discarded for reform to be possible in recognition that the CAP is an obstacle and anachronism in an integrated Europe. With the demands of monetary union, environmental quality, Eastern Europe and intra-European differences in the distribution of income posing even greater challenges, the EC cannot afford to squander its scarce resources on already wealthy farmers. Finally, neither the US nor the EC will benefit from a total breakdown in the Uruguay Round. The losses in the other negotiating areas are a terribly high price to pay simply to insure an unsatisfactory status quo in agriculture.

If the US and EC can both discard the premises that have made the Uruguay Round appear to be a zero-sum-game, a GATT agreement in agriculture may thus be possible. Such an agreement must be built around (1) a shift to a safety net concept of income protection, coupled to a reorientation in support to environmental improvements, rural development, and low income areas; (2) reduced export subsidies; and (3) a commitment to improved market access, including the conversion of nontariff border measures to tariffs.[20] The motives to achieve such an agreement, while mixed, are present. So long as agriculture poses serious budgetary and distributional problems on both sides of the Atlantic, and is perceived as a threat to the entire Uruguay Round, a chance remains that the US and EC will find a station at which to get off together, though perhaps not until after 1990.

---

[20]Such a package corresponds to what Hathaway has called a "maximum" reform. See the chapter by Dale E. Hathaway, "Agriculture," in Jeffrey J. Schott (ed.), Completing the Uruguay Round: A Results-Oriented Approach to the GATT Trade Negotiations, Washington, D.C., Institute for International Economics, 1990.