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# **Agricultural Trade Liberalisation and the Uruguay Round\***

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**NSW 2006**

\* Presidential Address to the 40th Annual Conference of the Australian Agricultural and Resource Economics Society held at the University of Melbourne, 13 February 1996.

† I wish to acknowledge the helpful comments of Kym Anderson, Allen Craswell, Will Martin and Alan Swinbank on earlier drafts of this paper. I am especially indebted to Alan Swinbank who, over a number of years, has generously shared his insights on the CAP and policy making in the European Union.

# **Agricultural Trade Liberalisation and the Uruguay Round**

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Since the General Agreement on Tariffs and Trade was established in 1947, there have been eight rounds of multilateral trade negotiations. The most recent — the Uruguay Round — was the longest; it was launched in September 1986 in Punta del Este and was signed, nearly eight years later, in Marrakesh in April 1994. It was the most complex because, for the first time, the vexatious issues of trade in services and intellectual property were included and, more particularly, national support policies for agriculture were on the agenda. Given the political power of farm lobby groups world wide, it was perhaps inevitable that agreement would be difficult to reach.

Prior to the Uruguay Round, conditions for agricultural trade were deteriorating with increasing use of subsidies, build-up of stocks, declining world prices and escalating costs of support. The aim in this paper is to assess the extent to which the Agreement on Agriculture will overcome these problems. In the following sections, the development of the GATT framework is briefly examined together with a discussion of the special treatment afforded agriculture. This is followed by a discussion of prior attempts to rectify the impediments to freer international trade in agricultural products. The course of the Uruguay Round is charted to explain the changes in the negotiating positions of the major participants and their effect on the final outcome. Finally the likely impact of the round on the liberalisation of world agricultural trade is assessed and conclusions are drawn as to the lessons for the next round.

## **The GATT Framework**

The General Agreement on Tariffs and Trade was part of the post-World War II economic framework developed to avoid repeating the disastrous mistakes of the 1920s and 1930s. As a result of bilateral talks between US and UK officials to establish a multilateral non-discriminatory trading system, a set of proposals was developed for an International Trade Organization (ITO), the final version of which became known as the Havana Charter. The General Agreement on Tariffs and Trade was developed as part of the process for drafting the ITO Charter and was envisaged as an interim measure only, pending the setting up of the ITO. When the efforts to establish the ITO were abandoned — due to the US Congress' failure to ratify the ITO Charter — the GATT, which incorporated many of the commercial provisions of the ITO Charter, continued to operate.<sup>1</sup>

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<sup>1</sup> See Swinbank and Tanner (1996, Ch. 1) and Anon. (1987, Ch. 10) for discussion of the historical development of the GATT.

The General Agreement contained a framework for the mutual reduction of tariffs between signatory countries, or Contracting Parties as they are termed, and a code of conduct regulating governmental interference in trade. The Preamble to the General Agreement set out the economic objectives as:

raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of the resources of the world and expanding the production and exchange of goods (as quoted in Dam 1970, p. 391).

These objectives were to be achieved by the Contracting Parties "entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce" (Preamble). As has been noted by McGovern (1986, p. 12) it is unlikely that the signatories intended the "fairly cursory statement of ends and means" provided in the Preamble to be "comprehensive" and other principles can be inferred from the terms of the General Agreement.<sup>2</sup> One legal expert, Roessler (1987, pp. 71-72), has identified three basic principles underlying the General Agreement:

- *non-discrimination* or the most-favoured-nation (MFN) principle required each member country to treat trade of all other member countries equally; that is any advantage given to one member must be given immediately and unconditionally to all other GATT members;
- *open markets* or free trade: this "principle is realised by the General Agreement through a prohibition of all forms of protection except customs tariffs and the establishment of a procedural framework for tariff negotiations"; and
- *fair trade*: this principle is encompassed by the General Agreement's prohibition of the use of export subsidies on manufactured products and limitation of their use for primary products.

Another frequently invoked principle is that of *reciprocity* (see, for example, Curzon and Curzon 1976; Winters 1987). Although the articles of the General Agreement define neither reciprocity nor how reciprocal negotiations are to be conducted, in practice, reciprocity became a fundamental element in the *modus operandi* of the GATT.<sup>3</sup> Over the years it was agreed that developing countries should receive "special and differential treatment" and thus

<sup>2</sup> For a discussion of the legal constitution and the development of the GATT rules, see Dam (1970), Hudec (1975) and McGovern (1986).

<sup>3</sup> For a contrary view see McGovern (1986, p. 13) who argues that reciprocity seems "little more than an aspect of self-interest", since countries "will naturally prefer to give concessions as part of a bargain in which they acquire benefits in return."

be excused from reciprocity. Consequently, many developing countries maintained high levels of protection. As long as trade with developing countries was relatively unimportant, this exemption was accepted by the developed countries but as trade increased, they began to insist on reciprocity.

The underlying principles of the GATT were meant to apply, with only limited exceptions, to *all* trade. The most important exception to the MFN rule was contained in Article XXIV which permitted countries to form free trade areas or customs unions provided that the trade barriers following integration were not on the whole "higher or more restrictive than the general incidence" of the trade barriers which applied in the constituent countries prior to integration. Another important exception to the MFN principle is the Generalised System of Preferences, which was introduced in 1971, whereby developed countries apply preferential tariff rates to developing countries (Roessler 1987, p. 72).

There were also exceptions to the principle of open markets or free trade. For example, if the tariff commitments or any other obligations under GATT led, or threatened to lead, to serious injury to domestic producers, then a member country was permitted to take emergency action on imports of that product. The General Agreement also permitted member countries to impose quantitative restrictions to deal with balance-of-payments difficulties, provided such restrictions were gradually relaxed as the balance-of-payments situations improved (see Finger 1995).

### **Agriculture and the GATT**

It has been widely acknowledged that the GATT rules relating to trade have had very little impact on the conduct of agricultural trade or the levels of protection afforded the farm sectors of the major developed economies (for example, see Hathaway 1987; Hine, Ingersent and Rayner 1989; Johnson 1991). From the outset, the approach to agricultural trade and the approach to trade in manufactures in the GATT were fundamentally different. As Hathaway (1987, pp. 103-4) observed:

In general, GATT rules relate to how governments may intervene to protect domestic markets and industries. . . . These rules were agreed to by member countries of the GATT, and governments brought their practices in line with these rules.

For agriculture, the process was exactly the reverse. The GATT rules were written to fit the agricultural programs then in existence, especially in the United States. Since then the rules have been adopted or interpreted to fit various other national agricultural policies. So instead of developing domestic agricultural policies to fit the rules of international trade, we have tried to develop rules to fit the policies.

It is hardly surprising, therefore, that the GATT rules, as they evolved, failed to provide a suitable framework for the conduct of agricultural trade, negotiations on agricultural trade matters or the settlement of agricultural trade disputes. According to Johnson (1991, p. 311),

the responsibility for the inclusion in the GATT rules of exceptions applying to agriculture lies, to a considerable extent with the United States: "American responsibility goes back to the origins of the GATT and the American insistence on exceptions from the general rules for agricultural trade". To obtain the support of the US Congress, it was necessary to include exceptions permitting the use of import restrictions where a country was operating a domestic supply management programme and export subsidies for agricultural trade. The two main areas in which agriculture received special treatment were:

- quantitative restrictions (Articles XI and XIII); and
- subsidies (Article XVI).<sup>4</sup>

These areas of special treatment have also been the basis of many trade disputes between GATT member countries (see Curzon and Curzon (1976, Ch. 3) and Hathaway (1987, Ch. 5)).

Despite these exceptions, the United States had difficulty in accommodating the GATT rules and in 1951 Congress amended Section 22 of the Agricultural Adjustment Act of 1933 to include: "No trade agreement or other international agreement. . . . entered into by the United States shall be applied in a manner inconsistent with this section" (Johnson 1991, pp. 311-12). Section 22 required the administration to impose quantitative restrictions (or special fees) in cases where imports would impinge upon the effectiveness of a farm programme. Subsequently, import quotas were imposed on wheat and other grains, cotton, peanuts and dairy products. When the US restrictions on dairy products were found to infringe Article XI, the United States was subject to retaliatory action. Consequently, when the GATT underwent an overall review in 1955, the United States sought to legalise its position with respect to Section 22 quotas and sought a formal waiver.<sup>5</sup> In response to the threat of a US withdrawal from the GATT, the waiver was granted. The waiver applied not only to dairy products but to all agricultural products, irrespective of whether they were subject to supply control measures under domestic programmes. As observed by Dam (1970, p. 261), the granting of a waiver of such breadth to "the contracting party that was at one and the same time the world's largest trading nation and the most vocal proponent of freer international trade, constituted a grave blow to GATT's prestige" (Dam 1970, p. 261).

The GATT rules with respect to subsidies were also influenced by the "unwillingness of the United States in the late 1940's and early 1950's to subject its domestic farm programmes to the discipline of international trade. . ." (Johnson 1991, p. 313). Whereas for manufactured

<sup>4</sup> For further discussion see Hathaway (1987, Ch. 5) and Swinbank and Tanner (1996, Ch. 1).

<sup>5</sup> For a discussion of the rules granting a waiver from the GATT obligations of member countries see McGovern (1986, pp. 30-31).



meagre and the CAP proceeded without fundamental modification, immune from international pressures.<sup>7</sup>

### **Dillon Round**

The focus of the discussions in the Dillon Round was on negotiating compensation for traditional exporters for loss of markets following the creation of the EEC. The case for compensation was based on the expectation that the creation of a common external tariff would reduce the level of imports. An added complication, as far as agriculture was concerned, was that the CAP was still being developed.

The move to a common external tariff and the proposal to change from import duties to variable levies for some products was seen by the United States as a violation of previous tariff bindings (Warley, 1976, p. 379). When the European Community denounced the tariff bindings on products which were to be covered by the CAP, the likely impact on US exports to the EC market was so alarming that the United States sought guaranteed access to the EC market at its then existing level of exports for products affected by the CAP. The European Community was successful in resisting claims for compensation but did agree to enter into tariff bindings on a number of products then thought to be unimportant for EC agriculture, namely oilseeds, manioc and sheepmeats. As observed by Warley (1976, p. 379), "completing the Dillon Round and thereby not impeding the progress of the Community was judged more important than resolving the agricultural issue" and the United States and the European Community formally agreed that the United States had "unsatisfied negotiating rights". By settling for this understanding, the United States and other exporters acquiesced to the establishment of the CAP and lost the opportunity to influence its mechanisms in the future (Swinbank and Tanner 1996, Ch. 1).

### **Kennedy Round**

In the lead up to the Kennedy Round, the United States made it clear that, as the world's largest exporter of agricultural products, it placed great importance on liberalising agricultural trade and on maintaining access to the world's largest importer — the European Community. Trade in cereals was of particular concern because of its overall importance in world trade and the US perception that the CAP would have a major impact on the cereals sector. A suitable framework for agricultural trade was discussed at length with the United States arguing for greater reliance on market oriented forces and the European Community favouring a more managed-market system. These fundamentally different approaches proved impossible to reconcile. The United States continued to press (again unsuccessfully) for greater access to the EC market and the European Community continued with the

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<sup>7</sup> For a brief review see Harris, Swinbank and Wilkinson (1983, pp. 275-79). Further discussion is provided in Swinbank and Tanner (1996, Ch. 1).

development of the CAP. Throughout the 1960s and 1970s the European Community was insistent upon its claim that the CAP was a *domestic* support measure unrelated to *trade* policies and, therefore, not negotiable in the GATT. For example, in the Kennedy Round the Commission of the European Communities' negotiating position stated that the CAP's "principles and mechanisms should not be called into question and therefore do not constitute a matter for negotiation (cited in Harris, 1977, p. 39).

The Kennedy Round achieved little for agricultural trade liberalisation because of three main factors:

- the widespread use of non-tariff barriers in agriculture was not addressed;
- the stage of development of the CAP made agreement on an EC negotiating mandate for many imported products difficult;<sup>8</sup> and
- both the United States and the European Community rejected any proposals which would have subjected their domestic agricultural policies to international scrutiny.

### **Tokyo Round**

The next round of multilateral negotiations, which has become known as the Tokyo Round, opened in September 1973 amidst concern about the impact that the new wave of protectionism was having on both agricultural and industrial markets. The mood of the time was captured by Golt (1978, p. 7): ". . . it is now impossible to ignore that, alongside the avowed protestations by governments of their devotion to the open and liberal trading systems, essentially protectionist actions have been increasing on both sides of the Atlantic". The traditional trade balance between the major trading powers of the United States and Europe was being challenged — initially by Japan and then by a number of other newly industrialised countries. Faced with increased competition, rising unemployment and inflation, and a stagnant world economy following the oil crisis of the early 1970s, it is not surprising that governments resorted to more protectionist measures in an attempt to placate nationalistic interests.

The economic conditions of the early 1970s were not conducive to progress toward trade liberalisation in the multilateral framework. The Tokyo Round negotiations made little headway during the 1974–77 period, mainly due to an impasse in the agricultural negotiations. The US and EC negotiating positions were essentially the same as in the previous round and the European Community continued to maintain that "the CAP was inviolable, and that neither its principles nor its mechanisms could be subject to negotiation" (Wingham, 1986, p. 156). The EC negotiators also insisted that, because of the unique

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<sup>8</sup> For example, CAP support regimes for dairy products, beef and sugar were not agreed upon until July 1966, some two years into the round.

characteristics of the agricultural sector, a separate negotiating group should be established for agriculture. This demand was eventually accepted by the Americans thus making more difficult any direct trade off between US industrial concessions and increased access to the EC agricultural market.

Despite attempts during the Tokyo Round by agricultural exporters to increase their access to the EC market and to bring agriculture under the same disciplines as industrial trade, little was achieved. However, agreement was reached on setting up a consultative council to improve the conduct of agricultural trade. One outcome of the Tokyo Round with the potential to improve agricultural trade was the Code of Subsidies and Countervailing Duties which obliged signatories to avoid causing harm or prejudice to the use of subsidies, prohibited the use of export subsidies for manufactured goods and attempted to define in greater detail the meaning of "equitable share of world trade" for export subsidies on primary products.<sup>9</sup> Not surprisingly, the definition of concepts such as "equitable share" provides ample scope for debate and it is widely acknowledged that the implementation of the code has not been successful (see, for example, Hathaway (1987, Ch. 5) and Hartwig, Josling and Tangerman (1989, Ch. 3)). As with the previous rounds, the Tokyo Round had failed to deal with the crucial issues of domestic agricultural support and the special treatment accorded agriculture under the GATT rules.

### **The Progress of the Uruguay Round**

By the early 1980s, the benefits to the world trading system of reduced tariff levels were being eroded by the increasing use of non-tariff barriers and anti-dumping duties especially for agricultural products, clothing and textiles, steel, motor vehicles and electronic goods. The rising levels of protection and erosion of respect for the GATT rules were causing concern in international trade circles. The lack of confidence in the multilateral trading system led to a proliferation of preferential trading arrangements during the 1980s, further undermining the multilateral system.

The disarray which occurred in world agricultural markets during the 1980s as a result of rising levels of protection is well documented (for example, see Hathaway (1987), Johnson (1987; 1991), Miller (1987) and Tyers and Anderson (1992). During much of the 1980s, agricultural trade was affected by the build-up of surplus stocks, particularly in the United States and European Community. To reduce stocks and win back market share, the United States introduced generous export subsidies for targeted markets to counter what the United States claimed to be "unfair competition" from other exporters, notably the European

<sup>9</sup> See Wingham (1986, pp. 422-24) for a summary of the code.

Community.<sup>10</sup> The disposal of US stocks was highly disruptive to world markets and depressed prices even more.

As might be expected, the crisis in commodity markets resulted in severe financial hardships for many farmers, especially those in countries such as Australia which did not support farm incomes to any significant extent. Reduced farm incomes and a lack of confidence in the conduct of world grain markets were reflected in falling land values. It is estimated that from June 1985 to June 1987 land values in the broadacre sector of Australian agriculture declined, on average, 25 per cent in real terms (Kingma, 1987). Even in countries such as the United States, where farm support programmes provided subsidies for producers, farmers were experiencing financial difficulties, land values were falling and farm bankruptcies increased dramatically during the eighties. A study by Tweeten (1986) shows that, by April 1985, real land values in the corn belt had fallen to less than half their 1981 values.

The policies of the major industrial countries of insulating their domestic producers from falling world prices meant that, not only did the levels of protection increase but the costs imposed on taxpayers, consumers and the wider economy also increased. These costs were made more transparent by work undertaken by the World Bank (1986), OECD (1987) and USDA (1988a; 1988b) as well as an array of Australian studies undertaken to stimulate the process of international policy reform (for example, see BAE 1981 and 1985; Stoeckel 1985; Miller 1987; ABARE 1988; Roberts *et al.* 1989 and Riethmuller *et al.* 1990).

### **The Punta del Este Declaration**

The Uruguay Round was first mooted at the GATT ministerial meeting in Geneva in November 1982. Although that meeting was "widely regarded as a failure", a work programme was developed which "set the stage for the launching of a new round of negotiations as and when the political and economic environment made such a decision by governments possible. . . . In particular, the work programme enabled some worthwhile work on agriculture to take place." (Anon. 1987, p. 137). The United States, Japan and Australia were early advocates of a new round but, with the world economy in the grip of recession, other countries were unwilling to embark on another time-consuming and potentially disruptive round. For the US administration, the attraction of embarking on a new round was that the protectionist tendencies of the Congress could be constrained more easily through the multilateral framework. Paarlberg (1993) has argued that the market-oriented appointees of the Reagan administration developed a strategy to pursue domestic agricultural policy reform in the international arena and thereby limit the influence of farm lobby groups on the final outcome. An international approach to farm policy reform has the added advantage that the impact on the incomes of US farmers would be less than if reform

<sup>10</sup> For a discussion of factors influencing US market share and stocks of wheat see Roberts *et al.* (1989, Chs 2 and 3).

were pursued unilaterally. For Japan, entering into multilateral discussions would reduce the bilateral pressure being applied by both the United States and the European Community for changes to Japanese trade policies (Winters 1990, p. 1297). For Australia, the main objective was to ensure that agricultural trade issues were accorded prominence in any new round. By mid-1985 support for a new round of multilateral negotiations had increased and a Preparatory Committee was established in November 1985 to develop the framework for a new round.

Despite the Preparatory Committee's work, when in September 1986, the GATT ministerial meeting assembled in Punta del Este for the formal launch of what was to become known as the Uruguay Round, the scope and terms of the negotiations were still to be finalised. The ministers were faced with three different texts and a number of outstanding issues, the most important of which were agriculture and the "new issues" of trade in services, intellectual property and investment measures (Anon. 1987, p. 142). That agriculture was to be part of the round had been accepted prior to the ministerial meeting but the scope of the agricultural negotiations was yet to be determined. Support for inclusion of agriculture had been strengthened by the formation of the Cairns Group of agricultural exporting nations, following a meeting in Cairns in August 1986.<sup>11</sup> An intense four days of political compromise and negotiation between ministers resulted in the Punta del Este Declaration that formally began the round.

According to Alan Oxley (1990), the then Australian ambassador to GATT, the successful launch of the Uruguay Round in September 1986 was due largely to US efforts, the Americans having continued to lobby for a new round after the disastrous ministerial meeting in 1982. It was also significant that the United Kingdom — a supporter of a new GATT round — held the presidency of the EC's Council of Ministers in the second half of 1986 because there was little enthusiasm among other EC member countries for a GATT round that would embrace agriculture.<sup>12</sup>

As previously noted, the Uruguay Round was the most wide-ranging and ambitious round yet launched as it covered trade in agricultural products, services, intellectual property and investment. For the first time, agriculture was to be accorded prominence in the negotiations. With respect to agriculture, the Punta del Este Declaration stated:

The Contracting Parties agree that there is an urgent need to bring more discipline and predictability to world agricultural trade by correcting and preventing restrictions and

<sup>11</sup> The Cairns Group comprises Australia, Argentina, Brazil, Canada, Chile, Colombia, Fiji, Hungary, Indonesia, Malaysia, New Zealand, the Philippines, Thailand and Uruguay. Tyers (1994) discusses the contribution of the Cairns Group to the Uruguay Round agricultural negotiations.

<sup>12</sup> The role of the presidency in the EC decision making is discussed in Swinbank (1989) and Swinbank and Tanner (1996, Ch. 3).

distortions including those related to structural surpluses so as to reduce the uncertainty, imbalances and instability in world agricultural markets.

Negotiations 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, taking into account the general principles governing the negotiations, by:

- (i) improving market access through, *inter alia*, the reduction of import barriers
- (ii) improving the competitive environment by increasing discipline on the use of all direct and indirect subsidies and other measures affecting directly or indirectly agricultural trade, including the phased reduction of their negative effects and dealing with their causes
- (iii) minimising the adverse effects that sanitary and phytosanitary regulations and barriers can have on trade in agriculture, taking into account the relevant international agreements (Anon. 1987, pp. 150-151).

There are two points which should be noted about this declaration:

- for the first time the European Community had agreed that the CAP was negotiable; and
- the inclusion of "all direct and indirect subsidies and other measures affecting agricultural trade" meant that the negotiations would not focus exclusively on the CAP's variable import levies and export refunds. Other countries' support measures, most notably the US deficiency payments, would also be subject to scrutiny.

The timetable set for the round provided for a mid-term review in Montreal in December 1988 and a ceremonial conclusion in Brussels in December 1990. This was necessary to accommodate the US "fast-track" procedure which allowed the president until 31 March 1991 to sign an agreement, which would then have to be ratified by the Congress. The rules of the fast-track procedure favour ratification by limiting Congressional debate, precluding amendment and restricting Congress to a vote for or against the entire agreement (Avery 1993, p. 6). Thus, if the deadline were met, the Congress would be committed to accepting or rejecting the agreement as a whole.

### **The Initial Offers**

The initial offers submitted by the major negotiating parties in the latter half of 1987 revealed major divergences in the extent of their commitment to reforming agricultural policy. The US initial offer, which has become known as the zero option, proposed the phased elimination over a ten-year period ending in the year 2000 of all trade-distorting farm policy mechanisms (Hine, Ingersent and Rayner 1989, p. 386; Josling 1991, p. 272). The US position was broadly supported by the Cairns Group which also advocated some early relief measures to ease the continuing crisis in world commodity markets.

By contrast, no longer under the influence of a British presidency, the European Community's offer was very limited in scope. Whilst prepared to accept some reduction in agricultural support, the European Community would not agree to a complete phasing out because that would have threatened the CAP. The EC initial offer also provided for a programme of short-term relief measures to alleviate the conditions being experienced in world markets which would have extended onto the world scene the "managed-market" concept of the CAP by means of agreed minimum prices for cereals and cereal substitutes, market sharing arrangements for dairy products and production quotas for sugar (Riethmuller *et al.* 1990).

From the outset, two opposing groups of countries could be identified in the agricultural negotiations. On the one hand, there was the United States, supported by the Cairns Group, which "insisted that there should be significant reform of the trade rules in agriculture and that there should be significant liberalization of agricultural trade via reductions in border protection and removal of other trade-distorting policies" (Hathaway and Ingeo 1995, pp. 2-3). The opposing side, led by the European Community with the support of the EFTA countries, Japan and Korea, argued "that agriculture is a special case and that all countries should not be required to adopt the same policies for internal support and border protection regardless of farm structure or degree of self-sufficiency" (Hathaway and Ingeo 1995, p. 3). Whilst most of the countries in this group were prepared to entertain some changes to the GATT rules on agriculture, they were opposed to significant agricultural trade liberalisation because of the political power of the farm pressure groups.

The zero option was seen by most of the world, including the Europeans, as an outrageous bluff and was therefore not taken very seriously. As a result, preparation for the mid-term review held in Montreal in December 1988 proved inadequate. The purpose of the review was to reassess and review negotiating positions to find common ground. In eleven of the negotiating groups tentative agreement was reached but agreement proved elusive in the groups concerned with agriculture, intellectual property, textiles and clothing, and safeguards. The divergent views of the United States and the European Community on the phasing out of agricultural support measures led to an "unbridgeable" gap, with the parties unable to agree on the long-term objective of the negotiations.<sup>13</sup> With the stalemate in the Negotiating Group on Agriculture threatening to undermine the agreements already reached in other areas, a compromise was reached which allowed the negotiations to continue in Geneva until April 1989.

### **The April 1989 Negotiating Agreement on Agricultural Trade**

On returning to Geneva, the United States and the European Community "began seriously to address the agriculture issues" and "moved away from their rigid positions" (Oxley 1990, p.

<sup>13</sup> For a fascinating insight into the Montreal negotiations and its key players see Oxley (1990, Ch. 12).

169). By April 1989, the parties had reached agreement and the mid-term review was brought to a successful conclusion with the Negotiating Group on Agriculture agreeing that:

- "the long-term objective . . . is to establish a fair and market-oriented trading system" and "to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time", as measured by an aggregate measure of support (AMS);
- "credit would be given for measures implemented since the Punta del Este Declaration which contribute positively to the reform programme";
- "all measures affecting directly or indirectly import access and export competition" would be included;
- participants would make detailed proposals along these lines by December, 1989; and
- support levels, expressed in national currencies (or in ecu in the case of the European Community) would not be raised "above the level prevailing at the date of this decision" (Riethmuller *et al.* 1990, Appendix A).

The Geneva agreement is significant because it is the first time that the European Community had agreed to reduce agricultural support. Despite this concession, the outcome was favourable from the Community's perspective. The provision for "credit" for measures implemented since the Punta del Este Declaration meant that significant reductions in the AMS could already be demonstrated, given the high 1986 AMS on which the European Commission would subsequently base its calculations. In addition, expressing the support "standstill" in ecu meant that some member states could increase their support levels in national currencies simply by devaluing their green conversion rates.<sup>14</sup>

By the end of 1989, several countries had tabled proposals for the long-term reform of agriculture with the Negotiating Group on Agriculture, the major submissions being those of the United States, the Cairns Group, Japan and the European Community.<sup>15</sup> The fundamental differences which had been evident at the outset of the negotiations persisted. The United States, supported by the Cairns Group, proposed that all trade distorting domestic and export subsidies be phased out over an agreed period and that all import protection be converted to tariffs which were then to be reduced to zero or low levels. The European Community's submission failed to specify the extent to which it was prepared to reduce price support under the CAP but suggested some reduction in support and protection be undertaken progressively over a five-year period, at the end of which the situation would be reviewed.

<sup>14</sup> For a discussion of green conversion rates see Swinbank and Tanner (1996, Ch. 3).

<sup>15</sup> For a comparison of the submissions of the major GATT signatories for long-term agricultural reform see Riethmuller *et al.* (1990).

At the same time the European Community indicated that, despite fundamental reservations, it might be willing to accept some form of tariffication, provided it be allowed to "rebalance" protection for cereal substitutes (that is, to increase protection levels for cereal substitutes which had previously been bound, in return for reducing support for cereals).

During 1990, efforts were directed at trying to bridge the gap which existed between the European Community's proposal and, in particular, those of the United States and Cairns Group. However, agreement again proved elusive. A deadline of 15 October 1990 was set for tabling the final offer for the Brussels ministerial meeting at which the Uruguay Round was scheduled to conclude. After months of internal wrangling,<sup>16</sup> the European Community finally put forward its formal offer on 6 November 1990 "to reduce its support and protection by 30% for main products". The major components of the offer were:

- a reduction of support by 30 per cent based on an Aggregate Measure of Support backdated to 1986;
- "tariffication of certain border measures and a concomitant reduction of the fixed component resulting therefrom, together with a corrective factor";
- a decrease in import barriers to be subject to rebalancing; and
- a "concomitant reduction" of export subsidies (European Community 1990, p. 1).

As has already been noted, by backdating the offer to 1986, part of the 30 per cent reduction in support had already been achieved. Further, because the reduction in the AMS could be achieved by either a reduction in price or volume (or a combination of both), the percentage cut in the AMS could translate into a much smaller cut in price. It would also be possible for compensation to occur within product groups. In addition, the offer to introduce tariffication did not conform with the conventional application of tariffs because of the inclusion of the "corrective factor".<sup>17</sup>

Although the United States had shifted away from its zero option, there was still an immense gap between the European Community's 30 per cent offer and the US offer of a 75 per cent cut in the main trade-distorting domestic subsidies and a 90 per cent cut in export subsidies over a ten-year period starting in 1991. Not surprisingly, the plan to hold a ceremonial conclusion in Brussels became unachievable when the major participants failed to reach agreement.

The failure to strike a deal on agriculture in December 1990 meant that the entire package of agreements lapsed. Ingersent, Rayner and Hine (1994, p. 73) conclude that: "The crux of the

<sup>16</sup> See Swinbank and Tanner (1996, Ch. 4) and Moyer (1993).

<sup>17</sup> For elaboration on this point see Annex IV of the EC's offer and Swinbank and Tanner (1996, Ch. 4).

lack of agreement on agriculture was that the US and Cairns Group were unable to accept the EC's refusal to offer specific quantitative commitments to lowering border protection and reducing export assistance."

### **Reforming the CAP and the Dunkel Proposal**

Despite predictions that the breakdown of the GATT negotiations would result in an all-out trade war, this did not eventuate. The attention of the world powers switched to other concerns — the Gulf War and the events of Eastern Europe. During 1991 very little progress was made in the Uruguay Round. The US "fast-track" authority was extended by two years and the European Community began debating another set of reforms to the CAP — the Mac Sharry reforms — which were to pave the way for the European Community's eventual agreement to major reforms of the GATT rules for agriculture.

Following the failure of the Brussels December 1990 meetings, EC officials had recognised that the other key participants in the Uruguay Round were not prepared to conclude the round without a satisfactory agreement on agriculture. To satisfy the demands of the United States and the Cairns Group, even partially, it was going to be necessary to reform the CAP.<sup>18</sup> It was considered politically easier to make the reforms first and then fit a GATT agreement around those reforms than to gain the support of member countries for a GATT agreement which would necessitate subsequent reform of the CAP (Hathaway and Ingco 1995, p. 4). Although astute political observers recognised the significance for the GATT negotiations of the proposals for reform of the CAP put forward by the Commissioner for Agriculture, Ray Mac Sharry, in early 1991, the European Commission (1991) indicated that the proposals were designed to alleviate budgetary pressures and to help redress the unequal spread of benefits among the farm population (for example, 20 per cent of farmers were receiving approximately 80 per cent of the support). The proposals for the cereals regime were at the core of the Mac Sharry plan:

- levels of price support in the cereals sector to be reduced substantially, bringing them much closer to world market levels;
- farmers to be compensated for their loss of revenue via a system of area-based payments;
- the compensation to be "modulated", that is "small" farmers would be compensated in full but beyond a specified size only partial compensation would be paid; and
- compensation to be linked to a set-aside scheme (Swinbank and Tanner 1996, Ch. 5).

The prices being proposed were different to those of the European Community's GATT offer and the Mac Sharry reforms made no reference to tariffication. Notwithstanding, if the

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<sup>18</sup> For a discussion of earlier attempts to reform the CAP see Tanner and Swinbank (1987).

compensation payments were to be classified in the "green box", the Mac Sharry reforms were more than sufficient to meet the Community's GATT offer. Heated debate ensued on a number of aspects of the Mac Sharry proposals, in particular, the magnitude of the price cuts (bitterly opposed by the French farmers), the modulation of compensation (strongly opposed by large British farmers), the form of compensation and whether or not it would be classified as decoupled for the purposes of the GATT negotiations (Swinbank and Tanner 1996, Ch. 5).

Final agreement to the reform package, which was achieved after a marathon negotiating session in May 1992, retained the basic elements of the original Mac Sharry proposals with the exception of modulation, which was rejected. The reforms came into effect in 1993 and will be fully operational by 1996. Basically, the Mac Sharry reforms shifted support from consumers to taxpayers. Producers receive compensation for the lower internal support prices by generous compensation payments for crop and livestock products. Although the gap between world prices and internal prices has been reduced, the European Community still needed to use export subsidies for many products. For politically sensitive areas like dairying there was very little change and the sugar regime was not included in the Mac Sharry reforms.

Serious negotiations on a GATT agreement for agriculture did not resume until late 1991. In an attempt to bring the negotiations to a conclusion, the Director-General of GATT, Arthur Dunkel, put together a draft text which included feasible compromises in a number of areas of disagreement in agriculture and other contentious areas.<sup>19</sup> These proposals, which became known as the "Dunkel Text" were published in December 1991 and form the basis of the final agreement. The proposals focused on three main areas:

(a) *Market access*

- tariffication of all border measures;
- an average reduction of 36 per cent in border protection over the period 1993-99 compared with the base period of 1986-88, with a minimum reduction for each tariff line of 15 per cent; and
- minimum access of 3 per cent of domestic consumption to be established by 1993, rising to 5 per cent by 1999, determined from a base of 1986-88 domestic consumption in the importing country.

(b) *Domestic support*

- trade-distorting domestic support measures to be reduced by 20 per cent compared with a 1986-88 base level.

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<sup>19</sup> As suggested to me by Will Martin, this was a significant departure from normal GATT procedures. Generally, the Secretariat acts on instructions from the member countries and does not develop policy.

(c) *Export subsidies*

- budget expenditure on export subsidies to be reduced by 36 per cent and volumes of subsidised exports to be reduced by 24 per cent compared with their average 1986-90 levels (GATT 1991).<sup>20</sup>

The agreement was due to come into force on 1 January, 1993 and the GATT signatories were requested to submit detailed proposals by 1 March, 1992 with a view to concluding negotiations by 15 April, 1992. The Dunkel Text was fairly rigorous in its definition of what was included in trade-distorting domestic support measures which would then be subject to reduction. It encompassed both the US deficiency payments and the proposed EC compensation payments. The proposals would also have required large initial cuts in either the value or volume of export subsidies to comply with the requirement that after the first year the volume and value of export subsidies were to be below the 1986-90 base levels. For example, application of the Dunkel proposal would have required US expenditure on export subsidies of soybean oil to be reduced by 89 per cent in the first year (Hathaway and Ingeo 1995, p. 5). This aspect of the proposal also caused considerable concern in the European Community for which wheat and cheese exports would be particularly hard hit.

With the publication of the Dunkel Text and the new deadline for concluding negotiations fast approaching, the attention of the various participants shifted to how the proposals would affect their domestic agricultural policy and protection regimes, and what changes would be necessary. Although the proposals offered significantly less liberalisation than the original demands of the United States and the Cairns Group, they nevertheless endorsed the Dunkel Text. Japan and Korea continued to oppose the tariffication of the border measures, protesting that they could not remove their bans on rice imports. As might have been expected, the response of the Europeans was not particularly favourable: the concession on imports was seen as too large; there was no consideration of rebalancing; and the classification of compensation payments as production positive was unacceptable (*Agra Europe* 10 January 1992, p. P/1). The European Community's response was complicated by the fact that final agreement on the Mac Sharry reforms was not achieved until May 1992.

The French government was strongly opposed to the Dunkel Text and threatened to block any final agreement if changes were not made to the agricultural agreement to make it more consistent with the reforms already being made to the CAP. The French were concerned to avoid the need to make additional reforms in order to accommodate the GATT agreement and vigorously opposed the 24 per cent reduction in the volume of subsidised exports. There was also concern about the product-by-product requirements for minimum access, the EC countries preferring instead to aggregate across broad categories which would avoid the need to make changes in sensitive areas. The Germans, in particular, were opposed to Dunkel's

<sup>20</sup> For a useful discussion of the Dunkel proposal and an analysis of its effects on world agricultural trade, if implemented, see Andrews, Roberts and Love (1992).

intention not to exempt the new compensatory payments from the domestic support measures which were subject to reduction. The Germans had agreed to the Mac Sharry price reduction only after receiving a commitment from the European Commission that the new compensatory payments would not be subject to reductions or limitations under a new GATT agreement (Hathaway and Ingeo 1995, p. 5). Dunkel's April deadline for a final agreement on agriculture passed with key areas still unresolved.

### **The Oilseeds Dispute and the Blair House Accord**

The next stage of the agricultural negotiations was precipitated by the threat of a trade war between the United States and the European Community over oilseeds. The dispute over oilseeds had its origins in the Dillon Round in the early 1960s when the European Community entered into GATT bindings on a number of products, including oilseeds, which meant that US soybeans could enter the European Community duty free. This had led to the growth of "cereal substitutes" in the livestock feed industry. With similar GATT bindings on manioc, feed manufacturers found that, rather than use cereals in animal feeds, it was cheaper to use a mixture of soybean meal (protein) and manioc (carbohydrate). However, the growth in trade in soybeans was threatened by the EC oilseeds support system developed during the 1970s which, because of the GATT bindings on oilseeds, was based on direct subsidy payments. These payments fluctuated inversely with world oilseed prices and allowed crushers to pay higher prices to EC oilseed producers. The United States argued that these subsidies encouraged EC oilseed production, thus negating the Dillon Round bindings, a view supported by two GATT Panel rulings.

The European Community's proposal for rebalancing was an attempt to resolve the oilseeds dispute within the framework of the GATT negotiations. The European Community had wanted to be released from its GATT bindings on oilseeds in exchange for lower support in the cereals sector. In an attempt to break the impasse in the oilseeds dispute the United States threatened to retaliate by introducing punitive import tariffs on a range of agricultural and food products in December 1992. The products were carefully selected to target the European Community and France in particular. The threat of a trade war brought the Europeans to Washington for yet another round of bilateral negotiations. However, on this occasion the Blair House Accord was reached on 20 December 1992.<sup>21</sup>

In addition to resolving the oilseeds dispute, which was not strictly part of the Uruguay Round, the Blair House Accord satisfied the major EC objections to the Dunkel proposals. The key elements of the agreement were, first, the volume of subsidised exports subject to reduction was scaled down from 24 per cent to 21 per cent. Second, it was agreed that commodities could be aggregated across product types to meet minimum access

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<sup>21</sup> The agreement became known as the Blair House Accord because it was negotiated at Blair House - the official US residence for visiting dignitaries.

requirements and domestic support reductions.<sup>22</sup> Third, it was agreed that the US deficiency payments and EC compensation payments would be classified in the "green box" and exempt from reduction. Finally, the accord included a "peace clause" which restricted the filing of GATT complaints during the implementation of the new GATT agreement provided the country in question was complying with the GATT rules. This was of particular importance to the European Community because of the succession of complaints filed against it by its trading partners.

Press reports of the Blair House Accord produced a strong reaction from the French who threatened to veto the agreement. With French Parliamentary elections pending in March 1993, the EC Commission and other EC member states were anxious not to aggravate the situation by pressing on with a GATT agreement. In the United States, the oilseeds producers were particularly unhappy with the deal and President Clinton seemed to be in no hurry to adopt what was initially seen as a flawed agreement entered into by his predecessor. The Cairns Group reluctantly agreed to endorse the Accord which was seen as weakening the Dunkel proposals. For the Cairns Group, the Dunkel proposals already fell far short of their demands.

### **The Final Agreement**

In the early part of 1993 it was clear that the GATT negotiations had again lost momentum and that an agreement was unlikely before the US President's fast-track negotiating procedure expired. However, in June 1993, Congress agreed to another extension whereby the President was given until 15 December 1993 to notify the Congress of his intention to sign an agreement which must then be submitted to Congress by 16 April 1994. Thus a new, and this time final, deadline for concluding the negotiations was set. During 1993 the battle of rhetoric continued with various interests in the European Union (the new name adopted by the European Community after the Maastricht Treaty came into force on 1 November 1993) declaring that the Blair House Accord was unacceptable and the Americans insisting that the agreement could not be renegotiated. After much high-level discussion, an agreement on the outstanding issues was reached between the United States and European Union for consideration by the other GATT participants in the few days remaining before the deadline.

Two major modifications to the Blair House Accord were incorporated in the final agreement: the removal of the front-end loading of the reduction in export subsidies (which were part of the Dunkel proposals) and the postponement of tariffication of a few products by a small number of countries. This latter provision allowed Japan and Korea to retain their rice import regimes in return for agreeing to higher minimum import levels that would have

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<sup>22</sup> The Europeans wanted a broader aggregation than they achieved. For example, they would have preferred to aggregate all meat products but the agreement allowed aggregation only across meat types, for example, pigmeat.

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applied under tariffication (Hathaway and Ingoe 1995, p. 7). The main provisions of the Agreement on Agriculture are discussed in the next section.

It is somewhat ironic that having been blamed for the impasse in Montreal in December 1988 and the breakdown in Brussels in 1990, in the final stages of the negotiations in Geneva in December 1993, agriculture was but one of the problem dossiers which threatened to jeopardise the talks. Thus, right to the end of the round, there was a risk that the parties would not agree. With only hours to spare before the American deadline expired, the Director-General of GATT, Peter Sutherland, declared that the 117 participating countries had approved the draft treaty.

The Uruguay Round agreement is a complex package incorporating not just the Agreement on Agriculture but also a number of significant changes to the 1947 GATT and the establishment of a World Trade Organization (WTO). The WTO is an umbrella organisation responsible for overseeing the 1994 GATT, the General Agreement on Trade and Services (GATS) and the General Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).<sup>23</sup> Unlike the 1947 GATT, the 1994 GATT was ratified by all the major participants and on 1 January 1995, the new World Trade Organization came into operation.

### **The Agreement on Agriculture**

The major outcomes of the Uruguay Round for agricultural trade are that the disciplines of the GATT have been extended to agricultural commodities and that the disruption caused to world markets by domestic trade-distorting support measures has been recognised and, to some extent, curtailed. The Agreement on Agriculture contains commitments on market access, domestic support and export subsidies. The new arrangements came into effect in 1995 and, for developed countries, are to be implemented over a six-year period.

Developing countries have been given ten years in which to implement the changes and are required to make only two-thirds of the reductions required by developed countries. The least developed countries are not required to make reductions.

#### **Market Access**

There are five basic components to the agreement aimed at improving market access.

- All non-tariff barriers are to be converted to tariffs and subject to reduction.
- All tariffs are to be reduced on average by 36 per cent, with each tariff line to be cut by a minimum of 15 per cent, in equal steps over the implementation period.

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<sup>23</sup> For a discussion of outcomes of the Uruguay Round agreement other than agriculture see Department of Foreign Affairs and Trade (1994a; 1994b; 1994c).

- All tariffs are to be bound.<sup>24</sup>
- In cases where, in the 1986-88 base period, imports were less than 3 per cent of domestic consumption, countries are required to open minimum access opportunities starting at 3 per cent and rising to 5 per cent at the end of the implementation period.
- A special safeguard provision applies which will allow the application of additional duties if a country faces an import surge or if the landed price of a particular consignment denominated in domestic currencies falls below the average price in the reference period.

Certain provisions were written into the agreement to provide special treatment for the Japanese and Korean rice markets. For example, Japan will only apply tariffication to its rice market after six years but must open up its market to provide 4 per cent initially, increasing to 8 per cent at the end of the implementation period (Department of Foreign Affairs and Trade 1994d). The special safeguard provision will allow additional tariffs above the scheduled levels if there is a surge in imports or if prices fall too low during the implementation period. This additional protection was demanded by the European Union from the outset as a way of protecting its internal market, especially in periods of exchange rate fluctuations. The rules concerning the operation of the special safeguards clause are complex but, in practice, they mean that in cases of major price declines the application of an additional import duty will work in much the same way as a variable levy (Swinbank and Tanner 1996, Ch. 7).

The elimination of non-tariff barriers and changes to the rules on market access will lead to greater transparency and increased security of access to particular markets. In short, agricultural commodity markets should become more predictable. The binding of virtually all agricultural tariffs in one round is a significant achievement when compared with the number of rounds needed to achieve the same result for manufactured products. The tariff bindings will ensure that the "slippage" in the tariff reductions which occurred in the Uruguay Round will not occur in subsequent rounds (Martin and Winters 1995a, p. 14). The act of binding all tariffs will have a liberalising effect, even if at the end of the implementation period the tariffs are bound above the levels applying in the reference period. Martin and Francois (1994) have shown that, because the binding of a tariff which was previously unbound prevents a country raising that tariff above the bound level, the range of the tariff is limited and its expected value is reduced. The tariff bindings will also affect the costs of protection (see Martin and Winters 1996).

The requirement for developed countries to reduce tariffs by 36 per cent (24 per cent for developing countries) by the end of the implementation period is unlikely to have the major

<sup>24</sup> It should be noted that this does not prevent a country using an applied rate which is lower than the bound rate (DFAT 1994d, p. 12).

impact on protection levels that the "headline" figure would suggest. This is for three main reasons. First, the base period, 1986-88, was a period of very low commodity prices which means that when tariff equivalents in the base period were calculated, they were automatically high compared to a more representative period. Second, in calculating tariff equivalents for non-tariff barriers in the base period most OECD countries, with the exception of Japan, were guilty of "dirty tariffification", that is, the newly calculated base-level tariffs provide even higher protection than the non-tariff barriers they replaced in the base period. Third, in respect of commodities not previously bound, many developing countries chose to offer ceiling bindings (arbitrarily chosen maximum levels) which were prohibitively high.

An extensive study undertaken by Ingco (1995) and reported in Hathaway and Ingco (1995) comparing the tariffs declared in country schedules (which form part of the Uruguay Round agreement) with the estimated tariff equivalents of border measures in 1986-88 indicates that dirty tariffification "appears to have occurred in the 'sensitive' commodities such as dairy, sugar and grains. The extent of the 'dirty' tariffification varied widely among countries and commodities. . . . the magnitude appears largest in the European Union and EFTA" (Ingco 1995, pp. 22-23). For the European Union, the largest differentials (in percentage points) were estimated for rice (207 per cent), dairy products (112 per cent) and sugar (63 per cent). The differential for wheat was estimated as 53 per cent. For the United States, the highest differentials were for sugar (66 per cent) and beef and veal (28 per cent) while Canada increased base tariffs relative to the actual 1986-88 levels by 207 per cent for poultry meat and 101 per cent for dairy products. Australia increased the level of protection afforded the sugar industry by 41 per cent (Ingco 1995, Tables 2a and 2b). As indicated previously, Japan offered base level equivalents significantly lower than the levels actually applying in 1986-88 but, nevertheless, extremely high. However, Japan did obtain special arrangements which delayed tariffification of rice imports.

As with the industrial countries, many developing countries offered very high base tariff levels in several major commodities although there were large variations between countries and commodities (Ingco 1995, Tables 2a and 2b). It will be recalled that developing countries had the option of establishing ceiling bindings on commodities not previously subject to bound tariffs. The establishment of these ceiling bindings significantly above current applied rates provides these countries with the flexibility to raise tariffs and to operate variable tariffs below the bound rate; this does not auger well for improving the stability of world commodity trade (Ingco 1995; Anderson 1995).

The combination of these three factors — the choice of base period, dirty tariffification and the use of ceiling bindings — has resulted in what Martin and Winters (1995b, p. xii) have termed "stratospheric levels" from which the reductions are to be measured. It is therefore not surprising that at the end of the implementation period, tariff levels will be higher than

those currently applied for most products in many countries. The major exceptions to this generalisation are Japan and the high income Asian countries where significant liberalisation will occur compared with either the long run or the more recent past (Hathaway and Ingco 1995, Tables 1a and 1b). If the commodity patterns in changes in protection are examined around the world, it would appear that border protection for sugar and dairy products was maintained or even increased whereas for oilseed products protection was reduced from already low levels. Thus, the "net effect of the tariff cutting exercise is probably to increase the distortions in protection between the highly protected items and those with low levels of protection" (Hathaway and Ingco 1995, p. 15). The operation of the special safeguard clause will have the effect of providing even higher levels of protection.

Those concerned with the Uruguay Round negotiations recognised from the outset that the tariff levels established by the tariffication process would be high, although few would have anticipated the final outcome (Hathaway and Ingco 1995, p. 16). The minimum access provisions were designed to offset the effects of the high tariffs and to provide minimum access through the use of tariff quotas. With the exception of rice, the minimum access provisions will have little impact on access to world commodity markets and the expansion in world trade is likely to be modest (see Hathaway and Ingco 1995, Table 4). This is because the provisions contain loopholes which countries have been able to exploit. For example, the European Union was able to count its current sugar imports from the African, Caribbean and Pacific (ACP) countries toward meeting its minimum access requirements and has maintained its allocation of sugar imports to the same countries as before the Uruguay Round agreement came into effect.<sup>25</sup> The new trade opportunities provided by the opening up of the Japanese and Korean rice markets are a significant improvement.<sup>26</sup>

The use of tariff quotas as the instrument to provide minimum access is a retrograde step because it will create quota rents which, for the most part, will be captured by the quota holders. These rents can be quite valuable. The Industry Commission (1994, p. 71) has estimated the quota rents in 1993 on access to the restricted US meat market at A\$1.40 per kilogram and, for the sheep and goat meat market in the European Union, at A\$1.00 per kilogram. Such rents will develop a constituency of quota holders who will be opposed, in the next GATT round, to any liberalisation of the markets which erodes the value of the quota rents.

<sup>25</sup> ACP countries which were former colonies of the EU member countries receive preferential access to the EU market at EU<sup>1</sup> market prices under the Lomé Convention.

<sup>26</sup> For a discussion of the change in market access for a wide range of commodities and markets see DFAT (1994d).

## Domestic Support

The Agreement on Agriculture requires countries to reduce support on trade-distorting domestic policies by reducing expenditure, over the six-year implementation period, by 20 per cent compared with the 1986-88 base using an Aggregate Measure of Support. The Dunkel proposals provided for the calculation to be undertaken on a product-by-product basis but the Blair House Accord weakened this provision by providing for an AMS calculated across the farm sector as a whole. This provision was retained in the final agreement and allows countries to make smaller reductions in more politically sensitive sectors. As previously noted, the Dunkel proposals which would have subjected the European Union's compensatory payments and the United States' deficiency payments to reduction, was vigorously resisted by the European farmers. This requirement was also renegotiated at Blair House and the EU compensatory payments and US deficiency payments "reclassified" into the green box of non-trade distorting measures exempt from reduction. The final agreement creates an incentive for governments to "divert" more of their support payments into these categories of support. Other policies which are excluded from reduction include genuine relief payments to farmers which have a minimal impact on trade such as disaster relief, research, disease control, environmental protection and food security.

The exemption of the European Union's compensatory payments whilst necessary for political acceptance of the agreement has seriously weakened the discipline imposed on the European Union. As Swinbank and Tanner (1996, Ch. 7) have observed, the inclusion of the European Union's area compensation and headage payments in the exempt category has a "magical impact" on the calculation of the AMS because the base period *includes* the old system of supporting cereal growers and livestock producers, whilst future area compensation and headage payments will be excluded from the calculations." The "credit" earned in the livestock and cereal sectors can thus be used to avoid reductions elsewhere. The temptation to extend compensatory payments to other sectors will be great, subject only to budget constraints and the adverse public reaction to newspaper reports of the magnitude of the payments received by wealthy farmers.

The final agreement on reducing domestic support is likely to have very little impact on limiting overproduction and falls far short of the original objectives of the Punta del Este Declaration. Notwithstanding, the agreement on domestic support is significant because, as pointed out by Hathaway and Ingco (1995, p. 22), "For the first time there is an official recognition of the fact that domestic subsidies can and do distort trade" and as "countries consider ways to assist their agricultural producers they are likely to move to those policies not subject to challenge as trade distorting."

## Export Subsidies

The Agreement on Agriculture has made significant progress in extending the GATT rules on subsidies to agricultural products. Although it proved politically impossible to phase out export subsidies completely, those countries which did not use export subsidies in the base period are prohibited from introducing them in the future while those countries that did cannot extend their use to any new commodities. Where export subsidies are used, expenditure on the subsidies is to be reduced by 36 per cent and the volume of *subsidised* exports is to be rolled back by 21 per cent, compared with the base period of 1986-90, during the six-year implementation period.

For developing countries, reduction commitments will be two-thirds of those rates. At Blair House it was agreed that additional flexibility should be built into the reductions to avoid the "front-end loading" problem which the Dunkel proposals imposed for some commodities. Where subsidised exports had increased during the Uruguay Round negotiations, countries could use the 1991-92 period as the starting point for the export subsidy reductions. The end point for the reduction commitments is the same irrespective of which base period is used. However, the amounts of subsidised exports which can be shipped by both the United States and the European Union during the implementation period are significantly increased if the 1991-92 base is used for commodities such as US and EU wheat and EU cheese. Although the flexibility in the starting point has weakened the impact of the reductions, the impact on world markets of the reductions is likely to be significant. The Department of Foreign Affairs and Trade (1994d, p. 16) has estimated that there will be "50 million tonnes less subsidised wheat and flour on world markets during the period 1995-2000 than if the current levels of export subsidies had been allowed to continue". The volumes of subsidised beef, cheese and rice exports can also be expected to decline significantly.

For the European Union, the volume constraint of 21 per cent is expected to be binding (which is why the French, in particular, were opposed to the Dunkel proposal of 24 per cent). For the United States, the expenditure constraint of 36 per cent is more likely to be binding unless world price levels rise significantly above those applying in the 1986-90 base period (Hathaway and Ingco 1995, p. 20). The final effect on trade and world prices of the reductions in export subsidies is complex and difficult to predict. For example, if the European Union were to lower its internal prices further and increase the levels of unconstrained compensation payments or if world prices were to rise (as has occurred recently for wheat), then what were subsidised exports would be able to continue in the future as unsubsidised (and unconstrained) exports. Enlargement of the European Union may allow the European Union to "internalise" some of their export sales. For example, the sugar import deficit of the three new member states — Austria, Sweden and Finland — if sourced entirely from within the Union will go a long way toward achieving the Union's required reduction in subsidised sugar exports (Swinbank and Tanner 1996, Ch. 8).

## The Impact on World Trade

Since the Uruguay Round was concluded in December 1993 a number of models has been used to assess the global impact of the Agreement on Agriculture, for example, Andrews, Roberts and Hester (1994), Goldin and van der Mensbrugghe (1995) and Francois, McDonald and Nordström (1995).<sup>27</sup> Whilst the numbers generated from these models vary according to the underlying assumptions, the reference scenarios used and data availability, the overall conclusion appears to be that the impact on world agricultural trade when the Uruguay Round's agricultural provisions have come into effect is likely to be modest. For some products prices are likely to rise but for others there will be little change or even falls. Using a reference scenario of 1982-93 to represent long-run levels of protection, Goldin and van der Mensbrugghe (1995, p. 36) posit that: "Viewed in the context of the instability and secular decline in world commodity prices, the predicted changes are barely significant," and go on to suggest that the "Uruguay Round is unlikely to have a discernible impact on world prices." Compared with the more recent and more highly protected reference scenario of 1989-93, Goldin and van der Mensbrugghe's (1995, Table 3) simulation suggests somewhat larger overall gains in prices but for some commodities (such as rice, wool and cotton) prices are still expected to decline. The magnitude of the predicted increases is still modest with the largest increase being 3.8 per cent for wheat.<sup>28</sup> In line with the smaller increases in predicted prices, estimates of the likely impact of the round on world welfare have also been revised downwards. Work of Goldin and van der Mensbrugghe (1995, Table 4) suggests that, using the 1989-93 reference scenario, annual world income will increase by some US\$48 million by early next century, with the major gains being experienced by the OECD countries followed by the high-income Asian region. The African region is expected to suffer a loss in income whilst the Latin American region and low income countries experience small gains. Their analysis incorporates the impact of manufacturing trade liberalisation as well as agricultural liberalisation but excludes trade in services and intellectual property.

The smaller increases in food prices now predicted go some way toward assuaging fears that the Uruguay Round would cause severe problems in net food importing countries. The minimal increases in staple foods are likely to have only a small impact on the cost of food imports and it is possible that the availability of food aid may even increase as a result of the Uruguay Round. The Agreement on Agriculture does little to reduce the incentives to producers to continue to expand output. With the constraints on the use of export subsidies likely to be binding, food aid will remain a convenient means of disposing of unwanted surpluses. It will be recalled that genuine food-aid shipments are exempt from the export subsidy constraints. Swinbank and Tanner (1996, Ch. 8) have argued that even if world

<sup>27</sup> For a useful survey of this modelling work see Martin and Winters (1996).

<sup>28</sup> For other scenarios and further discussion, see Goldin and van der Mensbrugghe (1995).

market prices increase, because of the binding constraints on export subsidies, the opportunity cost of maintaining current levels of food-aid shipments will not increase for the European Union and the United States. As the export constraints begin to bite, food-aid as a legitimate means of disposing of surplus stocks is likely to become more attractive and will continue to provide a safety net for many developing countries.

Those involved in attempting to quantify the outcome of the Uruguay Round are at pains to point out that their models capture "only a small part" of the potential welfare gains from the Uruguay Round agreement (Goldin and van der Mensbrugghe 1995, p. 41). For example, the models do not capture the benefits of establishing a rules-based system for agricultural trade and of better dispute settlement mechanisms. Also excluded are the benefits from improved predictability of trade and reduced commodity price instability expected to result from the replacement of non-tariff barriers with tariffs. The relationship between price instability on international markets and the use of domestic prices which provide stable domestic prices has been recognised since Johnson's (1975) seminal paper. Tyers and Anderson (1992, p. 225) have argued that world price volatility can be reduced by countries either liberalising their agricultural trade policies or by changing to policies which use only *non-insulating* instruments such as *ad valorem* tariffs and export taxes and subsidies. Their model (based on 1980-82 data) suggests that if such a change were implemented by industrial market economies alone, the volatility of international food prices would be reduced by a quarter. If all industrial and developing countries were to make the change, this "would reduce global food markets volatility by more than two-thirds." Whilst the Uruguay Round will clearly not lead to reductions in price volatility of such magnitude, the process of tariffication is an important first step. However, as already noted, the beneficial effects of tariffication have been dampened by the use of tariff quotas and the establishment of high ceiling tariffs by developing countries. This will allow such countries to provide additional protection for local producers in times of depressed world prices (Anderson 1995). Further, the export subsidy constraints do not limit the per unit rate of subsidy paid and therefore export subsidies are likely to remain variable. Thus prohibitively high tariffs, special safeguard provisions, import arrangements for cereals into the European Union and rice into Japan, and variable export subsidies will all continue to insulate domestic markets from world price movements (Swinbank and Tanner 1996, Ch. 8).

### **Lessons for the Next Round**

Although the Uruguay Round has been less successful in liberalising world agricultural trade than the United States and Cairns Group may have wished, in the longer run the round has the potential to deliver significant benefits because, for the first time, the GATT disciplines have been extended to the agricultural sector and the disruption to world markets caused by domestic support policies has been addressed in the GATT framework. The Uruguay Round has restored confidence in the multilateral system and demonstrated the on-going importance

of the multilateral negotiations as a forum for trade liberalisation. How was this outcome achieved and how can the experience acquired during the Uruguay Round be used to provide a better basis for the next round?

There is now general agreement by political observers that the inclusion of agriculture as a key issue on the Uruguay Round agenda was largely due to US efforts, albeit strongly supported by the Cairns Group. Paarlberg (1993, p. 41) has argued that, having been unsuccessful in reforming American farm policy in the 1981 and 1985 Farm Bills, US officials "sensed an opportunity to pursue their domestic objective of farm policy reform at home through an international negotiation abroad." As noted previously, "internationalising" the reform effort would have the effect of limiting the influence of the powerful American farm lobby group and "sharing the pain" of farm policy reform (see Paarlberg 1993, p. 43). The key American negotiators at the time the Uruguay Round commenced — Clayton Yeutter, the US trade representative, and Daniel Amstutz, the under-secretary of agriculture responsible for international trade and domestic programmes — believed that once they got the discussion of farm policy reform into the GATT area they would be able to strike a deal with "reform-minded trade officials" from the European Community and Japan who were also concerned about the escalating cost of agricultural support (Paarlberg 1993, p. 44). As well as limiting the influence of the farm sector on the final outcome, the international framework makes it possible to trade off gains and losses between sectors, making ratification of the final agreement more likely. As observed by Putnam (1988, p. 446), given some flexibility, international negotiators will sometimes agree to a package of policies some of which are individually unacceptable domestically but which collectively cannot be rejected because major benefits to other sectors would be lost. For example, it is easier to get France to agree to a package which includes agricultural policy reform if rejecting the package would mean losing the benefits of the other negotiations on services, investment and intellectual property rights. For trade negotiations, the US "fast-track" procedure is biased toward ratification and in the European Community endorsement of the final agreement comes not from the Council of Agriculture Ministers but from the Council of Foreign Ministers (Moyer and Josling 1990, p. 175; Moyer 1993).

The strategy of internationalising domestic policy reform, known as a "two-level game", can be used as a strategy in international negotiations (Putnam 1988). However, in this instance, it was not particularly effective. What support there was in the European Community for a GATT-brokered reform package quickly waned and, as observed by Paarlberg (1993, p. 45), US officials "never really found enough like-minded counterparts in the European Community and Japan with whom they could play this game." The initial US offer — the zero option — can now be seen as far too ambitious and a serious misjudgment on the part of the US officials. It did not provide enough flexibility to be taken seriously by the EC and Japanese negotiators. Not surprisingly little progress was made in the Negotiating Group on

Agriculture in the early years and agriculture was the cause of the impasse at Montreal in December 1988 and the breakdown in negotiations in December 1990 at Brussels. Even though at the time of the Brussels meeting the more pragmatic Bush administration had backed away from the zero option, the key participants did not have a sufficient understanding of the negotiating positions of the other participants. It will be recalled that, because of the complexity of EC decision making, the European Community had extreme difficulty developing its negotiating mandate prior to the Brussels meeting and very little flexibility to manoeuvre within the negotiations. Studies such as those by Paarlberg (1993), Moyer and Josling (1990), Moyer (1993) and Rapkin and George (1993) will undoubtedly assist in developing a better understanding for the next round, particularly, of the complexity encountered by the European Union and Japan in conducting such negotiations.

It seems unlikely that the radical reform of the CAP embodied in the Mac Sharry reforms would have occurred without the influence of the GATT round. Although denied by the European Commission at the time, the reforms were clearly an attempt by the European Community to reform the CAP so that some concessions could be made to the demands of the United States and the Cairns Group. To the extent that the Uruguay Round provided the catalyst for the Mac Sharry reforms, it could be argued that multilateral trade negotiations can be used to stimulate domestic policy reform.<sup>29</sup> The opening of the Japanese rice markets to imports is a clear example of the use of the international framework to achieve a result which could not be obtained through domestic reform.

In the next round it is vital that the momentum for liberalisation be maintained. With respect to further reductions in tariffs and expenditure on domestic support and export subsidies, this implies reductions of 50 per cent, 25 per cent and 50 per cent, respectively over the implementation period (see Swinbank and Tanner 1996, Table 8.3). In the subsequent round it would then be possible to eliminate totally or to reduce to very low levels the use of tariffs and export subsidies by developed countries. It would be unrealistic, given the influence of the farm lobby groups, to envisage domestic support being totally eliminated but some reduction may be possible.

The use of tariff quotas should also be reviewed in the next round with a view to their eventual elimination. If tariff quotas are increased and at the same time the MFN tariff rate falls, the value of the quotas will be eroded. The special safeguards provisions should also be reduced and the reference period revised to make it more relevant to trading conditions at the time. Another contentious issue, on which the Cairns Group should lobby, is for the reclassification of the United States' deficiency payments and the European Union's compensatory payments into the "amber box". Their exemption from reduction in the Uruguay Round was a necessary political compromise to reach agreement on an agricultural

<sup>29</sup> In a game theory framework the Mac Sharry reforms can be seen as widening the European Community's win set.

package. There is now far greater awareness of the budget costs of agricultural support and the excessive payments being made to wealthy US and EU farmers than when the Uruguay Round commenced. Public opinion may well create a political environment which is less sympathetic to the farm lobby. Irrespective of what happens in the next round of GATT negotiations, the European Union will need to take a hard look at the CAP and, in particular, the use of compensatory payments in preparation for the likely expansion to include Central and Eastern European countries.

Hathaway and Ingeo (1995, p. 19) argue that one of the most serious barriers to agricultural trade — the use of state trading agencies — was not adequately addressed by the Uruguay Round and should be on the agenda for the next round. State trading agencies or state-controlled monopoly trading agencies have the potential to cause serious disruption to trade by selling imports well above (in the case of Japan) or well below the world price (in the case of some developing countries which are subsidising consumers). Prior to the Uruguay Round, Article XVII of the GATT established rules requiring state trading agencies to act in a non-discriminatory manner and to follow commercial practices. However, as noted by Hathaway and Ingeo (1995, p. 19), "they have never been enforced and are probably unenforceable." The Uruguay Round does not restrain a country's use of state trading agencies, all that is required is an annual report. With a number of former centrally planned countries having already joined the GATT and others, including China, seeking membership, the role of state trading agencies will become more important.

### Concluding Comment

Although the immediate impact of the Agreement on Agriculture on world agricultural trade is likely to be modest compared with earlier expectations, it would be wrong to dismiss the outcome as disappointing. The Uruguay Round will provide significant longer term benefits to agricultural trade through the extension of the GATT rules-based system to agriculture. The elimination of non-tariff barriers will increase the transparency and improve the conduct of agricultural trade. The binding of tariffs which is now in place should eliminate the problem of slippage — so evident in the Uruguay Round — in future negotiation rounds. For the first time countries have been willing to acknowledge and to some extent limit the effects that domestic policy has on world agricultural markets.

The framework which has been laid down in the Uruguay Round should provide a sound basis for future negotiations and for further reductions in tariff levels and domestic agricultural support. However, the difficulties encountered in gaining agreement in the Negotiating Group on Agriculture in the past two rounds does not auger well, if in any subsequent round, agriculture is considered in isolation.<sup>30</sup> Unless there are opportunities to

<sup>30</sup> The Agreement on Agriculture provides for another round of agricultural negotiations to commence in 1999 but it has not yet been decided what else will be on the agenda.

offset losses in agriculture with gains in other sectors, countries such as Australia which are committed to liberalising agricultural trade may need to revise their strategy if they are to capitalise on the progress made in the Uruguay Round. By their very nature multinational trade negotiations depend upon consensus. Within this consensus framework, the pace of change is determined by the extent to which the most recalcitrant participant is prepared to proceed. This is apparent in the Uruguay Round where the imprint of the European Union's domestic reforms is clearly stamped on the final agricultural outcome. This principle of the coincidence of domestic and international reforms means that progress in the next round will depend on the domestic pressures for reform — political and economic — in the key participating countries.

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