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Economics, Agriculture and the Gatt

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Abstract

It is tempting for economists to believe that the objectives of the GATT were founded in the theorems associated with the gains from trade. In this paper it is argued that the Articles of the General Agreement and the structure of the negotiations owe more to political economy and to law than to economic theory. This argument is illustrated through reference to the Articles in which international trade in agricultural products is accorded special status. The proposals contained in the Draft Final Act which deal with dispute settlement procedures are also reviewed.

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1. Introduction

During the Uruguay Round (1986-1993), negotiations on agriculture again proved very difficult, just as they had done in the Tokyo and Kennedy Rounds. However, in the Uruguay Round the stakes were higher because not only were agricultural trade measures the subject of the negotiations but, unlike the earlier Rounds, so too were domestic agricultural policies. In the Ministerial Declaration on the Uruguay Round it was stated that "[n]egotiations shall aim to achieve greater liberalisation of trade in agriculture and bring *all* measures affecting import access and export competition under strengthened and more operationally effective GATT rules and disciplines ..." [emphasis added] (GATT 1986). Having the more comprehensive set of policies on the table removed one of the deficiencies of the agendas for agriculture in these earlier Rounds and established one necessary condition for a fundamental change in the conditions under which agricultural trade would take place. Since agricultural trade policies to a large extent are merely an adjunct to domestic policies, negotiations on the former make little difference to trade outcomes. As Dam observed: "GATT has been ineffective in agriculture because it has tried to separate the international trade aspects of agriculture from the internal policies which lead to restrictions on international trade in agricultural products." (Warley 1976, p.339).

A second necessary condition for success was a change in government attitudes towards the consistency of their agricultural policies with the rules of GATT. The unplanned extension to the Round from 1990 to 1993 gave the region most responsible for the delay, namely, the European Community (EC), the opportunity to undertake substantial reforms of the Common Agricultural Policy which then enabled the EC to reduce the levels and nature of income support for farmers and to make them more

consistent with the content of the *Draft Final Act* (Anon 1993). The EC's main protagonist, United States, once again survived a GATT Round without having its own behaviour attacked in any substantive way. For example, the US maintained its infamous waiver granted originally in 1955, it continued its Meat Import Law and its Export Enhancement Program.

The bilateral tension between the US and the EC over agriculture has been on-going for three decades. However, the source of that tension is to found at least a decade earlier when the US government allowed its domestic farm lobby to override the country's international obligations in the GATT system. In trying to understand why the agricultural component of the Uruguay Round negotiations proved to be so protracted, despite the mounting empirical evidence of the costs of unchanged policies,[0] it is necessary to consider the way in which the Articles of the GATT and the economics and politics of agriculture interact.

The aims in this paper are: first, to argue that the original objective of the GATT was not free trade based on economic theory but the establishment of an international legal framework within which international commerce could occur with minimal international tension (Section 2); second, to illustrate the producer bias in the GATT (Section 3); third, to identify where the origins of the difficulties lie with respect to agricultural trade (Section 4); and fourth, to assess the extent to which the outcome of the Uruguay Round is likely to ensure that agricultural trade issues do not dominate the trade agenda in the next Round (Section 5).

2. GATT Articles and Agriculture

"The GATT is an international legal document whose primary purpose is to promote or protect certain political goals of nation-states" (Baldwin 1980, p.83). In the

[0] For a survey of some of these results see Anderson and Tyers (1991) and Blandford (1990).

case of agriculture these goals have been largely internal and to the detriment of international relations. "It appears that in agricultural trade, ... many governments do not hesitate to violate both the letter and the spirit of the General Agreement if they feel that domestic political life is easier that way" (Tangermann 1987, p.249). It is often stated that agricultural trade has remained outside the GATT. To the extent that this has been true, it has stemmed from an unresolved ambivalence on the part of governments about the status of the agricultural sector and of agricultural trade. At one extreme there have been governments which have advocated the standard neo-classical position that agriculture should be treated as any other sector: there should be the progressive removal of trade barriers with the consequent structural adjustment forced by international competition, moderated as required by adjustment assistance programmes. From this standpoint, the Articles of GATT are appropriate for agriculture and the problems have lain with the lack of will of governments to adhere to the rules. At the other extreme are governments which have advocated the position that agriculture is different from other sectors, that it has a special status requiring different rules for trade: the establishment of regulated and managed international markets which would permit harmonised national production and price policies are seen as the appropriate policy environment (Warley 1976). In principle, the United States has been associated with the former position, the European Community with the latter. However, in practice, the US has also been associated with the latter: " ... from the very outset, the trade rules of the GATT were tailored to fit domestic farm programmes rather than the reverse" (Hathaway 1987, p.104).

Those who framed the GATT recognised that in many sectors, but particularly in agriculture, there were pre-existing domestic and trade policies for which allowance had to be made. It was accepted that governments had legitimate aims for agriculture and that economic efficiency was but one, and perhaps even a minor one.[1] Other aims

[1] For a recent discussion of the non-economic objectives for agriculture and a criticism of the term 'non-economic', see Winters (1990)

have included the provision of higher and more stable incomes for farm families, the conservation of the social fabric of rural areas, assistance with the modernisation of the sector, the provision of food security, and the protection of the sector from international market instability.[2] To this list of traditional objectives should now be added the preservation of the rural environment. Nevertheless, under the leadership of the US, only three Articles make special provision for policies towards agriculture, namely, Article XI on quantitative import restrictions, Article XVI on export subsidies and Article XX on commodity agreements.

Throughout the last three decades, governments in the developed countries, with very few exceptions, have continued to pursue agriculture policy objectives which are inconsistent with the notion of the gains from trade. The assumptions on which the gains from trade depend are implicitly assumed by governments not to be relevant. Moreover, to achieve some of these objectives, policy instruments have had to be used in ways which are inconsistent with the rules of GATT. For example, the international stability of internal markets has been thought to necessitate the use of import quotas rather than tariffs.[3] It is no surprise that international negotiations over the rules for agricultural trade should have been so protracted: the liberalisation of agricultural trade would have undermined the ability of governments to achieve national economic and social goals for agriculture, goals which are perceived to more easily achieved, the more insulated the domestic sector is from international competition. In addition, until the 1980s, the economic costs and distributional effects of farm programmes, although well enough understood, were of insufficient political status to cause governments to alter course. However, for several countries, including those of the EC, the pursuit of these goals has been modified over the past decade because of rising and unsustainable budgetary costs and by public perceptions of the environmental damage done by

[2] During the 1980s, the governments of Australia and New Zealand have attached much lower weights to these priorities, in some cases appearing to give them a weight of zero.

[3] For an interesting discussion of the choice of policy instrument to achieve internal market stability in a political economy framework, see Lloyd and Falvey (1986).

modern intensive agriculture which has been encouraged by excessively generous price support programmes. Both of these forces have weakened the political influence of the farm lobby. Hence, by 1987 the members of the OECD agreed that there should be a 'recoupling' of national and international prices, the 'decoupling' of support for farm incomes from production decisions and the targeting of support on clearly identified groups (Warley 1990, p.312).

3. Economics and the GATT

In the theory of international trade there is a certain symmetry between import and export taxes and subsidies in their internal distorting effects. Yet in the GATT these instruments are treated as if they were different, as indeed politically they are, a point not lost on those who drafted the Articles. This asymmetry arises because of the greater lobbying or rent-seeking powers possessed by producers relative to those of consumers. Hence, in the GATT, import and export taxes are permitted but are to be negotiated away over time; export subsidies are banned altogether except in the special case of primary products; and there is no mention made of import subsidies (Baldwin 1980). Of these four cases, the two which are of greatest importance are import taxes and export subsidies. Acknowledging the ineffectiveness or non-existence of consumer power to overcome the resistance of producers, GATT permits time for adjustment to lower levels of import taxes as well as reciprocal concessions, i.e. the request and offer approach to tariff reductions. Crucial for the international exchange of concessions is the support of domestic producers in the export sectors who would gain from a reduction in foreign tariffs. So long as domestic exporters lobby for greater access to foreign markets and reciprocal tariff reductions are the only means of achieving the outcomes, then governments have domestic producer support for reducing tariffs in the import-competing sectors. Crucial to the maintenance of this mechanism is the inability of governments to use export subsidies as a means of assisting domestic exports. With the banning of export subsidies under Article XVI, exporters are a force for freer trade: with such subsidies, they are not.

It is in this context that the special provisions for agricultural products in Article XVI:3 are fundamental. Had primary products been treated in the same way as other products, then governments, particularly those in the US and the EC, would have been forced to act at a much earlier stage to curb the excessive budgetary costs of their agricultural policies because unit storage costs are generally much higher than unit export subsidy costs. Of course the mechanism outlined above for reciprocal concessions would not have applied often to agricultural trade because of the substantial use made of non-tariff barriers. Nevertheless, the banning of export subsidies for primary products would have prevented the present distortions in international trade in agricultural products on the export side and permitted at least some semblance of trade patterns driven partly by comparative advantage rather than largely by government policy settings.

The producer bias inherent in the Articles is also found in the conduct of trade negotiations. Krugman (1992) uses the term 'GATT-think' to characterise the mercantilist undertone of trade negotiations, e.g. the use of the term 'concessions' in the language of the negotiations. Underlying the term 'concessions' are the notions that exports are good and imports are bad. Although such notions make no economic sense, Krugman suggests that they do explain a great deal about the conduct of international trade negotiations. By negotiating on the basis of concessions, countries move towards freer trade without even acknowledging the economics of the gains from trade.

4. The Origins of Agriculture's Trade Problems

For international trade in non-agricultural products, the drafters of the Articles of GATT provided governments with the means of trading off the interests of producer groups one with another, thereby weakening each group's ability to dominate the trade policy agenda. To a large extent this strategy has been successful; tariff rates on manufactures now average around five per cent. However, for agricultural products the

strategy has failed. It has failed because of the substantial number of domestic policy goals for agriculture and the support of these by both producers and consumers; because governments have not chosen policy instruments based on the targeting rule that was developed in the 1960s but have allowed political economy considerations to dictate the choice of instruments; because imports of agricultural products are subject to non-tariff barriers which are more difficult to reduce on a request and offer basis; because of the ability of governments to use export subsidies to remove domestic surpluses and to shift the burden of structural adjustment to other countries; and because of the capture of governments by the farm lobby. This capture stems from the inability or unwillingness of governments to effect fundamental changes in their domestic farm policy instruments because of the way in which interest groups interact with vote-maximising governments. Therefore, if international trade in agricultural products is to become a reflection of comparative advantage rather than domestic policy instruments, then this endogeneity has to be broken.

The existing Articles of the GATT, with the exception of Article XVI, provide a set of rules which would have permitted a government willing to break the shackles of its domestic farm lobby to do so. However, for domestic political considerations, governments have avoided this opportunity in a number of ways. These have included: avoiding the use of Article XI:2 which permits the imposition of import quotas on agricultural products, because of the proviso that domestic production should also be reduced simultaneously, the very outcome which farm programmes are designed to avoid;[4] and introducing "grey area" measures such minimum import prices, variable

[4] It has turned out to be unfortunate that during the 1950s the United States allowed its domestic farm lobby to gain supremacy in the debate over whether national legislation (Section 22 of the 1933 Agricultural Adjustment Act as Amended) should take precedence over international obligations. The outcome was that the US sought a waiver under Article XXV.5 of its commitments concerning import quotas under Article XI. Therefore, much of US agricultural trade policy was removed from the rules of GATT. It is ironic, therefore, that in the 1960s when the CAP was being defined and implemented that the US should demand a return to the original intention of the GATT. However, by the 1960s the US had lost its undisputed leadership in this area and the power to impose its will (Warley 1976, p.353). From this period stems the continuing tension between the US and the EC over agricultural policy and trade and, ultimately, the bilateral deals struck between them on agriculture in the Uruguay Round.

import levies, state trading and voluntary export restraints, rather than using the contingency protection provided under Article XIX on safeguards. Hence, governments could have used the existing rules of GATT to protect themselves from domestic lobby pressure had they wished to do so. Therefore, what is required is a strengthening of the resolve of governments to seek to achieve their domestic policy goals for agriculture by instruments which are more efficient domestically, less disruptive internationally and which minimise rent-seeking by the farm sector. The governments of Australia and New Zealand are unusual amongst the OECD countries in having moved in this direction.

The Subsidies Code which emerged from the Tokyo Round implicitly acknowledged that governments required some outside help in order to achieve greater discipline in the use of subsidies. Part of the framework was provided by strengthened dispute settlement procedures under Article XXIII. However, for agricultural trade disputes the establishment of GATT Panels has resolved very little as governments have contested the interpretation of the Articles, particularly Articles VI and XVI. There have two major difficulties. The first has been that governments have often ignored or failed speedily to implement a ruling which has required them to modify their policy. The second has been that Panels have had to use an outcomes approach rather than a means approach to determine whether the use of an export subsidy has caused more than an "equitable market share" to be achieved. In many instances, the Panels have been unable to make a judgement because they have found it difficult to be certain what the trade flows would have been in the absence of the export subsidy and, therefore, they were not in a position to judge what was equitable (Tangermann 1987, p.255).

In order to avoid these difficulties which the Dispute Panels have encountered, three approaches could be adopted. The first approach would be to strengthen the means approach by banning the use of certain troublesome domestic and trade policy

instruments, e.g. domestic production subsidies and export subsidies. A second approach would be to strengthen the Dispute Settlement's procedure in such a way as to weaken the ability of the 'defendant' to ignore rulings against them. And a third approach would be to adopt a modified outcomes procedure which did not depend on hypothetical trade flows.

For agriculture in the Uruguay Round a hybrid of the first and third approaches was suggested early on in the Round by a number of the countries which submitted proposals.[5] This hybrid was the Aggregate Measure of Support (AMS) which had been revived by OECD in the mid-1980s following its original development by Josling.[6] Through employing the AMS, it became possible to measure the amount of income support being provided to the farm sector without being concerned about the different trade distorting effects which different policy instruments impose. At the same time, the AMS enables changes in support to be measured and then monitored over an agreed time period. While the AMS is not perfect in the context of trade negotiations, since the focus is domestic transfers and not trade effects, nevertheless it provides a pragmatic potential solution to a problem which has remained intractable for four decades.[7]

The other aspect of the AMS is that, in conjunction with the categorisation of policy instruments, it breaks the endogeneity of agricultural policies and forces governments to adopt greater discipline in the use of these policies. It is well-known from economic theory that income support is best provided by direct means and not by the manipulation of product prices. Hence, agricultural policies can be categorised as either good or bad depending on whether they effectively decouple income support

[5] For a summary, see Rossmiller (1988).

[6] See OECD (1990, pp.13-43) and FAO (1973).

[7] For a discussion of the debate surrounding the use of the AMS in trade negotiations, see MacLaren (1991, pp.254-256).

from decisions about production. Good policies can then be exempted from the AMS calculation whilst bad policies are not. In the *Draft Final Act*, it was proposed that agricultural policies should be classified as either 'amber box' policies, i.e. those which influence production or trade decisions, and 'green box' policies, i.e. those which do not.[8] Since 'amber box' policies become part of the AMS calculation and the size of the AMS has to be reduced over time, there is an incentive for governments to change their policy instruments and to provide income support by less distorting means.

5. The Uruguay Round Outcome

At first glance, it would appear that the outcome of the Uruguay Round has been more successful in agriculture than any of the previous Rounds have been. First, there was an agreement to convert all non-tariff barriers to tariff barriers and then to reduce the tariff rates by an agreed amount over a six-year period beginning in 1995. Second, domestic policies which fall into the 'amber box' are part of the AMS calculation and the value of the total AMS has to fall by 20% of the base period value (1986-1988) over a six-year period beginning in 1995. Third, it was agreed that the use of export subsidies would be curtailed such that the volume and the value of exports subject to subsidies would be reduced from the base period (1986-1990) over a six-year period beginning in 1995. And fourth, some progress has been made on harmonising sanitary and phytosanitary regulations. At the insistence of the EC, the AMS is measured across all commodities and not on a commodity-by-commodity basis. This weakens the agreed outcome as it provides scope for increased protection for some commodities.

To buttress this timetable towards achieving more rational agricultural policies, there was also the proposal in the *Draft Final Act* to modify the Dispute Settlement's procedure. This amendment may well turn out to be crucial, given the latitude which still remains for different interpretations of the time series of values of a country's AMS. The principal modification proposed is that a strict timetable be established for

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[8] See ABARE (1992, p.199).

each component of the dispute process. In addition, an appeals procedure will be established which will allow the 'defendant' the opportunity to appeal against the ruling on grounds of law and legal interpretation. The outcome of the decision by the Appellate Body would then be binding unless the Dispute Settlement Body decides by consensus not to adopt the decision (Anon 1993). This change of emphasis will remove the present effective veto which the Contracting Parties have over the findings of a Dispute Panel.

6. Conclusions

The Articles of the GATT make special provision for agricultural trade to only a very limited extent. Yet the waiver granted to the US removed much of that country's agriculture from the rules of GATT and, subsequently, has weakened US hegemony in the three most recent negotiating Rounds. In addition, the special status of primary products in Article XVI has removed an important check on government policy and has permitted governments to use export subsidies to avoid making the difficult political decisions necessary to bring about structural adjustment in the farm sector and freer international trade in agricultural products. It appears that the outcome of the Uruguay Round has done nothing to alter this Article, although there has been agreement that the levels of export subsidies will be reduced by modest amounts during the remainder of this decade.

At a fundamental level, it remains unclear whether in the minds of governments agriculture remains a special sector with respect to economics and the rules of GATT. In some countries, e.g. Australia and New Zealand, it would appear that, at least for the time being, agriculture will be subject to the normal operation of market forces; in other countries, e.g. most of the other OECD countries, but particularly France and the United States, governments remain captured by the farm lobbies and, consequently, agriculture will continue to be protected from market forces. Hence, it is unlikely in the near future that agricultural policies will be consistent with either economics or with the

original intention of the GATT, namely, to have a rules-based rather than a power-based framework for international trade.

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