THE EUROPEAN UNION PERSPECTIVE ON AGRICULTURAL TRADE LIBERALIZATION IN THE WTO

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Preface

The Department of Agricultural Economics and Business has a long history of providing information to stakeholders on trade policy issues. In July 1989 the department published the results of a symposium "Agriculture in the Uruguay Round of GATT Negotiations" and in 1990 the results of a follow-up symposium "Agriculture in the Uruguay Round: The Final Stages" were published. As it transpired the title of the 1990 symposium was somewhat optimistic because the Uruguay Round of trade negotiations were not completed until December 1993 and not implemented until January 1, 1995. In 1996, the department again co-hosted a symposium focused on trade issues entitled "The Road-Ahead Trade Policy Conference."

The paper presented by Dr. Stefan Tangermann "The European Union Perspective on Agricultural Trade Liberalization in the WTO" represents the latest effort by the Department of Agricultural Economics and Business to provide information on important trade policy issues. New multilateral trade negotiations are scheduled to begin in late 1999. It is perhaps an overstatement to say that the views of the European Union and the United States will determine the outcome of these negotiations, but there is no doubt that there will be no deal these two agrifood superpowers do not find acceptable. For that reason, the current negotiations in the European Union on domestic agricultural reform are crucial. As Professor Tangermann notes, the European Union's room to negotiate multilaterally will largely be determined in the next few months.

Professor Tangermann's seminar was presented in Guelph on January 29, 1999 and simultaneously viewed via video conference in Ottawa, Quebec City, Regina, Saskatoon and Winnipeg. The seminar would not have been possible without the financial support of the Donner Canadian Foundation. I would like to thank Sid Friesen for his help in organizing the seminar and the Ontario Ministry of Agriculture, Food and Rural Affairs for agreeing to include Professor Tangermann's presentation in their excellent series of trade policy seminars. The seminar also represents the first formal activity of the newly formed Canadian Agricultural Trade Policy Research Network, a joint research and training program being conducted by the University of Guelph, University of Saskatchewan and Laval University.

Special thanks are due Martin Rice, Canadian Pork Council and Peter Gould, Dairy Farmer's of Ontario for putting their discussion comments in writing for inclusion with Professor Tangermann's paper.

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About the Author

Dr. Stefan Tangermann is Professor of agricultural economics at the University of Göettingen, Germany. Professor Tangermann is an expert in international agricultural trade issues, including the treatment of agriculture in the World Trade Organization, European Union agricultural market and trade policies, and agricultural developments in Central Europe. Following the completion of the Uruguay Round of trade negotiations, Professor Tangermann co-authored "Agriculture in the GATT" a definitive history of the treatment of agriculture over 50 years of multilateral trade negotiations.*

Professor Tangermann has a Ph.D. in economics from the University of Göettingen. Since joining the faculty of the University of Göettingen in 1980 Professor Tangermann has served as Director, Institute of Agricultural Economics; Dean, Faculty of Agriculture; and as Vice-President.

Professor Tangermann has made his expertise available to various international institutions, including the OECD, World Bank, EU-Commission, European Parliament, US-AID, UNCTAD and the Council on Foreign Relations.

In 1998, Professor Tangermann was granted the Jean Monnet Chair for European Agricultural Policies by the European Commission.

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* Josling, T.E., S. Tangermann and T.K. Warley. 1996. Agriculture in the GATT. New York: St. Martin's Press.

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1.0 Introduction

One of the major achievements of the Uruguay Round Agreement on Agriculture was the resolve to continue the process of agricultural policy reform beyond the current implementation period of the Agreement. The next round of agricultural negotiations has to be initiated in 1999, and the decision has been taken to launch the next round of talks in December 1999 at the WTO Ministerial Conference in the United States.

In the Uruguay Round negotiations on agriculture, the EU was one of the most difficult negotiating partners. Indeed, at one stage during the negotiations, EU resistance to reform of the international trading order for agriculture and the implied need for changes in its Common Agricultural Policy (CAP) threatened the completion of the Uruguay Round. Is the EU going to be a similarly difficult negotiating partner in the next round of WTO talks on agriculture? This is the question this paper attempts to discuss.

It should be noted that a definite answer to this question cannot be provided. A number of EU politicians have publicly commented on the next round of WTO talks on agriculture, most recently the trade Commissioner Sir Leon Brittan (1999). However, the EU is far from having defined anything like an official position on the next round of the WTO negotiations on agriculture. Indeed, as will be argued below, it can not do so in the absence of a decision on the next round of CAP reform as proposed by the European Commission under Agenda 2000. Decisions in the Council of Ministers on this package of proposals for the future of the European Union in the face of the impending Eastern enlargement of the EU will not be taken before March 1999. Even then it will take the EU some time to develop its approach to the next round.

Given the lack of an official EU negotiating position for the next round of WTO talks, one can only speculate about the approach the EU may adopt when these talks begin. Academics like this author love to engage in such speculations, but they cannot predict political decisions because they are inherently unpredictable. This said, the present paper will try to outline at least some elements of the EU position for the next round of WTO negotiations on agriculture, under alternative outcomes of the ongoing domestic EU debate about Agenda 2000. It concentrates on the more fundamental issues involved in the WTO Agreement on Agriculture, but will not comment on current agricultural disputes in the WTO involving the EU, such as the dispute on beef hormones and bananas.

The paper begins with a brief look at the historical relationship between the CAP and the GATT (Section 2). Section 3 then discusses the extent to which the EU's current WTO commitments in agriculture constrain the CAP. This lays the foundation for a discussion on the relationship between Agenda 2000 and the EU's position in the next round of WTO talks (Section 4). Some specific negotiating issues that will be of interest to the EU in the next round are considered in Section 5, before a few brief comments are made on the potential for partnership or conflict between Canada and the EU in the negotiations on agriculture.

2.0 The European Union's Common Agricultural Policy and the GATT

The European Union's CAP has been considered as the epitome of an agricultural policy that is largely insensitive to international influences and obligations. When the newly created European Community began to establish its Common Agricultural Policy in the early 1960s, it soon became obvious that the EC was in the process of embarking on an agricultural trading regime which was likely to be difficult to control under the GATT because it was not based on bound tariffs. Moreover, even though Europe was not a major agricultural exporter at the time, its market regimes provided for the possibility of subsidizing agricultural exports if surpluses were to emerge. It would have been surprising had the United States and other agricultural exporters greeted these prospects enthusiastically. However, in times of the cold war and an emerging European alliance, foreign policy considerations prevailed, and the European Community went away from the Dillon Round with essentially no constraints imposed on its potentially highly distortive CAP. Later GATT rounds did not fundamentally change that situation.[1]

The Community's trading partners and competitors were not exactly happy with this state of affairs, and at the political level they complained bitterly. However, in the GATT no fundamental attack was launched against EC agricultural trade measures which would have successfully shaken the foundations of the CAP (Tangermann 1993, Josling, Tangermann and Josling 1996). Of the many complaints that were raised against EC trade policies in agriculture, most were targeted on peripheral aspects of EC agricultural market regimes. Where complaints related to more fundamental issues, they were either unsuccessful in the sense that the panel found the EC measure not

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1 For a detailed account of the history of the GATT negotiations on agriculture, including the evolution of the CAP in that framework, see Josling, Tangermann and Warley (1996).

inconsistent with GATT rules, or only marginally successful in the sense that panel reports were inconclusive and the complaints led to only minor technical modifications of EC measures. In other words, hardly any of the GATT complaints against EC agricultural policies changed the course of events under the CAP. The only exception was the two GATT disputes on the EU oilseed regime in 1989 and 1991. As a result of these disputes, the EC significantly modified its oilseeds policy in 1991, and the way in which it did so turned out to become a model for the reform of the CAP in 1992. However, important as the oilseeds case was, ironically it related to an anomaly of the CAP, i.e. a market regime with domestic subsidies instead of the infamous variable levies and export restitutions used in other CAP market regimes.

In summary, before the Uruguay Round the CAP could be pursued as EC agricultural policy makers saw fit from a purely domestic point of view. The GATT did not impose any major constraints on the Community's agricultural market and trade regime. However, in other countries the situation was not much different. GATT rules for agriculture were weak, and governments around the world had found all sorts of ways to circumvent even these weak rules (Josling, Tangermann and Warley 1996). This is why a completely different approach to dealing with agriculture had to be tried in the Uruguay Round.

And how successful the Uruguay Round was! Quite apart from the general impact of the Uruguay Round Agreement on Agriculture in terms of bringing order to international agricultural trade, the Uruguay Round was the first time that the GATT had a noticeable effect on the CAP. Indeed, it triggered the first real reform of that policy. When it turned out that the EU was unable to accept commitments on agriculture that were in any way meaningful to its major negotiating partners, above all the United States and the Cairns Group, EU Commissioner for agriculture Ray MacSharry managed to push through a fundamental reform of the CAP in 1992. How different this reform was from any previous attempts at changing that policy is obvious from the fact that this was the first reform which did not focus on budget savings, but actually raised budgetary expenditures on the CAP. This was an implication of the new direct payments introduced in order to compensate farmers for the income effects of the large cuts in support prices that were achieved under that reform. At the same time, the MacSharry reform was the first case where support prices under the CAP were reduced significantly. At the time, any relationship between the domestic reform of the CAP and the ongoing negotiations in the Uruguay Round were strongly denied by EU agricultural policy makers. However, there is no doubt that the MacSharry reform was a direct response to the difficulties the EU had in the GATT negotiations (Coleman and Tangermann 1998, Tangermann 1998).

3.0 The Significance of the European Union's WTO Commitments in Agriculture

After the MacSharry reform had been successfully arranged by the European Commission, the European Union was ready to accept meaningful commitments in the Uruguay Round. In a way it can be argued that there was a two-way relationship between internal agricultural policy reform in the EU and the GATT negotiations. The MacSharry reform was triggered by the Uruguay Round, and the Uruguay Round was saved from breakdown by the MacSharry reform. When the arrangements for agriculture that might result from the Uruguay Round negotiations were debated in the EU, during the last phase of the GATT negotiations and after the Blair House Accord, it was natural for the European Commission to argue that the GATT arrangements were fully consistent with the expected results of the MacSharry reform and would not require any additional policy changes in the EU. In retrospect, it is clear that this was not really the case (though it is less clear whether the Commission did or could know this at the time). However, the extent to which the EU's WTO commitments require further adjustments in the CAP differs among the major areas of the WTO arrangements for agriculture.

As far as **market access** is concerned, the commitments of the EU (like those of most other countries) have turned out to be rather generous. The reason is a combination of dirty tariffication, the special safeguard provisions, specific EU arrangements for tariffication, policy changes after the base period and preferential trading agreements with third countries. Only some of these factors are discussed here, and then for only selected products (for more detail, see Tangermann et al. 1997).

In the cereals sector, the price cuts brought about by the MacSharry reform have greatly reduced the level of tariffs required in the EU to protect the intended level of price support. The EU has, responding to pressure from its negotiating partners, agreed not to use the full level of tariff bindings, but to limit the level of applied tariffs so that the duty-included price of imported cereals is no higher than 155 percent of the EU intervention price.[2] The EU therefore cannot make use of its full level of tariff bindings,

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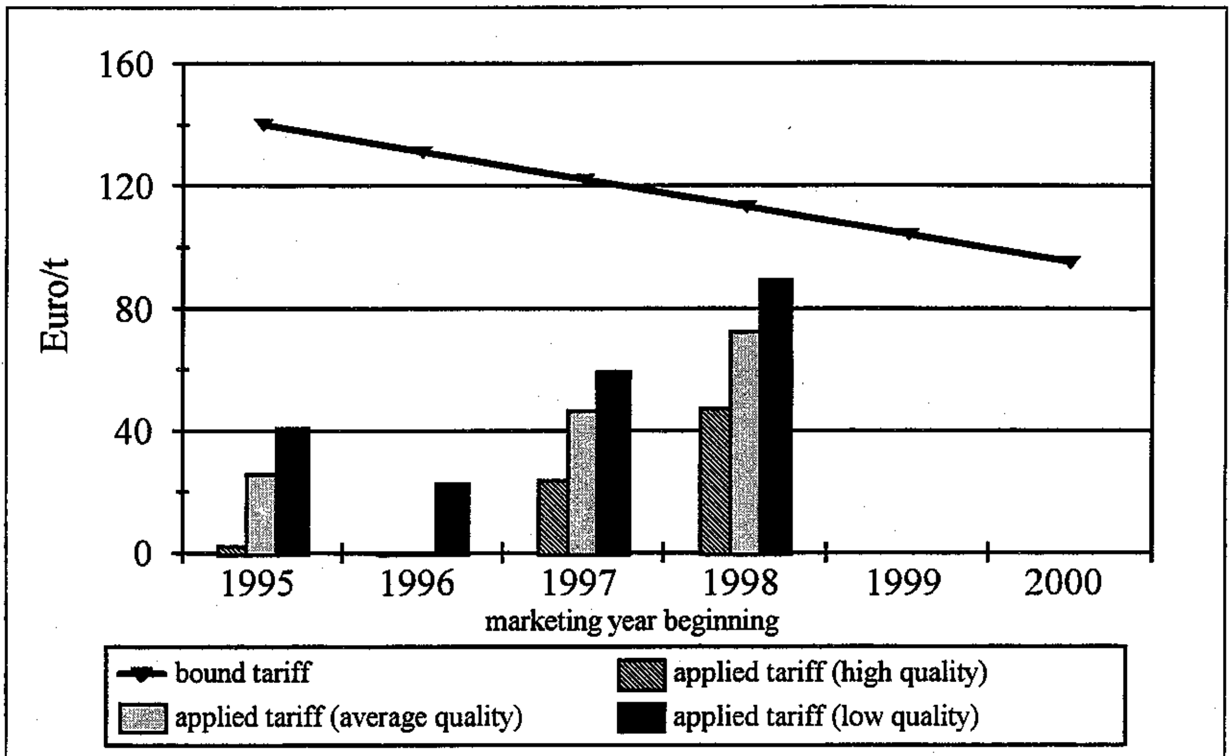
[2] The percentage of 155 resulted from the traditional ratio between threshold prices and intervention prices in the EU cereals sector.

unless the world price is rather low.[3] Initially, the EU's tariff bindings in the cereal sector looked as if they would not constrain the intended level of protection, at least for quite some time. This was certainly the case in the first years of the implementation period under the Agreement on Agriculture, because world market prices for cereals were so high that the EU did not need to, and under the 155 percent clause could not, charge higher tariffs on cereal imports. However, with the recent decline in world prices for cereals, and given the reductions in tariff bindings over time, the water that was contained in the EU's tariff bindings for cereals has, to a large extent, already evaporated. For wheat this is illustrated in Figure 1. In this graph, the tariffs actually applied by the EU, under the 155 percent rule, at the beginning of recent crop years (July 1) are compared with the EU's tariff binding for wheat. As the EU intervention price applies equally to all wheat qualities, the 155 percent rule means that the EU applies higher tariffs to low quality wheat than to high quality wheat. As shown in this graph, the tariff actually applied to low quality wheat in 1998 was not much less than the EU's tariff binding for the year 2000. In other words, if world market prices remain as low as they were in 1998, then most of the water in the EU tariff (on low quality wheat) will soon have evaporated. To be sure, the EU does not need a "safety margin" of 55 percent above its intervention price, and hence some further tariff reductions will not create major difficulties. However, the EU tariff binding on wheat no longer looks quite as generous as it did at the close of the Uruguay Round. In the case of barley, the EU tariff now contains even less water than in the case of low quality wheat (Figure 2).

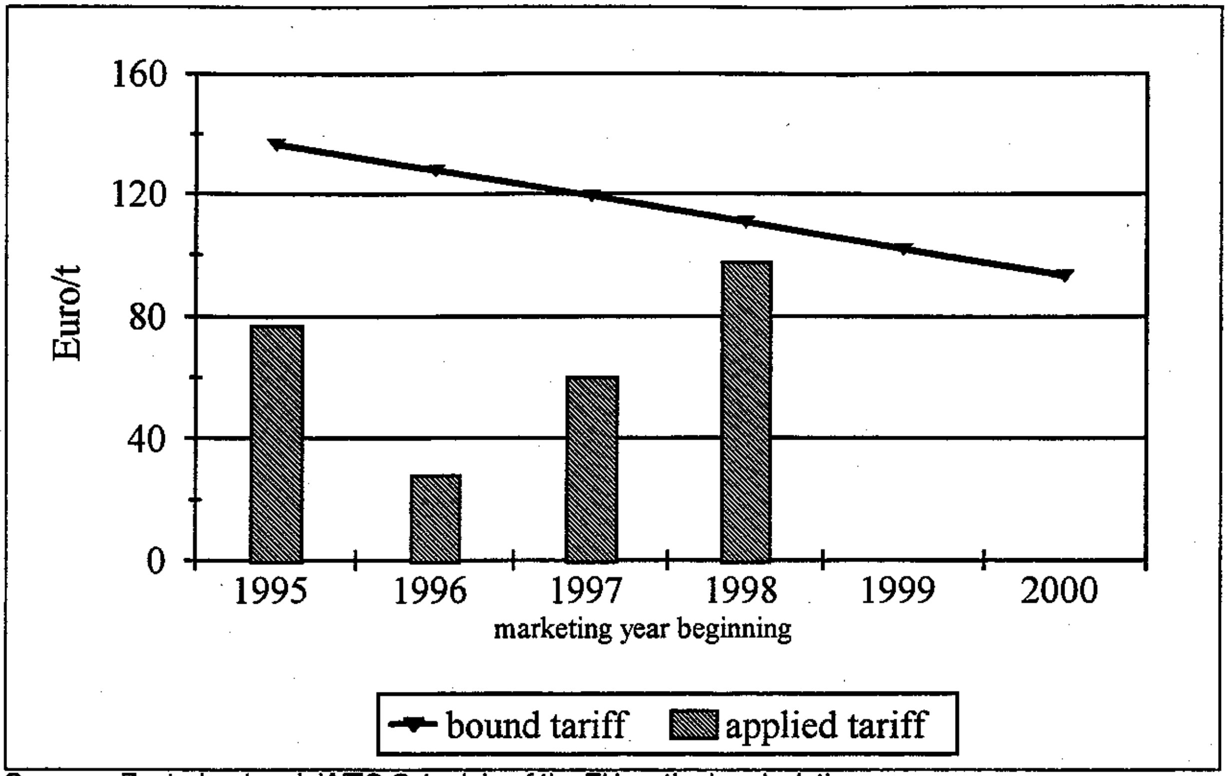
3 For an analysis of EU tariffication in the cereals sector, see Josling and Tangermann (1995).

Figure 1: Wheat Tariffs in the EU: Tariffs Applied and Tariff Binding



Source: Zentralverband, WTO Schedule of the EU, author's calculations

Figure 2: Barley Tariffs in the EU: Tariff Applied and Tariff Binding



Source: Zentralverband, WTO Schedule of the EU, author's calculations

For other products it is difficult to provide similar information, because the institutional arrangements are different and because, in some cases, there are almost no imports into the EU. This makes it difficult to obtain current cif prices. What can be done is to compare EU export subsidies with EU tariff bindings. As fob prices are probably below cif prices, export subsidies are probably higher than the tariff required to defend the actual level of domestic EU prices. On the other hand, if the EU wants some "safety margin" above its intervention price level, then the tariff required for that is probably of the same order of magnitude as the export subsidy actually granted.[4] Hence comparing export subsidies with tariff bindings should provide some insight into the amount of water that is still contained in EU tariff bindings. Results are presented for only two dairy products, butter and skim milk powder (Figures 3 and 4). In the case of butter, there is not very much water in EU tariffs under recent world market conditions. For skim milk powder, the EU tariff binding still provides a rather comfortable margin of maneuver.

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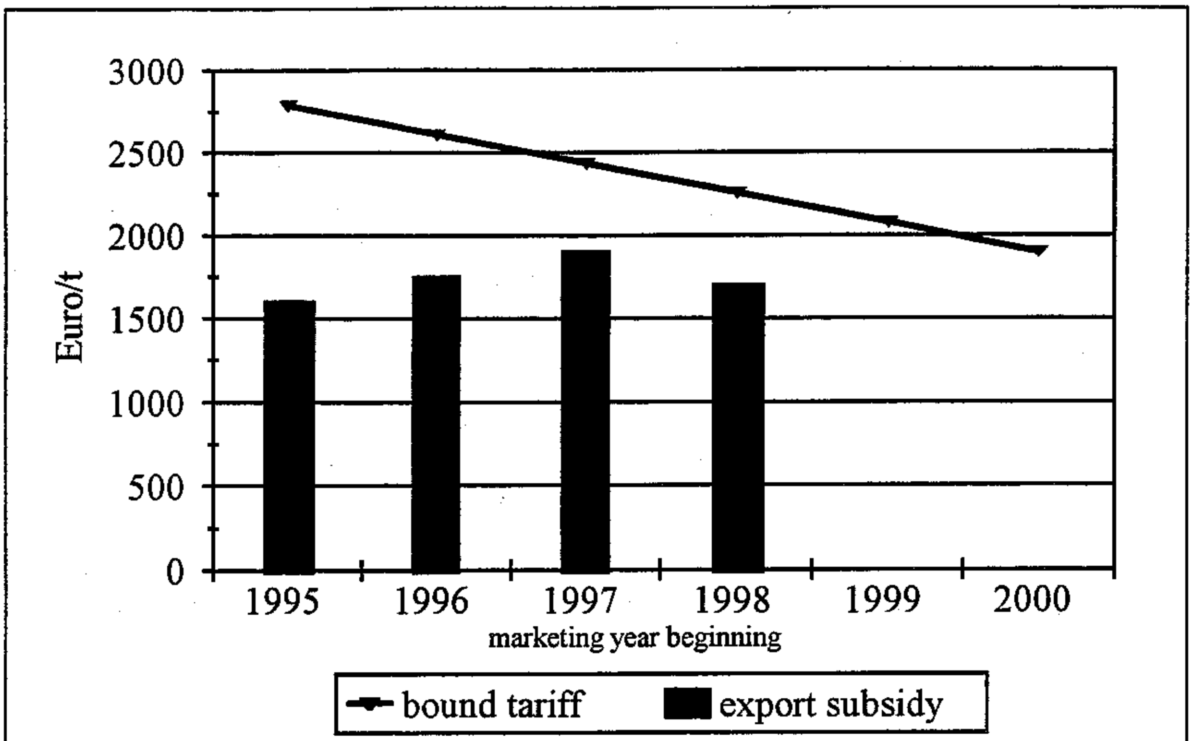
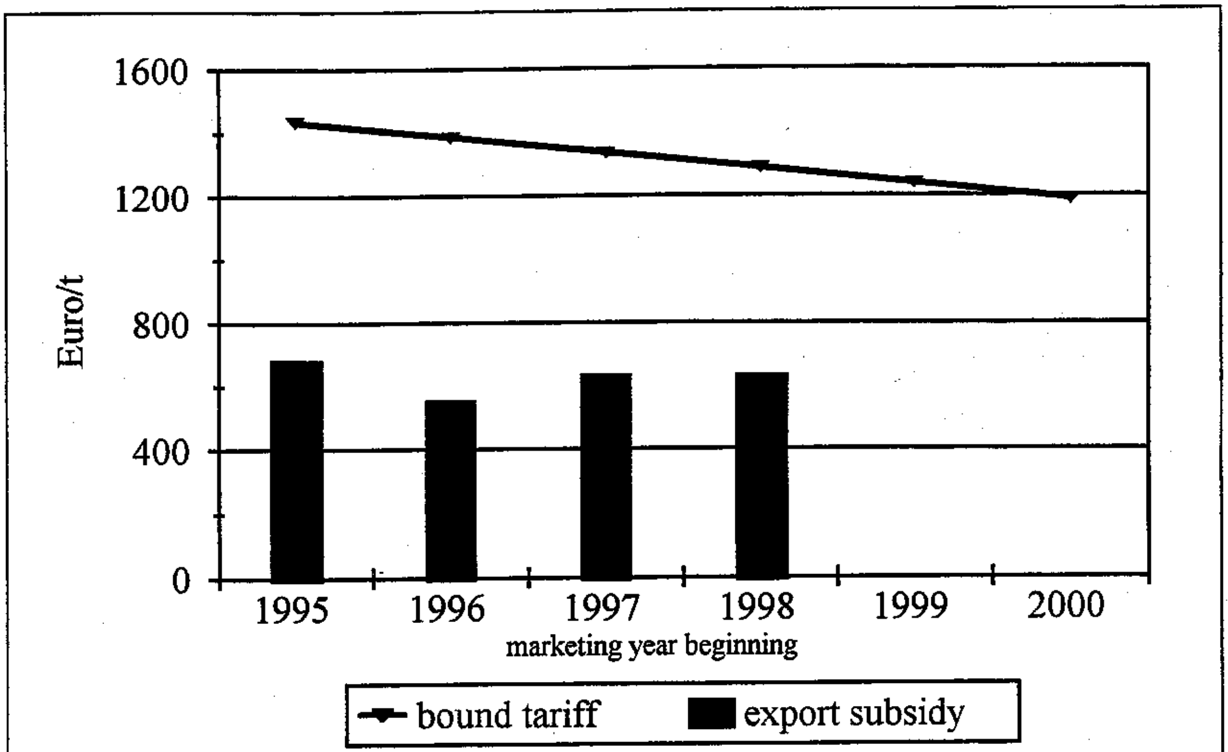
4 In order to guard against circular trade flows (subsidized exports flowing back into the EU market) it is advisable to set the import tariff above the export subsidy.

Figure 3: EU Butter Tariff: Export Subsidy versus Tariff Binding



Source: ZMP, WTO Schedule of the EU, author's calculations

Figure 4: EU Tariff on Skim Milk Powder: Export Subsidy versus Tariff Binding



Source: ZMP, WTO Schedule of the EU, author's calculations

In the area of **domestic support**, the WTO commitments of the EU are even less restrictive than for market access. For the marketing year 1995/96 the EU has notified a current total aggregate measure of support (AMS) of ECU 47.5 billion, while the AMS commitment level of the EU for that year stood at ECU 78.7 billion (WTO Committee on Agriculture 1998a).[5] Consequently, 40 per cent of the EU's commitment on domestic support went unused, or alternatively, the EU could have provided two-thirds more than it actually did in domestic support to its farmers without violating its WTO commitments in this area. Of course, this is a direct result of the combination of the MacSharry reform and the blue box arrangements. The substitution of direct payments for price supports in the MacSharry reform has reduced the countable level of domestic support in the EU. The blue box allows the EU to exclude the new direct payments from the calculation of its current total AMS.

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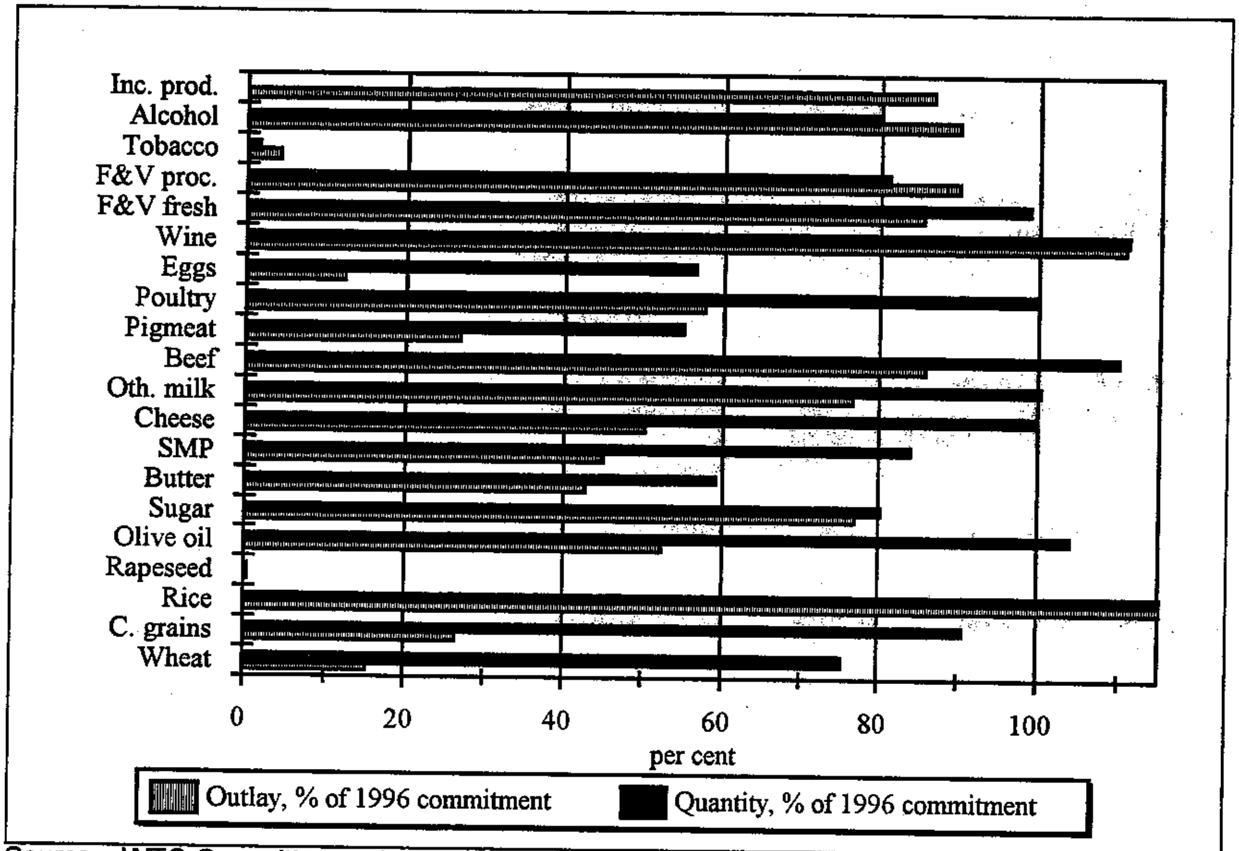
5 The only year for which the EU has notified its domestic support to the WTO is 1995/96.

It is only in the area of **export subsidies** that the new WTO commitments of the EU have begun to bite, or will bite soon. This is exactly what was expected by some negotiators during the Uruguay Round. It is also what some observers and stakeholders in the EU feared during the last phase of the negotiations, although the EU Commission, at the time, argued that the MacSharry reforms would allow the EU to live comfortably with the new constraints on export subsidization. As a matter of fact, in the first year of the implementation period the EU did not have any difficulty with its new commitments on export subsidies. In the cereals sector, the extremely high world market prices in parts of 1995 and 1996 allowed the EU to export cereals without subsidies, and at times to impose an export tax.

However, by the second year (crop year 1996/97, the most recent year for which the EU has so far notified export subsidies to the WTO) the quantity of agricultural goods exported with subsidies from the European Union was above the basic EU commitment for that year in the case of four products, and in two of these cases outlays on export subsidies also exceed the basic commitment (Figure 5). The products concerned are olive oil and beef (quantity only), and rice and wine (both quantity and outlay). Of course, as the EU is always meticulously anxious to honor its GATT/WTO obligations and commitments, there was, in the eyes of the EU, a good legal reason for exceeding its export subsidy commitments in 1996/97; namely, the "credit" resulting from the under-utilization of EU export subsidy commitments for the products concerned in 1995/96. Irrespective of the legal merits of this view (which on the surface appear rather convincing, given the wording of Article 9 in the Agreement on Agriculture), the implication of this experience with the EU's export subsidies in 1996/97 is that adjustments will have to be made in the years to come, at least for the four products concerned. At some stage, all of the "credit", if it is considered legally valid, will have been consumed. More importantly, in the final year of the implementation period under the UR Agreement on Agriculture, i.e. in the year 2000, no "credit" can be used, and both quantities of subsidized exports and export subsidy outlays will have to remain within the constraints of the EU's commitments.

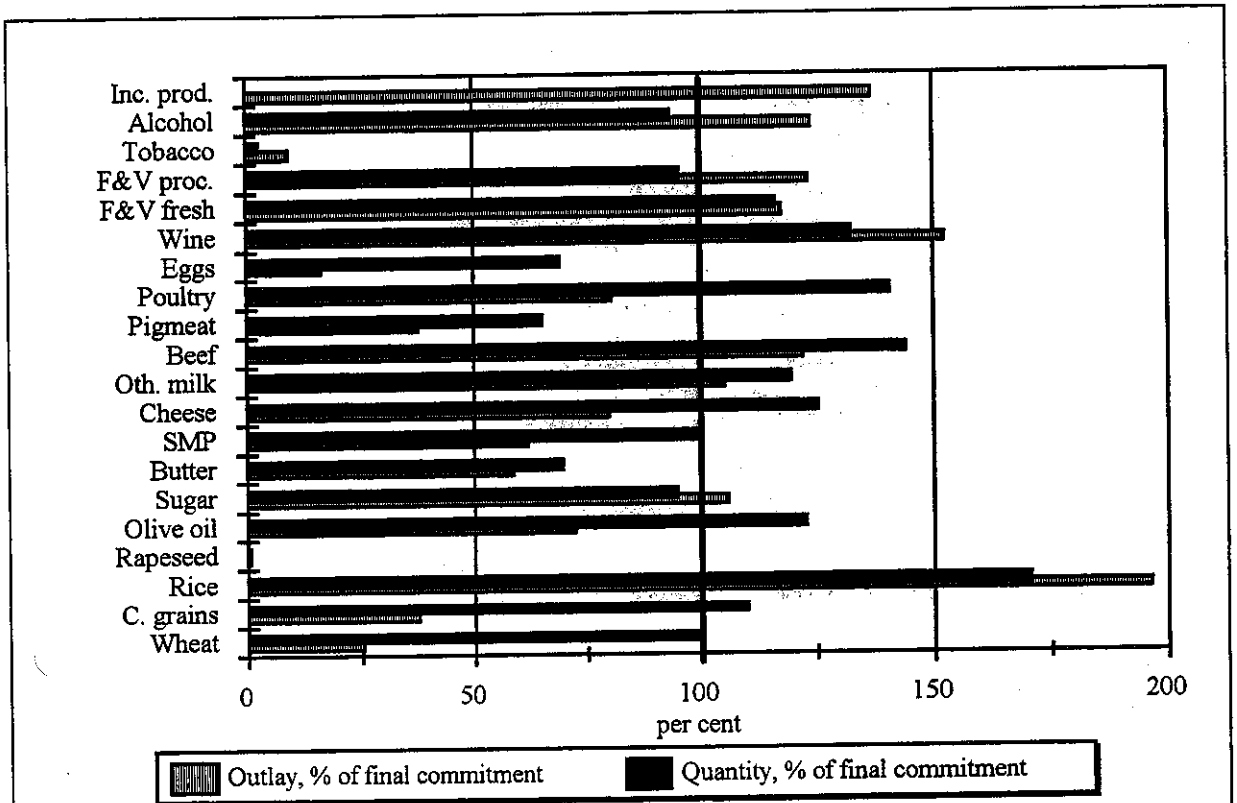
Figure 5: EU Subsidized Exports in 1996/97, Percent of Commitments for 1996



Source: WTO Committee on Agriculture (1998b), author's calculations

Indeed, as the quantities and outlays under export subsidy commitments decline over time, adjustments in EU market regimes will have to be made, not only for the four products which exceeded basic commitments in 1995/96 but for a significant number of other products as well. This is obvious in comparing actual subsidized exports and subsidy outlays in 1996/97 with the EU's commitments for the year 2000 (Figure 6). Wherever current EU export subsidies or, more precisely, EU export subsidies in 1996/97, do not fit into commitments for the year 2000, the EU will have to find a way of restraining subsidized exports in the very near future. The deepest cuts will have to be made for rice, where actual 1996/97 exports with subsidies will have to be reduced by 40 percent (and outlay by 50 per cent) in order to fit into commitments for 2000. Both beef and poultry exports with subsidies will have to be decreased by around 30 percent from 1996/97 volumes before they are consistent with commitments for 2000. For dairy products, butter is not a problem for the EU, and subsidized exports of skim milk powder can be maintained at their 1996/97 level. However, the EU's subsidized exports of cheese have to be brought down by 20 percent, and those of other dairy products by 16 percent from actual 1996/97 levels in order to keep them within the constraints resulting from the EU's WTO commitments. Reductions will also have to be made in subsidized exports of fresh and processed fruit and vegetables.

Figure 6: EU Subsidized Exports in 1996/97, Percent of Commitments for 2000



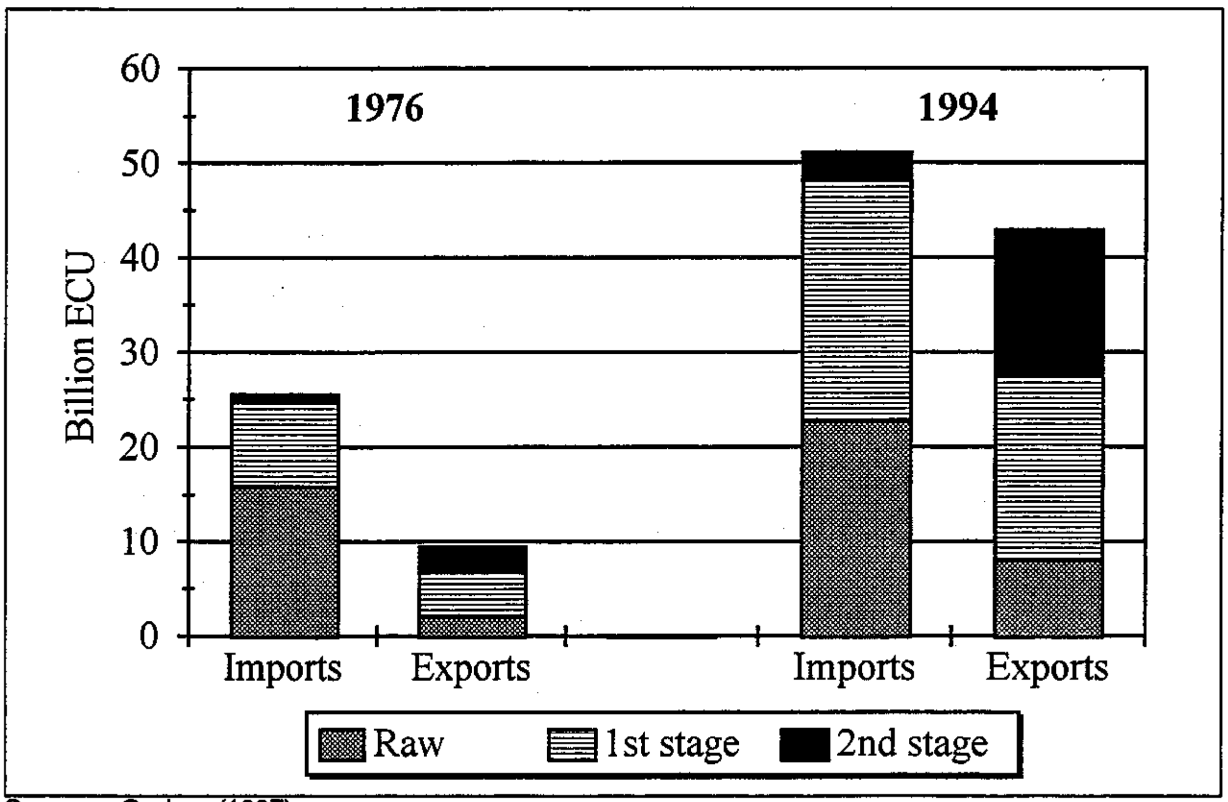
Source: WTO Committee on Agriculture (1998b), WTO Schedule of the EU, author's calculations

Noteworthy also are the required reductions in export subsidy expenditures on "incorporated products", i.e. agricultural commodities incorporated in highly processed foods, by more than one-quarter from 1996/97 levels.[6] The reductions that have to be made in this particular sector are about to create a new group of critics of price support under the CAP, i.e. the EU food industry. In the past, the food industry was, by and large, neutral vis-à-vis the CAP as the higher prices it had to pay for its raw materials, as a result of agricultural price support in the EU, were compensated through equivalent

6 In CAP jargon, these are the so-called Non-Annex-II products.

import levies and export subsidies for processed foods.[7] In spite of its high prices for agricultural raw materials, Europe was therefore able to expand its exports of processed foods significantly in the sectors of both lightly processed (first stage) and highly processed (second stage) products (Figure 7). Of course this also meant a large increase in subsidized exports of processed foods over time (Figure 8). This trend will now have to come to an end, as a result of the EU's rather restrictive commitments on export subsidy outlays for "incorporated products". The EU's food industry is very aware of this situation, and it now joins the camp of those criticizing high price support under the CAP.

Figure 7: EU Agricultural and Food Trade by Stage of Processing



Source: Gerken (1997)

In summary, the EU experience with the new WTO commitments for agriculture has been that no major problems have arisen in the areas of market access and

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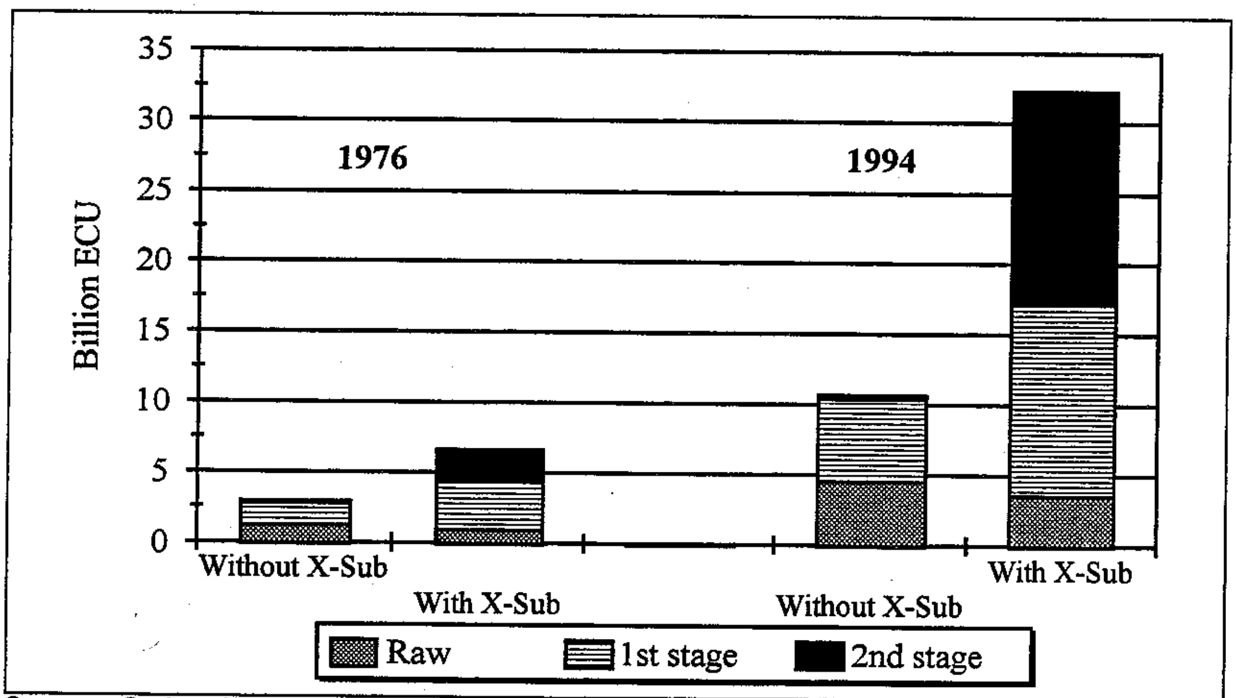
7 For an analysis of the complex regime the EU uses to compensate producers of processed agricultural products and foods, see Gerken (1997).

domestic support. The export subsidy commitments, though, are beginning to bite, and it becomes increasingly clear that they are important in forcing future adjustments to the CAP. It is in this context that Agenda 2000 is a key factor for the position of the EU in the next round of WTO negotiations on agriculture.

Figure 8: EU Agricultural and Food Exports by Stage of Processing – With and Without Export Subsidies



Source: Gerken (1997)

4.0 The Relationship Between Agenda 2000 and the Next Round of WTO Negotiations

The MacSharry package was the first reform of the CAP that was actually conditioned by the GATT/WTO, though at the time nobody involved in the reform decisions dared to publicly admit the GATT connection. Agenda 2000, coming only three years after the MacSharry reform was full implemented, is the first package of reform proposals in which the Commission not only admits, but explicitly argues that this reform is necessary because of the WTO. Almost everyone in the EU accepts that there is a close relationship between the WTO and the future of the CAP. What a revolution in the relationship between the GATT and the CAP! During the first thirty years of its existence, the CAP was in no way constrained by the GATT. As a matter of fact, as late as in the mid-1980s most people involved in Europe's farming industry and agricultural policy making probably did not know the meaning of the four letters "GATT". Then came the Uruguay Round and established, for the first time in the history of the GATT and the CAP, well-defined constraints on what Europe could do in many of its agricultural policies. After that, nothing is as it used to be, as far as the relationship between the CAP and the international trading order is concerned. Farmers even in remote corners of the European Union, now understand that there is a WTO and that it imposes constraints on the CAP. To be sure, not everyone in the EU farming industry is happy about the Agreement on Agriculture, and there is a heated debate about how best to prepare for the next round of WTO negotiations. However, it is an undisputed fact, in the European Union, that the CAP has to remain within the boundaries set by the WTO, and not the other way round.

Of course, the package of proposals tabled by the European Commission under the heading of Agenda 2000 are not only oriented towards WTO concerns. It is a wide-ranging reform project, going far beyond agriculture. Its major purpose is to prepare the European Union for the future, in a world where many factors change, both inside and outside the Union. As far as international conditions are concerned, the impending accession by the countries of Central Europe to the EU and the implications that this will have for the functioning of EU policies is the most important driving force behind Agenda 2000.[8] In agriculture, the Commission's proposals are also conditioned by a number of considerations regarding the internal functioning of the CAP. However, there is no doubt that the EU's WTO commitments in agriculture, both current and future, are among the factors which the Commission had in mind when it elaborated its proposals – and the text of the proposals says so.

For example, consider the following citations from the general Commission communication of July 1997 (European Commission 1997):

> "New multilateral trade negotiations will start in 1999 as a follow-up to the Uruguay Round. Cutting border protection, reducing export subsidies and reshaping internal support towards more "decoupled" instruments will enhance the Union's negotiating stance in the new Round." (p. I/25)
>
> "Greater market orientation ... will help prepare the Union for the next WTO Round. It will also help the Union to reinforce its position as a major world exporter." (p. I/27)

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8 For an analysis of the agricultural implications of EU Eastern enlargement, see for examaple Tangermann (1997).

"Dairy farmers should not be given the impression that the present system, with its intrinsic rigidities, can last for ever. The recent debate on long term prospects has revealed factors of uncertainty; in particular, the results of the next WTO Round could also affect the dairy sector." (p. 31)

"[In the dairy sector] the Commission also discards a double price - double quota system, which would raise serious questions of WTO compatibility, could be quite distortive, depending on how it were shaped and implemented, and would add to current administrative complexity and control problems." (p. 31)

In an explanatory memorandum that accompanied the concrete proposals for the new agricultural market regimes under Agenda 2000, tabled in March 1998, the Commission argues (European Commission, 1998a):

"The second factor [in addition to Eastern enlargement of the EU] is the international trade negotiations which are in the offing, both the new round of agricultural talks under the WTO and the negotiation of various bilateral trade agreements.

We cannot expect that these negotiations will result in a reversal of the trend towards greater liberalization of trade, with all the implications this has for the Community market.

The Union has to prepare its agriculture sector for these negotiations. This has two vital consequences:

First, with this reform the Union has to lay down the agricultural policy that it intends carrying out in the years ahead in a way that satisfies its own interests and takes a realistic view of developments in the international context. This needs to be done before the opening of the WTO negotiations so that the Union can negotiate on a solid basis and knows where it wants to go.

Secondly, it must be made quite clear to all that the reform to be adopted will outline the limits of what the Union is able to agree to in the forthcoming international negotiations.

These are the reasons why the CAP must be reformed."

Even the explanatory notes ("whereas clauses") in the chapeau of some of the regulations proposed under Agenda 2000 occasionally make reference to the WTO arrangements for agriculture.

In explaining its proposals, the Commission did not go into any technical detail regarding the concrete implications that current and potential future WTO commitments of the EU might have for the way the CAP is restructured and implemented. However, two considerations were particularly important. First, with a continuation of reduction requirements for tariffs, the water that many of them still contain is going to be squeezed out, and at some stage the reduced tariffs will begin to bite. In more concrete terms, EU intervention prices, which are supposed to continue to play an important role in the cereal and the dairy sectors, can not be sustained at a level above world market price plus tariff (plus, if and where available, extra duty under the special safeguard provision). Hence, at some point down the road of tariff reductions, one of the pillars of the CAP, the system of intervention prices, will be undermined, unless these prices are reduced in parallel with the tariffs concerned. In the dairy sector, where institutional prices remained essentially unaffected by the MacSharry reform, the point where tariff reductions could threaten the sustainability of high intervention prices could be reached soon. This may be one of the reasons why the Commission has argued that "the results of the next WTO Round could also affect the dairy sector" (see above) and led to the proposal to reduce intervention prices for butter and skim milk powder by 15 percent.

Second, and of more immediate and pressing importance, the EU's export subsidy commitments do not allow the Union to continue with its current agricultural policies. As shown in the preceding section, these commitments have already begun to bite, and will force the EU to reduce the volume of subsidized exports for a number of product categories below the levels shipped in the recent past. The full drama, however, is not revealed if recent subsidized exports are compared with the existing commitments. EU agricultural output continues to grow in most product sectors, while EU consumption is stagnant (if not declining, as in the case of beef). As a result, export availability continues to grow – while the scope for subsidized exports declines. The pressure for policy adjustments, therefore, is likely to grow in many product sectors, not all of which can be discussed here in any detail. However, what this could mean in the cereals sector is shown in Figure 9 for the case of wheat and in Figure 10 for the case of coarse grains.

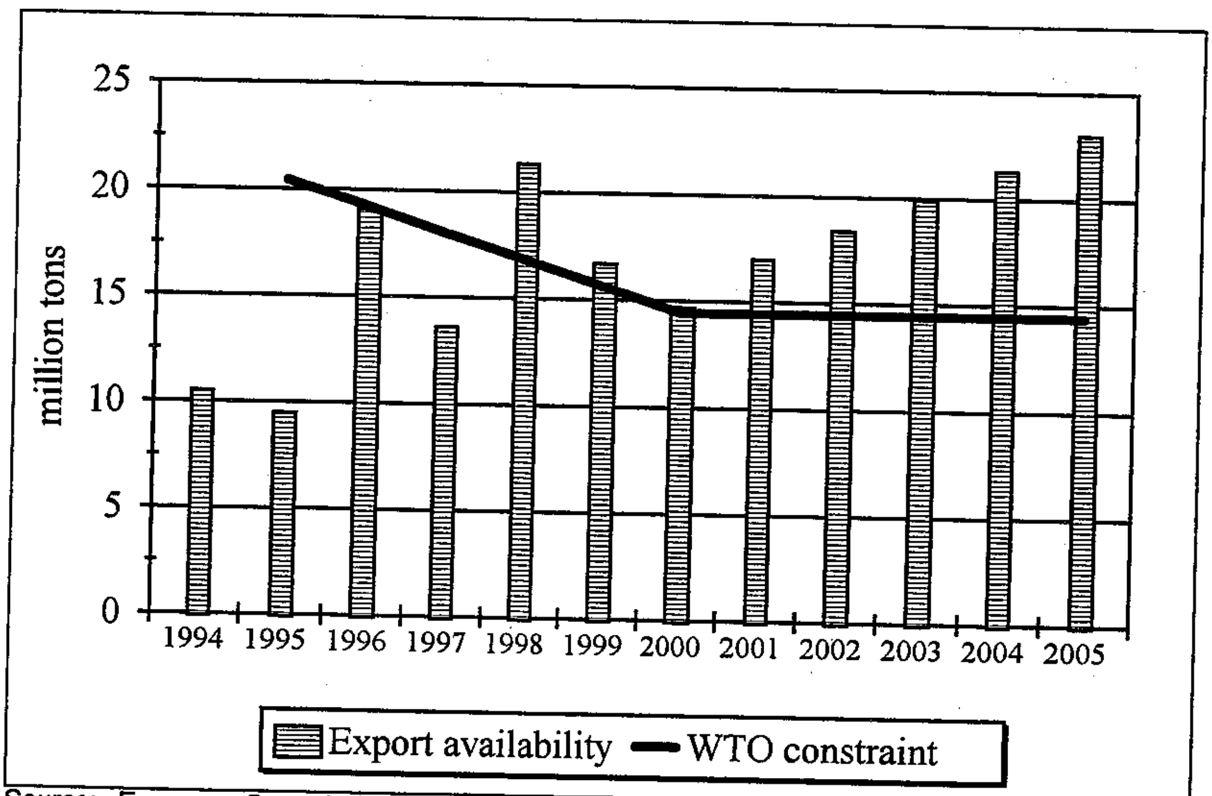
These graphs are based on the latest Commission projections of future developments on agricultural markets in the EU-15, which appear rather reasonable to this author.[9] "Export availability" is the excess of projected EU output over projected EU use, plus projected gross imports (most of which come in under the EU's current access commitments) minus food aid (1.5 million tons of wheat). The "WTO constraint" is the EU commitment regarding the volume of subsidized exports (in the case of coarse

---

[9] European Commission (1998b). In its previous projections the Commission had expected an even stronger growth of surplus on the EU cereals market.

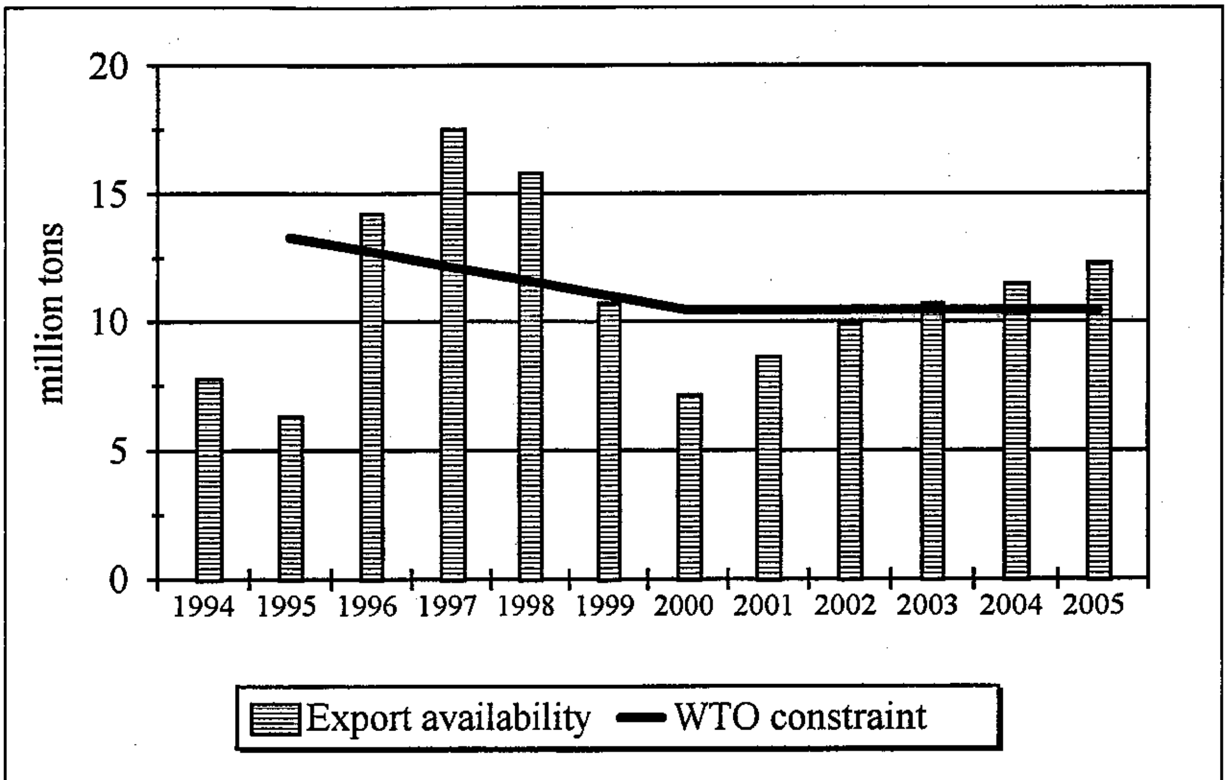
grains minus 0.4 million tons for potato starch that also belongs in that product group). In the figures it is assumed that after the year 2000 this commitment stays at the level reached in that year (which it would do in the absence of an agreement on further reductions). It is obvious that there will be a large amount of cereal output in the EU that can not be exported with subsidies. The excess of export availability over the WTO constraint will be particularly large in the wheat market. In the cereals sector, in aggregate, that excess is projected to be around 10.5 million tons in the year 2005, about five percent of projected EU cereals output in that year. In its outlook projections, the European Commission of course does not assume that the total amount of export availability will actually be exported, because world market prices are expected to remain below current EU intervention prices and hence export subsidies are required. Under such conditions the EU cannot export more than what is in line with its WTO commitment on subsidized exports. The EU Commission assumes that the excess is bought into intervention, and it projects EU intervention stocks of cereals to reach 51 million tons in 2005 (European Commission 1998b, p26).

Figure 9: Export Availability and WTO Constraint on Subsidized Exports: The Case of Wheat



Source: European Commission (1998b), WTO Schedule of the EU, author's calculations

Figure 10: Export Availability and WTO Constraint on Subsidized Exports: The Case of Coarse Grains

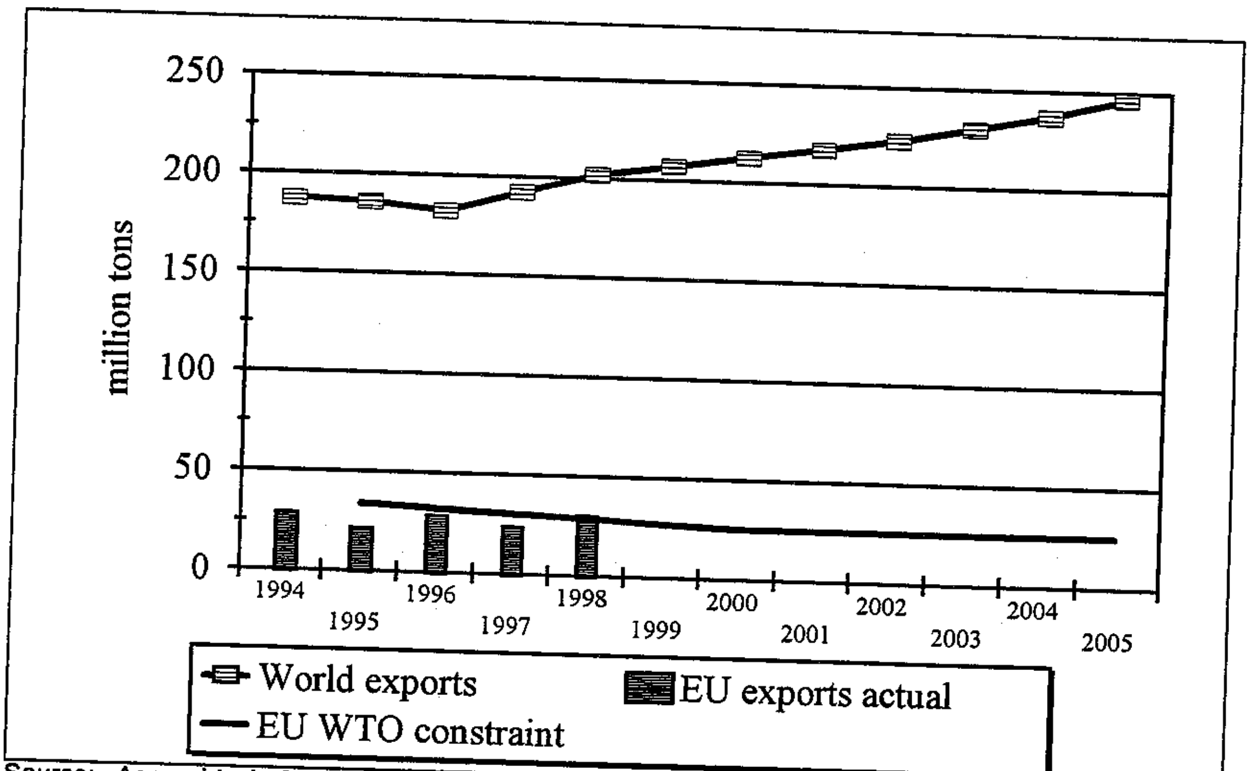


Source: European Commission (1998b), WTO Schedule of the EU, author's calculations

In reality, intervention stocks cannot increase permanently, and they would never be allowed to reach 51 mmt. Cereal stocks reached their historical record of 33 mmt in 1993. Hence, as long as the EU maintains its current level of price support and is bound by its WTO commitments on subsidized cereal exports, the only sensible response is to raise the level of (quasi) mandatory set-aside in order to reduce cereal output. It is important to note that the Commission's projections, on which this analysis is based, assume that the current standard rate of set-aside, which is 17.5 percent of base area, is maintained. The actual rate of set-aside would, then, have to go significantly above that level, presumably to something in the area of 25 percent in the year 2005. After that, of course, cereal yields in the EU will continue to grow (and with modern biotechnology the growth rate may actually accelerate). In other words, it is easy to see how under current policy conditions the EU may soon reach a situation where one-third of its farmers' base area has to be set-aside. This is definitely not an attractive prospect for EU agricultural policy makers, and many farmers in the EU are also loath to see the strait-jacket of supply controls being tightened even more.

At the same time, being bound by the WTO constraint on subsidized exports means that the EU cannot participate in the expected growth of world markets for agricultural products. In the case of cereals, the implications of such a development are illustrated in Figure 11. The share of EU gross exports in world cereals trade, which in 1996 stood at 16 percent, would under such conditions fall to ten percent in 2005. In other words, EU farmers would have to cut back domestic production while farmers in other countries were expanding supplies to a growing world market.

Figure 11: World Market for Cereals and WTO Constraint for the EU



Source: Agrarwirtschaft 1/1998+1999; USDA, Baseline Projections; WTO Schedule of the EU, and author's calculations

With these prospects it is easy to understand why the European Commission has proposed, under Agenda 2000, a significant further cut in EU intervention prices for cereals, of 20 percent, to be made in one step in the year 2000. The hope is that this price reduction will be sufficient to bring the EU support price for cereals down to, if not below, the level of world market prices for cereals, so that the EU no longer has to grant export subsidies in order to allow EU traders to sell on the international market. The EU's WTO commitments on subsidized cereal exports would then become redundant, and the EU could export as much as it can produce. It is, therefore, also logical that another element of the Agenda 2000 proposals for cereals is that the normal rate of set-aside be cut to zero. With zero export subsidies for cereals, the EU would no longer want to, and not have to, subsidize exports of pigmeat and poultry products because the only reason to subsidize exports of these grain-based livestock products is that the level of feed grain prices in the EU is above those on the world market.

The Agenda 2000 proposals for beef also foresee a major cut in the level of price support, by 30 percent in four annual steps, beginning in 2000. The hope, there too, is that this would not only reduce the level of surplus on the EU market, but also allow the EU to export beef without export subsidies.

In the dairy sector, the Commission proposals go less far. The proposed cut of intervention prices for butter and skim milk powder of 15 percent (also to be made in four annual steps) may allow the EU to increase the share of its dairy product exports that can be sold in international trade without export subsidies. After all, in the recent past the EU has, in spite of its high level of domestic price support for milk, managed to export a considerable amount of (mainly high quality) dairy products without export subsidies (WTO Committee on Agriculture 1998b)[10]. This share is likely to expand with lower domestic price supports, and this would make it easier for the EU to meet its WTO constraints on subsidized exports in this sector. However, the proposed price cut of 15 percent is not considered sufficient to allow the EU to export all of its surplus of dairy products without export subsidies, and thus the WTO constraint would continue to threaten the viability of this EU market regime.

What does all this mean for the EU position in the WTO negotiations on agriculture? Two implications are particularly noteworthy. First, as a general remark on what the Uruguay Round has achieved in agriculture, it should be noted how important the WTO is as a factor shaping domestic political decisions on the future of Europe's agricultural policies. The very concrete changes that the European Commission has

10 In 1996/97, according to the EU's WTO notification, 18 percent of total cheese exports and 16 percent of total exports of "other dairy products" were shipped with the use of export subsidies.

now proposed under Agenda 2000 are, to a significant extent, conditioned by what EU agricultural policies can, and what they cannot do under the EU's WTO commitments.[11] Much has been said about the lack of success of the Uruguay Round negotiations on agriculture in making a large step towards liberalizing agricultural trade. At face value such critical comments are justified as the quantitative commitments agreed to in the Uruguay Round, in particular in the areas of market access and domestic support, were such that they did not force many countries to make large immediate changes in their agricultural policies. However, even if the Uruguay Round had done no more than to change the parameters for future agricultural policy decisions, in a major trading block like the EU, as is now the case, then the WTO Agreement on Agriculture would have achieved a lot.

Second, the outcome of the ongoing negotiations on Agenda 2000 in the EU will have direct and important implications for the EU's position in the next round of WTO negotiations on agriculture. If the Council of agriculture ministers decides to reform the CAP in line with the Commission proposals, then the EU has a relatively wide margin of maneuver in the WTO negotiations. However, if the Council refuses to reform the CAP, or if it waters the reform down considerably, then the EU is likely to be a very difficult partner in the WTO. Indeed, possibly even more difficult than in the first half of the Uruguay Round. The EU Council of Ministers would then have explicitly decided that it is not prepared to reform the CAP (significantly). It would give its reasons for that decision, and they would be mostly domestic reasons, having to do with the unacceptable implications for farm incomes, the stability of rural regions, the budgetary burden of increased compensation payments, and so on. How could the same Council of Ministers then turn around a short time later and decide that it is prepared to reform the CAP "under the dictate of the WTO", as the argument would then go? To enact another reform of the CAP during the negotiations, like the MacSharry reforms were enacted during the Uruguay Round, would be nearly impossible. After all, the decision not to follow the Agenda 2000 proposals implies denunciation of the Commission's explicitly stated view that CAP reform is required because of the WTO. While the debate about the MacSharry reform was carried on as if that reform had nothing to do

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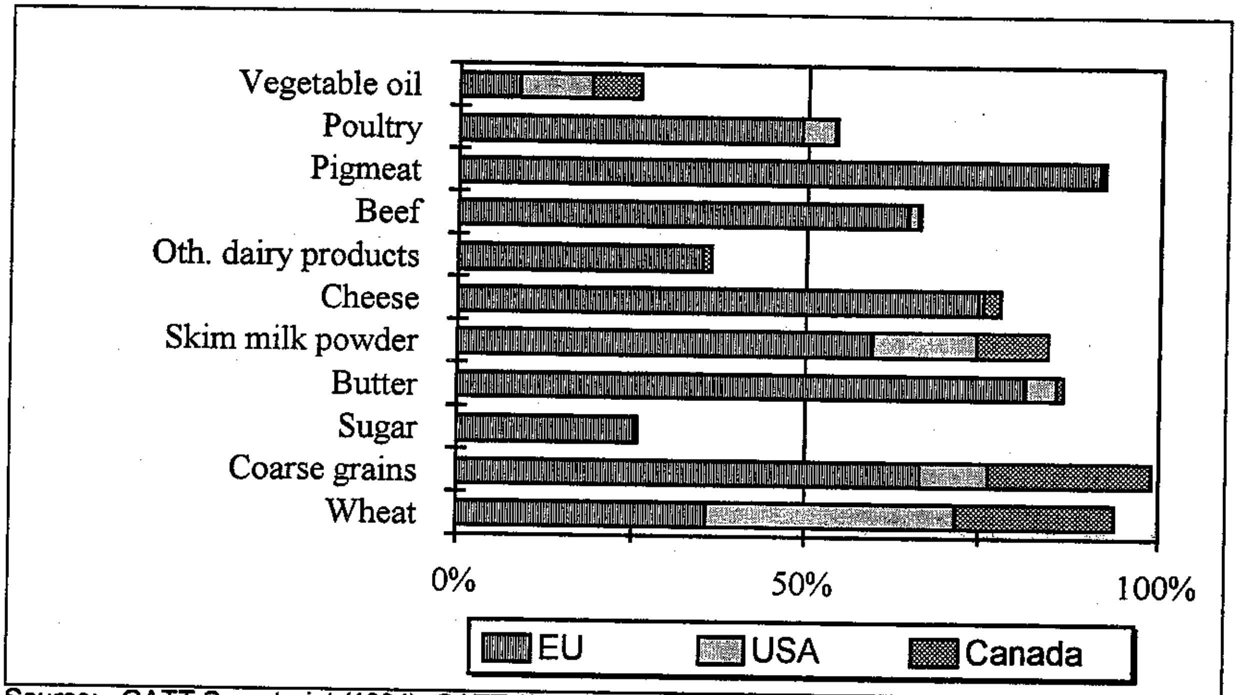
11 Another element of the agricultural package under Agenda 2000 which shows how the EU's WTO commitments have shaped the Commission's proposals is the proposed harmonization of the direct payments for oilseeds with those for cereals. The explicit aim of that proposal is to do away with the constraint on the area planted to oilseeds which applies as long as it grants "crop specific oilseed payments".

with the GATT, the same de-linking of CAP reform from the WTO would not be possible next time, not the least because the Commission has now established that link very firmly. In other words, the fundamental position of the EU in the next round of WTO negotiations on agriculture will, to a very large extent, not be decided during that Round, but during the internal EU negotiations on the Agenda 2000 package in February and March 1999.

In more concrete terms, what could either outcome of the Agenda 2000 decisions imply for the WTO negotiations? Let us begin with the scenario of no CAP reform in 1999. In that case the EU has nearly no room to maneuver as far as further reductions of export subsidies are concerned. As shown above, the EU's export subsidy commitments begin to bite increasingly, and even more if they have to be reduced as a result of the next round of negotiations. The EU would, under these conditions, try to resist any further reductions in export subsidies as much as it possibly can. On the other hand, it is clear that other countries will push the EU towards further significant reductions in the area of export subsidies. Both the United States and the Cairns Group have made it clear that a significant reduction, if not the elimination of export subsidies is one of their major objectives for the next round. It is also clear that the EU is the primary target of negotiations on export subsidies. A look at the relevant figures shows that the EU is the single largest holder of "rights" to export subsidies among all WTO members (Figure 12). However, if the EU has, in the negotiations on export subsidies, to fight with its back to the wall, because of domestic policy concerns then it is clear how difficult these negotiations are likely to be.

Figure 12: Share of the EU, US and Canada in Total Worldwide Export Subsidy Commitments (Quantity) on Selected Agricultural Products for 2000



Source: GATT Secretariat (1994), GATT (1994), WTO Schedule of the EU.

On the market access front, failure to implement the Agenda 2000 reforms will make it difficult for the EU to accept significant tariff reductions. In this area, the situation is not quite as difficult as in the area of export subsidies, given that there is more water in most of the EU's tariff bindings than there is in EU export subsidy commitments. However, as shown above for selected products, that water quickly evaporates if world market prices are low. Hence, because of the direct link between tariffs and the sustainable levels of intervention prices, failure to cut intervention prices in the near future will make it more difficult for the EU to accept large tariff reductions. This is particularly true for those products where tariff peaks prevail. Dairy products belong in this category, and hence the failure to cut EU intervention prices for dairy products is likely to make the EU more resistant against attempts to flatten tariff peaks. Butter is an obvious case in point, as shown above.

Prospects will look much different if the CAP is reformed under Agenda 2000. Even then the EU is unlikely to become an advocate of free trade in agriculture, and it would probably continue to remain in the camp of those arguing for only modest progress. However, with a bit of pushing and pulling, the EU would find it much easier to accept meaningful reductions in levels of protection and support. In particular, for the major product sectors covered by Agenda 2000 (cereals, oilseeds, beef, milk, and indirectly feather products and pigmeat) the EU could then more easily agree to further reductions in export subsidies and tariffs. As it is likely (and desirable) that negotiations will again focus on general formulae for reductions, rather than product-specific request and offer type arrangements, failure to reform other agricultural market regimes under the CAP in the context of Agenda 2000 may somewhat limit the negotiating scope for the EU. For example, sugar is not mentioned in the Commission proposals for Agenda 2000, and the high levels of tariff protection and export subsidization in that sector might be seriously threatened if significant reductions were agreed to, on a general level. However, the Commission might be happy to use the WTO negotiations as an argument for extending CAP reform to these sectors as well. Once Agenda 2000 is positively decided, it should also be politically much easier for the EU to extend reform to the remaining sectors as well.

Even though the EU will not become a free trader in agriculture even after a positive decision on Agenda 2000, it is not inconceivable that success in achieving that domestic reform could allow the EU to adopt, in the next round of WTO negotiations on agriculture, a position on some issues that could surprise its negotiating partners. In particular, the EU could potentially become an advocate of a zero-for-zero approach in some product sectors. In the oilseeds sector, the EU has zero bound tariffs on unprocessed products, and it does not need export subsidies. Why should the EU not be prepared to accept, or even favor, an agreement to eliminate all tariffs and export subsidies in that sector? More surprising, but also potentially possible would be an EU initiative for a zero-for-zero agreement on export subsidies in the cereals sector. The price cut for cereals foreseen in Agenda 2000 would probably make it possible for the EU to live without export subsidies for wheat, and if everything goes well also for coarse grains. As a matter of fact, that is exactly what the EU Commission hopes to achieve with that price cut. The EU would then have an interest in seeing other countries renouncing export subsidies for cereals as well. As Figure 12 shows this would essentially mean agreeing with the United States and Canada on zero export subsidies for cereals.

If the EU were to adopt a position like that, it could then go one step further. As both the U.S. and the Cairns Group have expressed so much interest in eliminating export subsidies, could the EU not consider making them pay for the EU's willingness to eliminate export subsidies for cereals? And what would the EU like them to pay? A product sector of primary export interest for the EU is the dairy sector. Hence the EU has reasons to want countries like the U.S. and Canada to open their markets more widely to dairy product imports from Europe, and to restrain their subsidies on exports to third country markets. A deal of interest to the EU could be an elimination of export subsidies in the cereals sector as a quid pro quo for better access to North American markets for dairy products. The EU might, after Agenda 2000, even be prepared to consider significant multilateral tariff reductions in the dairy sector, in particular if the "gang of four" EU member states (UK, Sweden, Denmark and Italy), who have proposed a cut in EU support prices for dairy products by 30 percent in the context of Agenda 2000, should prevail. In the case of such drastic reform, the EU could also consider a very large reduction, if not elimination, of export subsidies for dairy products. On the other hand, if "only" the Commission's proposal of a 15 percent price cut in the dairy sector is adopted, then it would not be possible for the EU to accept an elimination of export subsidies in the milk sector.

If the EU's position in the next round of WTO talks on agriculture depends on the outcome of the Agenda 2000 process, then what are the chances for the EU Council to adopt Agenda 2000? These chances are not at all bad, in spite of all the publicly proclaimed resistance on the side of some farm ministers. This is not the place to engage in a discussion of the many political factors involved in that equation. However, one point should be made which establishes a direct link between the current domestic debate in Europe and the position of the other WTO members in agriculture. One of the most frequently mentioned arguments in the EU against accepting another round of CAP reform (at this moment) is the fear that this could weaken the EU's negotiating position in the upcoming round of WTO talks. If the EU makes "advance concessions", the argument goes, then it will be asked to pay a second time during the actual WTO negotiations, potentially forcing the EU to make even deeper cuts in its levels of support and protection. The EU's partners in the WTO could easily dispel these fears by making it clear that this will not happen. In a technical sense this could take the form of an (informal) agreement, to be envisaged very soon in the WTO process of Analysis and Information Exchange, that the starting point for the next round of reduction commitments will not be the status of actual policies towards the end of the current implementation period, but the commitments laid down in the existing country schedules, independently of whether they were fully "utilized" or not. An agreement like that would have the big advantage that it would not be necessary in the next round to find agreement again on something as difficult and potentially divisive as the "Modalities" for defining starting points for reduction commitments (Tangermann 1997a). All of the commitments are clearly defined, and it is best to use them as starting points anyhow.

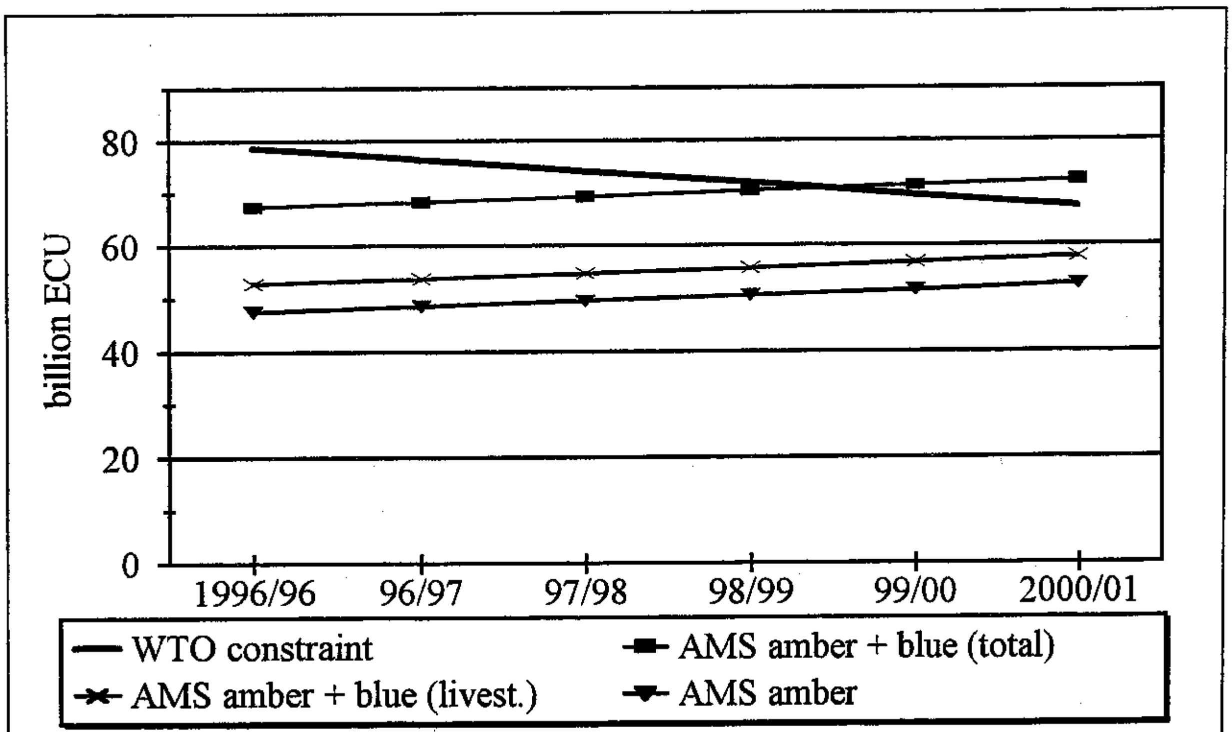
5.0 Specific Negotiating Issues for the European Union

While the outcome of the Agenda 2000 process will have a strong bearing on the EU's general position regarding further reductions in the next round of WTO talks, there are a number of more specific issues that will be of importance for the EU. The major items in this category are the future of the blue box, the scope for maintaining the "European Model of Agriculture", and concerns about social, environmental and consumer-related issues.

The blue box is a particularly difficult issue in the context of future EU policies for agriculture. It is obvious that the blue box is an anomaly that does not really fit the overall spirit of the Agreement on Agriculture. In a more narrow technical sense it has never been clear whether the measures that have been allowed to find a shelter under the blue box are really "production-limiting" as stipulated in Article 6:5 (a) of the Agreement on Agriculture. The blue box was a politically expedient solution in a specific negotiating context, and of specific use to its two major protagonists at the time, the United States and the EU. The political base under that solution has been eroded to a significant extent since the U.S. has (arguably) placed its area payments in the green box as a result of decoupling under the FAIR Act. As a result the EU is now isolated in the blue box, with only three other countries making use of that specific clause (Iceland, Norway and Slovakia). The EU knows that, and also knows that many other countries, including the U.S. and the Cairns Group, strongly favor elimination of the blue box in the next round of negotiations. The EU has, therefore, already begun to argue strongly for maintaining the blue box. Even trade Commissioner Sir Leon Brittan (1999) has made the point that the EU wants to maintain the blue box, and has suggested that the EU could "pay" for that through reductions in export subsidies and tariffs, and possibly even in sectors outside of agriculture.

The relevance of the blue box for the EU is illustrated in Figure 13 where the EU domestic support commitment for the current implementation period is compared with three different AMS levels in the EU. The lowest level is the Current Total AMS ("amber") as notified by the EU (1995/96), and projected into the future assuming that it will grow by an annual rate of 2 percent, due to the expected growth in EU agricultural production. It is obvious that the EU will probably not have any problems meeting its WTO commitment regarding amber domestic support during the current implementation period, and for some time beyond the year 2000. This is even more the case if Agenda 2000 is adopted, with the result that amber support would decline, while blue payments would increase. However, if the blue box were to disappear and hence total blue support were to become amber, then the EU would have difficulties meeting its AMS commitments in 2000, and certainly thereafter. This is clear when total blue support (for crops and livestock) is added to what currently is amber support (as is done in the uppermost ascending line in Figure 13). This explains why the EU is so interested in maintaining the blue box beyond the current implementation period.

Figure 13: Domestic Support in the EU and WTO Constraint



Sources: WTO Committee on Agriculture (1998a), WTO Schedule of the EU, author's calculations

However, if the EU is pressed, in the next round of negotiations, to give up on the blue box, what could it do? Two options are particularly relevant. First, the EU could begin to reduce its current compensation payments as introduced under the MacSharry reform, and also later those that might be added under Agenda 2000. This is exactly what EU farmers fear might happen. This is not the place to discuss the (questionable) merits of making permanent payments to compensate for one-time cuts in support prices. Suffice it to say that in the EU the longer-run future of compensation payments is a political problem that has so far been swept under the carpet: nobody among the agricultural policy makers dares to talk about this issue.[12] In any case, reductions in compensation payments forced upon the EU by the WTO would create major political problems. This was obvious during the last phase of the Uruguay Round, when there was much talk in the EU about the need to guarantee that the newly introduced compensation payments were "durable and reliable". It was exactly this heated internal debate that made EU negotiators press for the blue box arrangement at Blair House.

A second option for the EU would be to decouple the payments completely from production, so that they could be placed in the green box. For the livestock payments that would be difficult (though not impossible) because it would require major changes to current EU provisions. For crop payments, on the other hand, the changes required over and above those already foreseen in Agenda 2000 would be relatively small.[13] As the crop payments are the largest part of the EU's blue box support (Figure 13), shifting these payments into the green box would go a long way towards making it possible for the EU to consider accepting an elimination of the blue box. It will be interesting to see how flexible the EU position on this issue can be in the next round of negotiations.

While the blue box issue is pretty straightforward (though not necessarily easy to resolve in the negotiations), it is far less clear what EU insistence on the "European Model of Agriculture" would mean for the next round of WTO negotiations. This phrase is a recent addition to the agricultural policy jargon in the EU, injected into the debate by Commissioner for Agriculture Fischler in the context of Agenda 2000. It is often cited in public speeches on the future of Europe's agriculture under the "threats" of Agenda 2000 and the next round of WTO negotiations. In a way it is (implicitly) suggested to be Europe's interpretation of the "non-trade concerns" as mentioned in Article 20 of the Agreement on Agriculture, and of "multifunctionality" as increasingly referred to in the AIE process by a number of countries. Defending the "European Model of Agriculture",

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12 In his recent speech about the next WTO negotiations on agriculture, Commissioner Brittan (1999) has suggested that the payments should be made digressive over time.

13 See Tangermann (1997b). "Cross-compliance" (the requirement to respect certain environmental criteria in order to be eligible for payments) as proposed in Agenda 2000, is certainly not sufficient to put the payments in the green box. Payments would have to be completely decoupled from land use for given crops.

it is suggested, will be one of the major objectives for the EU in the next round of WTO negotiations on agriculture. What this means in terms of concrete arrangements that the EU may advocate in the WTO negotiations has not been defined. However, in the farming community it is often vaguely interpreted as saying that the EU will resist further reductions in support and protection, or at least will argue for some sort of arrangement that allow Europe to continue safeguarding its farmers' interests.

In its explanatory memorandum on the agricultural elements of the Agenda 2000 package, the European Commission (1998a) describes its perspective of the "European Model of Agriculture" in the following way:

> "All these proposals [in Agenda 2000] together have the aim of giving concrete form to a European model for agriculture in the years ahead. It is worth listing here what the main lines of this model should be:
>
> - a competitive agriculture sector which can gradually face up to the world market without being over-subsidized, since this is becoming less and less acceptable internationally;
> - production methods which are sound and environmentally friendly, able to supply quality products of the kind the public wants;
> - diverse forms of agriculture, rich in tradition, which are not just output-oriented but seek to maintain the visual amenity of our countrysides as well as vibrant and active rural communities, generating and maintaining employment;
> - a simpler, more understandable agricultural policy which establishes a clear dividing line between the decisions that have to be taken jointly and those which should stay in the hands of the Member States;
> - an agricultural policy which makes clear that the expenditure it involves is justified by the services which society at large expects farmers to provide.
>
> This is not the same model as pursued by our major competitors elsewhere. There are many differences between ours and theirs. Seeking to be competitive should not be confused with blindly following the dictates of a market that is far from perfect. The European model is designed to safeguard the earnings of farmers, above all keeping them stable, using the machinery of the market organizations and compensatory payments.
>
> For centuries Europe's agriculture has performed many functions in the economy and the environment and has played many roles in society and in caring for the land. That is why it is vital, as the Luxembourg European Council concluded in December 1997, that multifunctional agriculture must develop throughout Europe, including those regions facing particular difficulties. In connection with Agenda 2000 and its implementation, care will accordingly need to be taken to provide proper compensation for natural constraints and disadvantages.
>
> The fundamental difference between the European model and that of our major competitors lies in the multifunctional nature of Europe's agriculture and the part it plays in the economy and the environment, in society and in

preserving the landscape, whence the need to maintain farming throughout Europe and to safeguard farmers' incomes.

In any case, it is wrong to claim that there is another model available. Those who claim it is possible to reconcile the two models outlined above are prey to an illusion. They would like to believe that there is a future in high prices, protectionism and bureaucratic steering of production. But that way lies a loss of international markets, falling home consumption and, as a result, declining production in Europe. This model, if it can be called that, may offer short-term comfort but means inevitable decline in the longer run.

This is not in the interests of farmers who want to have a future and need to bank on future growth. Nor is it what consumers, the private sector or the taxpayer want, since they are less and less inclined to pay for rising surpluses."

Reading this text carefully (as most observers from Europe's farming community obviously do not), the Commission does not suggest anything that could justify the expectation that Europe might join the camp of those countries which will emphasize "non-trade concerns" in the WTO negotiations and accordingly be difficult partners when it comes to talking about further reductions. In a technical sense, the Commission's statement can be seen as arguing for more ample use of the green box. As a matter of fact, in a convoluted way, the Commission's explanation provides support for its proposal to cut traditional forms of support and protection under the CAP. An optimistic interpretation of the current emphasis on the "European Model of Agriculture", therefore, is that this phrase is being used to calm fears in the public debate. It tries to do so by projecting the image of a Brussels Commission that, in spite of proposing major reforms to the CAP, is prepared to defend the interests of Europe's farmers vis-à-vis the rest of the world. If it achieves that without forcing the EU Commission into a corner in the WTO negotiations, then the invention of the new phrase of the "European Model of Agriculture" was a clever political move.

This is not to say that the EU will not want to discuss issues in the WTO that go beyond tariffs, export subsidies and domestic support. As a matter of fact, in its original text on Agenda 2000 the European Commission (1997, p. I/25) said in regard to the next round of WTO negotiations that "another, increasingly sensitive, issue is the need to introduce environmental and social standards at the international level and to take into account consumer concerns." Environmental issues and social standards have been discussed in the WTO for some time. Consumer concerns, though, are a more recent element on the shopping list. In the European debate, this is related to issues such as beef hormones and food containing substances from genetically modified organisms (GMO). For the time being, and to an increasing extent, some European policy makers have difficulties with the notion that only scientific criteria should justify levels of sanitary and phytosanitary (SPS) protection above those internationally agreed, as stipulated in the WTO SPS Agreement. They argue that subjective consumer concerns also need to be taken into account. Of course, in principle this can be done through labeling requirements. However, in practice there are a number of potential difficulties involved in labeling as well. Moreover, at least in principle the argument can be advanced that under certain conditions the transaction costs involved in labeling can be larger than the (domestic) welfare loss resulting from a ban (domestic and import) on a product considered unsafe by a large majority of consumers.

This is not the place for a detailed discussion of such issues and possible solutions, which will be extremely difficult to find. However, Europe's negotiating partners should be aware of the weight that such concerns have in the domestic European debate. They should also consider that in Europe's general public the acceptance of and support for the WTO in general and the SPS Agreement in particular may depend, among others, on the willingness of other countries to take such European concerns seriously.

6.0 The EU and Canada in the Next Round of Negotiations: Partnership or Conflict?

After all this has been said about Europe's potential position in the next round of negotiations, what does it mean for Canada? Will EU relations with Canada in these negotiations be characterized by partnership or conflict? It is still too early to provide a definitive answer to this question. Canada has not yet formulated its negotiating position. Europe is still struggling with the Agenda 2000 package. However, a few necessarily speculative comments can be offered. Fundamentally, Europe and Canada will sit at opposite sides of the negotiating table on a number of important issues. Europe will certainly not join the Cairns Group and begin to argue for wholesale liberalization of agricultural trade. But then Canada also has slight difficulties with some Cairns Group positions. Indeed, on some issues Canada and Europe may find it possible to join forces.

In the area of market access, attitudes in Canada and Europe are not altogether different. Both share the slightly inconsistent position that they want other countries to open up their markets as much as possible, while insisting on the right to protect their own domestic markets. The similarity of their traditional interests in the dairy sector is a particularly good example. However, this is also an area where the EU could potentially turn out to be more progressive than Canada. If the Agenda 2000 provisions for a 15 percent price cut in the EU dairy sector are accepted, and even more so if the "gang of four" manage to achieve their proposed 30 percent price cut, then the EU may be prepared to live with less protection in dairy than Canada.

As far as export subsidies are concerned, Canada's interest in complete elimination, will be in conflict with the EU's interest in maintaining the scope for subsidizing exports. Only in the grains sector could the EU, if Agenda 2000 is implemented, possibly agree to a zero-for-zero approach on export subsidies. A potential conflict on export subsidies could also relate to two-price systems. After considering some form of a two-price scheme for dairy product exports, the EU has definitely decided against such a regime. The EU, therefore, has an interest in making sure in the next round that other countries cannot circumvent their commitments by relying on such solutions. On other circumvention issues, though, the EU and Canada can close the ranks, i.e., food aid, export credits, and export promotion.[14]

On the issue of state trading in general and single-desk sellers in particular, highly sensitive in Canada, a major conflict is unlikely to emerge immediately as the EU is uncertain of the status of its own procedures in the EU management committees and intervention agencies.[15] On the other hand, if it can be clarified that these EU institutions do not fall into the category of state trading, then the EU is more likely to join the U.S. position on state trading – which again would mean that there could be a significant difference between Canadian and EU positions.

In the area of domestic support, Canada, which is not using much of its commitment on amber support, can push for large reduction commitments in the next round, while the EU will have a tendency to minimize further cuts (Tangermann 1997, pp. 48-49). On the blue box, Canada's and the EU's positions are also bound to diverge. The EU should, on the other hand, not have major difficulties with Canada's interest in clarifying some of the green box criteria. As a matter of fact, the EU is likely to embark domestically on a debate about alternative forms of income support and safety net provisions in the near future, given the uncertain future of its compensation payments.[16] A clear-cut case for partnership between Canada and Europe is the future

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[14] See Commissioner Brittan's (1999) advocacy of disciplines on export credits in agriculture.

[15] See the discussion held in the WTO Working Party on State Trading Enterprises (1996).

[16] For a discussion of alternative options for future income support in Europe's agriculture, see Buckwell et al. (1997).

of the Peace Clause. Both parties have a strong interest in extending the life of the Peace Clause beyond the year 2003 (Brittan 1999).

A conflict between Canada and the EU, on the other hand, is likely to emerge regarding changes in the SPS Agreement. Europe's concerns about issues such as beef hormones and GMOs are not shared by Canada, and any attempt by the EU to introduce anything like consumer concerns into international trade regulations is likely to meet strong opposition from Canada.

7.0 Conclusions

The EU still has to define its position for the next round of WTO talks on agriculture. The outcome of the current negotiations on further reform of the CAP under Agenda 2000, to be concluded in the spring of 1999, will strongly influence what the EU can and cannot easily negotiate in the WTO. Prospects for agreement on the European Commission's reform proposals in the Agenda 2000 package are reasonably favorable. If agreement along these lines is reached among EU member states, then the EU may be able to adopt positions in the next WTO round which could be surprisingly different from those pursued by Europe during large parts of the Uruguay Round. Indeed, Europe increasingly understands that as a large agricultural exporter it has a strong interest in gaining better access to other countries' markets for agricultural commodities and, in particular, processed foods. It also begins to understand that in order to achieve that objective it has to be prepared to negotiate meaningful commitments for its own agricultural policies.

On the other hand, if the attempts at further CAP reform fail, Europe could find it even more difficult than in the Uruguay Round to agree to a meaningful package of further reduction commitments in the next round. If Agenda 2000 is not adopted in the coming months, or if it is watered down considerably, Europe will not be able to implement a reform of its domestic agricultural policies in parallel with the WTO negotiations. The MacSharry reform that allowed the Uruguay Round to come to a conclusion on agriculture was a one-time achievement that cannot be repeated in the next round of WTO talks.

Apart from its domestic decisions on CAP reform, Europe's negotiating stance in the next WTO round may also depend on the overall structure of that Round. The EU has a strong preference for going beyond agriculture and services, the two major items of the built-in agenda of the WTO for the negotiations that have to start by the year

2000. Europe wants to launch another comprehensive set of WTO negotiations, the Millennium Round. Other countries are not yet convinced that this is the right approach. They fear that inclusion of other sectors in the negotiations might delay progress on agriculture and services. Such fears may not be justified. Europe has at least two good reasons for working towards an early conclusion of the next round, clearly spelled out by trade Commissioner Brittan (1999).

First, Europe has a strong interest in extending the Peace Clause beyond the year 2003, and it knows that it has to conclude the agricultural negotiations before that date in order to have a chance of achieving that objective. Second, the EU wants to try and include the WTO negotiations on EU Eastern enlargement (under GATT Article XXIV:6) in the next overall round, and to conclude the overall round simultaneously with the Article XXIV:6 negotiations. Enlargement negotiations with the countries in Central Europe will take some time, but they should be largely concluded by the end of 2003, at least with the current five accession candidates. Pursuing negotiations on enlargement with the countries in Central Europe, and negotiations in the WTO on both Article XXIV:6 issues and on the overall round in parallel, argues for trying to conclude the WTO talks in 2003. If this time schedule is taken seriously, then Europe's negotiating partners should consider the advantage of being able to find trade-offs between agriculture and other sectors more important than their fears that another comprehensive round of WTO negotiations might take too long. The experience gained in the Uruguay Round speaks for negotiating a broader agenda with Europe. After all, it was mainly the prospect of losing in other sectors that finally brought Europe back to the agricultural negotiating table in the Uruguay Round (Coleman and Tangermann 1998). One would hope that Europe's negotiating partners have learned that lesson.

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DISCUSSANTS' COMMENTS

The European Union Perspective on Agricultural Trade Liberalization in the WTO: Comment

Martin Rice, Canadian Pork Council

Dr. Tangermann's paper provides grounds for optimism that the European Union is moving toward conditions that favour further world trade liberalization. I believe the author is one whose personal philosophy leans toward open trade, but the prospects he presents for that happening in a European context are decidedly more positive than anything I have seen for some time. I am reminded, however, of how sure the Canadian pork industry became in the Uruguay Round of obtaining meaningful access into the European Union based on the minimum access commitments. Actual access turned out to be far less than Canada had expected due to a very liberal interpretation, by the EU, of how their global minimum commitments could be expressed (meat instead of pork). Then, just to make the much smaller amount more difficult to use, it was further broken out into many different sub-categories.

The Uruguay Round process also consumed far more time to complete than anyone in industry would have hoped when it was launched. However, in this respect, I am in complete agreement with the author that a lot of time should be saved by using the "modalities" which were invented in the last negotiations. For example, those developed to express commitments for reducing internal support and export subsidies.

It is certainly an important development that the European Union now appears to be taking explicit account of the impacts of its Common Agricultural Policy on international trade flows. It has been a constant source of resentment by agricultural exporting countries, such as Canada, that the EU could continue to support its agricultural production so generously and simply 'export' the oversupply these policies so predictably generated.

It is interesting that as was the case with the Uruguay Round, the Common Agricultural Policy is being overhauled just prior to the initiation of a world trade round in which agriculture will be negotiated. If the current reform exercise, Agenda 2000, is successful, it can be both helpful and limiting to the trade liberalization objectives of agricultural exporters such as Canada. It is helpful from the point of view that Europe will have some negotiating flexibility. On the other hand, the reform process can set the limits of how far the EU can go in the negotiations. The internal review exercise may have extracted all of the concessions EU farm groups are prepared to accept, and politicians' courage to challenge them may be exhausted.

The two principal scenarios arising from the Agenda 2000 initiative are failure and success. The implications of the initiative not succeeding are rather dark for the prospective WTO round and for international agricultural trade itself. I tend to concur with Professor Tangermann that this result is less likely to occur, as it would render the European Union unable to participate in agriculture negotiations and thus dash interest in a comprehensive round on the part of the U.S. and many members of the Cairns Group. The EU will not want to be blamed for preventing another WTO round from even getting started. Its non-agriculture economic sectors, which wish to obtain improved foreign access for their products likely would intervene to ensure the EU does not preempt a trade round.

The more likely result is that important gains will be achieved through Agenda 2000 in bringing EU agriculture closer to a market-driven system. This will give the EU some important leverage in obtaining concessions in both the non-agriculture as well as the agriculture sectors, such as pigmeat in which Europe will be competitive with access to world-price cereals. As internal prices move to world prices, there will no longer be a rationale for cereals-using sectors, such as livestock and grain-processing industries, to be provided with export subsidies. There is even scope for the EU to be a proponent of banning export subsidies in agriculture, thus garnering important negotiating leverage to obtain concessions in other areas.

The significantly improved cost competitiveness of the EU's cereals-consuming industries will make it even more critical that the elimination of export subsidies and export taxes be achieved in the next round. We need to forestall the temptation for governments to reintroduce export subsidies in response to domestic pressures in times of low prices. Lower intervention prices for cereals will also justify important reductions in import protection, such as tariffs.

Professor Tangermann confirms that we are justified in having some fear that the EU will be pressing for changes in the technical codes in order to accommodate non-trade standards and consumer concerns. European preferences in agricultural production practices could replace conventional trade barriers as the means by which European agriculture is protected from external competition. The North American industry can be expected to be very firm in support of primary reliance upon the science-based rationale for trade-restricting measures and the use of equivalence as the key target result.

It may be a separate issue, but if it is argued that import protection is required to offset EU environmental standards or regulations, our response would be that these have been implemented to address inadequate environmental controls in the past. The adaptation costs of improved standards should not be borne by exports from outside of the EU.

A final observation is that we fear the negotiations will devolve into a US-EU show, as was the case for many of the agricultural elements of the Uruguay Round, with other interested parties being presented at the last possible moment with a "take it or leave it" package. To avoid this outcome, Canada will need to look to "third" forces such as the Cairns Group, which can force a true multilateral negotiation to take place.

The European Union Perspective on Agricultural Trade Liberalization in the WTO: Comment

Peter Gould, Dairy Farmers of Ontario

1.0 Overview

Describing EU agricultural policy is deadly difficult at the best of times, adding in the MacSharry reforms, Agenda 2000 and the CAP/WTO interface makes it an even more daunting task. Professor Tangermann has done an admirable job of describing this complex policy environment. His presentation has elements of honesty which I appreciate. For example, he readily acknowledges that the CAP is a program that promoted expanded production, had no constraints on price setting and had no limits for an ever increasing need to subsidize exports. While there is no question that European agriculture policy greatly contributed to the problems in global agricultural trade, over the last 40 years, it would not be fair to single them out without mentioning the U.S. waiver and other anomalies like the Japanese unbound tariffs.

To the best of my knowledge, Professor Tangermann is in no way responsible for the thinking within the European Commission. As such I might have expected a more critical evaluation. The convoluted logic in the EU does nothing if not reaffirm, that truth can sometimes be stranger than fiction. There is a theme throughout the presentation that left the impression that the EU would be very concerned if the last GATT round of negotiations would have had any real impact. There is reference to the fact that for some commodities, if world prices get any lower, the bound tariffs "wouldn't hold water" i.e. be effective as a trade barrier. Similarly, there is a parallel concern that for some products, the EU may have to cut back on exports because of their export subsidy commitments. This perspective is reinforced by references to market access provisions which are described as "rather generous". However, since virtually all, if not all access was allocated to countries already exporting to the EU, especially in the case of dairy, there doesn't seem to be much in the way of new imports.

I was also disappointed in that some essentials were lacking. For example, how much does the EU's entire agricultural policy cost? There is reference to the AMS of $83 billion, but what about the blue box, restitution payments, etc. The paper also smoothed over some of the troublesome issues like the Eastern European states who are about to join the EU, and the impact of this on EU agricultural policy.

2.0 Eurologic

Based on Professor Tangermann's paper Eurologic can be summarized as:

- Tariff protection is thinning especially when world prices are low.
- Export subsidies are high and will have to be cut back.
- Lower intervention prices re-establish the effectiveness of tariffs, reduce export subsides and maybe even give the EU some room to negotiate in the next Round.
- Make direct payments to farmers to compensate for lower intervention prices, and argue that these payments are in the blue box.
- Keep and extend the Peace Clause.
- Spend more, and possibly significantly more taxpayer dollars and if WTO partners don't accept the blue box, make direct payments green.

As the modalities of the Uruguay Round become institutionalized, the focus will turn to the individual elements of the agreement rather than on the more basic question of what causes trade distortions.

3.0 The EU Dairy Sector and Agenda 2000

In the dairy sector Agenda 2000 suggests: 1) lowering intervention prices by 15 percent and compensating farmers by making payments to producers on all milk, not just butter and powder (as referred to in the paper); and 2) increasing milk production quotas and allocating the increase to mountainous regions. The objectives of these changes, as described above, are to lower export subsidies, increase the effectiveness of tariffs, and presumably lower the value of the AMS.

Given the policy parameters as I understand them, I have tried to calculate some of the impacts of a 15 percent reduction in the EU intervention price for milk.

The current situation is simply a calculation of what it costs to subsidize exports, which equal 15 percent of total production, using the difference between the intervention price and the world price as the per unit value of the export subsidy.

The Agenda 2000 situation reflects the estimated impact of a 15 percent reduction in intervention prices on export subsidies, which will be lower by definition, and the cost of a direct payment to producers to compensate them for the lower returns.

- **Current Situation**[1]

Producer Payment	100 L @ $52.50/hl	=	$52.50
Restitution Payment	15L @ $30.00/hl	=	$4.50
Taxpayer Costs	0.15 x 1.2b x $30.00	=	$5.4 billion

- **Agenda 2000 Situation**

Producer Payment	100L @ $52.50/hl x .85	=	$44.60
Restitution Payment	15 L @ $22.10	=	$3.32 (-26%)

Taxpayer Costs (.15 x 1.2b x $22.10)+(1.2b x $7.09 x .90) = $4.0b + 8.5b

= **$12.5 BILLION**

It is staggering to contemplate the potential cost of continued "reform" of EU agricultural policy. There was a time when it appeared that the annual direct payments would not be transferable between producers, or between generations. While the cost would be burdensome for many years, at least in time there would be benefits to the treasury and an elimination of the trade distorting impacts of the policy. However, the proposals currently on the table do not appear to have any sunset provisions.

Many people have the impression that a part of the rationale for the MacSharry reforms, and further MacSharry style reforms was budgetary savings. Agenda 2000 implies savings in the context of the EU's WTO obligations, but these now seem to come at the cost of large and on-going direct payments.

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[1] The following assumptions are made: 1) 1 ECU = $1.75 Cdn; 2) total EU milk production = 1.2 billion hl; 3) the current price for milk in the EU = 30 ECU = $52.50 Cdn; 4) the current world price for milk is 12.9 ECU = $22.50 Cdn; and 5) the EU exports 15 percent of its production.

Following up on a question raised earlier, what is going to happen in Poland and the other countries that will soon join the EU? Like the CAP in the 1960's, higher prices will result in higher production and the need to increase exports. Will quotas have to be established to manage the situation? Has a race for base already started? How will the EU address these new export subsidy needs? It is clear that the EU wants the next WTO round to be completed by 2003, with a primary reason being the need to extend the Peace Clause which prevents countries from taking action against blue box subsidies.

4.0 The Canadian Dairy Perspective

With the signing of the WTO, there is no uniquely Canadian milk marketing system. Canada has tariffs, TRQs and subsidy reduction obligations like everyone else. In some sense, "dirty tariffication" leveled the playing field. However, Canadian dairy farmers are very concerned about:

- the current inequity between countries, e.g. if market access is to be 4%, then it should be exactly the same for every country;
- bilateral country allocations for market access; and
- the continuing extensive use of government subsidies – we have always said that "we can't compete with other countries treasuries" . . . subsidies are subsidies . . . and we need to know what are the trade distorting effects of various policies?

The use of the blue box in an EU context seems to be a way to circumvent the intent of reducing government funded agricultural subsidies. As suggested in the paper, the idea of moving these subsidy dollars into the green category, if there is too much pressure to eliminate the blue box, appears to make a mockery of the whole process. Professor Tangermann argues that "the blue box may not be as trade neutral as was once thought". It should be noted that a reduction in intervention prices would have an impact on trade to the extent that domestic consumption is expected to increase.

The Green Box has to be reviewed, it should be reserved for research, food inspection, food safety and disaster relief. The rules and protocols should be tightened. In general, the Canadian dairy industry is prepared to live with the results of the next Round of negotiations, provided that it is exactly the same for all countries, with no exceptions. If not, we'll fight for the status quo.