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AGRICULTURE IN A WORLD OF TRADING BLOCS

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The recent trend towards the negotiation of free trade areas has potentially important implications for agriculture. Agricultural trade will increasingly be influenced by the treatment of agriculture within free-trade areas and other regional trade associations. Such blocs will have to deal internally with many of the same issues as face the GATT. This will tend to reinforce the move to less trade-disruptive domestic policies. Moreover, independent trade policies become difficult to maintain in a trade bloc, even if there is no common external tariff. This could lead to harmonisation of external policies. As a consequence, the inclusion of agriculture in free-trade areas could be an important part of overall trade liberalisation in years to come.

The past few years have seen a growing concern with the prospect of a weakening of the multilateral trading system and the emergence of a small number of regional trade blocs. The fear is that these blocs will develop protectionist tendencies toward each other and (inadvertently) toward third countries, and thus force excluded countries to take shelter within other regional blocs. The benefits from a broad multilateral trade system would inevitably be compromised, though trade could still stay 'open' within the blocs. The growth of regionalism is indeed evident in many parts of the world, and the many delays that have overtaken the completion of the Uruguay Round of negotiations under the General Agreement on Tariffs and Trade (GATT) are enough to give any supporter of multilateral trade cause for concern. But the drift towards a world of trading blocs does not necessarily imply the break-up of the multilateral trade order. The GATT system still exists, and could yet be strengthened. Much will depend upon the behaviour of the blocs themselves in the next few years.

The issue of the treatment of agriculture in a world of trading blocs is likely to become more important whether or not these blocs come to dominate world trade. If they do, then world markets for agricultural

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products will be strongly influenced by the external trade policies of the bloc countries. There are reasons to believe that such blocs will tend to adopt more uniform policies toward third countries even if they remain free-trade areas rather than customs unions. But even if the trade blocs remain subsidiary to the multilateral trade system, the treatment of agriculture and agricultural policy within the blocs is of interest. There too dynamic forces can be pointed to which tend to shape policy actions.

Agriculture is treated in various ways in trading blocs and free-trade areas (FTAs).[1] In some it is ignored, as if not really subject to the same set of circumstances as other sectors. In rare cases it is treated as a regular sector of the economy, and subject to the same rules. In most cases countries have trod carefully in framing arrangements for free-trade areas so as to preserve as much as possible of the domestic autonomy of farm and food policies. Nevertheless, the agricultural sector is bound to be affected by the existence of free trade with neighbouring countries. The only issue is whether policies will be changed quickly to take advantage of possibilities that freer regional trade brings, or whether governments will resist until the policies are modified by market pressures or they collapse.

This issue of the evolution of domestic policies in free-trade areas is in turn crucial to the interests of small 'independent' countries selling into world markets for agricultural produce. If the blocs pursue aggressive policies toward each other in non-agricultural trade, their agricultural trade relations are unlikely to be liberal. And if each country were to keep its own restrictive agricultural policy in the face of otherwise open intra-bloc trade policies, it is not clear what scope would exist for global negotiations on types and levels of support. If, on the other hand, domestic policies became modified as a result of internal trade developments within the blocs, then the international implications of such blocs could be benign. Indeed one could imagine a path to liberal international markets passing through regionally liberalized agricultural policies brought about by the forces of regional market integration.

In this paper an attempt is made to explore this path by considering the interaction between agricultural policies and free-trade areas. As a structural device, the argument is focussed on eight 'propositions'. These

[1] This discussion focusses on free-trade area agreements. In the case of customs unions, a decision will already have been taken to harmonise tariffs and (usually) non-tariff border measures. The conclusions on the impact of free regional trade on domestic policy options will apply in this case, and in common markets where factor mobility is allowed. However the analysis of areas where common financing of domestic policies has been agreed, such as the European Community, raises different issues. Bilateral preference schemes will also have some of the characteristics described for FTAs, but are often designed to transfer terms of trade benefits whilst avoiding conflict with domestic policies. For a broader survey of such trade arrangements among countries, including commodity agreements and developing-country preference schemes, see A.F. McCalla, 'GATT, Preferential/Regional Trading Blocs and Agriculture', *Review of International Economics* 1 (1), 1992.

include three observations on the nature of trade blocs, followed by three predictions on the implications of free trade for agricultural policy within the blocs and two conclusions on the implications of bloc formation for world commodity trade. No attempt is made to match systematically the propositions with actual policy developments, though some illustrations are offered to support the analysis.

Proposition 1: Free Trade Areas are the Norm Rather than the Exception in World Trade

There is a sometimes a tendency to think of free-trade areas as affecting only a few countries in an otherwise multilateral trade system. In fact, regional trade associations have a long history and wide geographical coverage.[2] To show the prevalence of such arrangements, the most significant current free-trade areas are listed, together with their constituent countries, in Table 1. The 115 countries on the list include most of the Contracting Parties of the GATT, as well as a handful that are not GATT members.[3] The regions that are almost entirely covered by FTAs are Africa, Europe and the Americas: by contrast Asia and the former Soviet Bloc have not (yet) developed regional trade associations to the same extent.[4]

The trend toward regional trade liberalization has proceeded farthest in Europe. In the European Community, a large and seamless 'internal market' was largely in place by early 1993. The negotiation of a European Economic Area which includes the EC and the EFTA countries, and of Association agreements with Poland, Hungary and the Czech and Slovak Republics, effectively sets up an economic group of over twenty countries. North America is following close behind, with the North American Free Trade Agreement (NAFTA) between Mexico, Canada and the US,

[2] For a discussion of the current status of regional trade agreements see A. de la Torre and M. R. Kelly, *Regional Trade Arrangements*, Occasional Paper No. 93. Washington, D.C.: International Monetary Fund, 1992. The issue of whether the proliferation of trade blocs has in fact led to the 'regionalisation' of world trade is discussed in P. Lloyd, *Regionalisation and World Trade*, Economic Studies No. 18, Paris: Organisation for Economic Cooperation and Development, Spring 1992.

[3] The Table does not include preference schemes, such as the Lomé Convention between the EC and the African, Caribbean and Pacific (ACP) countries and the Caribbean Basin Initiative (CBI) of the US. The EC itself is included as a part of the European Economic Area, formed between the EC and EFTA. Switzerland has not ratified the EEA Treaty. Not all the FTAs in the list are equally effective, but all have been actively used in recent years as a vehicle for freer regional trade on a multicommodity basis. Many have plans for tariff harmonization, and some aim to liberalize capital and labour flows. Some are already in customs unions. In general the FTAs listed here do not plan full economic or political integration.

[4] Trade relations among the countries of the former Soviet Union, and between these countries and others in the region, have yet to stabilize. The Council of Mutual Economic Assistance (CMEA or COMECON), which acted as a framework for trade within the Soviet Bloc has been defunct since 1991.

TABLE 1

*Country Membership of Major Free Trade Areas, 1992**

EUROPE	AMERICAS		AFRICA		ASIA/PACIFIC	MIDDLE EAST
EFTA	CUSTA	AP	ECOWAS	PTA	ASEAN	ACM
Austria	Canada	Bolivia	Benin	Angola	Brunei	Egypt
Finland	USA	Colombia	Burkina Faso	Barundi	Indonesia	Iraq
Iceland		Ecuador	Cape Verde	Botswana	Malaysia	Jordan
Norway	NAFTA	Peru	Cote d'Ivoire	Comoros	Philippines	Libya
Sweden	Canada	Venezuela	Gambia	Djibouti	Singapore	Mauritania
Switzerland	Mexico		Ghana	Ethiopia	Thailand	Sudan
	USA	Mercosur	Guinea	Kenya		Syria
EEA		Argentina	Guinea Bissau	Lesotho	CER	Yemen (Dem)
EC-12	CARICOM	Brazil	Liberia	Madagascar	Australia	
(Belgium	Antigua/Barbados	Paraguay	Mali	Malawi	New Zealand	
Denmark	Bahamas	Uruguay	Mauritania	Mauritius		
France	Barbados		Niger	Mozambique		
Germany	Belize	CACM	Nigeria	Rwanda		
Greece	Dominica	Costa Rica	Senegal	Seychelles		
Ireland	Grenada	El Salvador	Sierra Leone	Somalia		
Italy	Guyana	Guatemala	Togo	Swaziland		
Luxembourg	Jamaica	Honduras		Tanzania		
Netherlands	Montserrat	Nicaragua	CEEAC	Uganda		
Portugal	St Kitts/Nevis		Burundi	Zambia		
Spain	St Lucia		Cameroon	Zimbabwe		
United Kingdom)	St Vincent and		Central African			
Austria	The Grenadines		Republic	SACU		
Finland	Trinidad/Tobago		Chad	Botswana		
Iceland			Congo	Lesotho		
Norway			Equitorial Guinea	Nambia		
Sweden			Gabon	South Africa		
			Rwanda	Swaziland		
			Sao Tome and Principe			
			Zaire			

*Bilateral preference arrangements are excluded.

Key:

ACM = Arab Common Market
AP = Andean Pact
ASEAN = Association of SouthEast Asian Nations
CACM = Central American Common Market
CARICOM = Caribbean Common Market
CEEAC = Economic Community of Central African States
CER = Closer Economic Relations Agreement
CUSTA = Canada-US Free Trade Agreement
ECOWAS = Economic Community of West African States
EEA = European Economic Area
EFTA = European Free Trade Association
MERCOSUR = Southern Cone Common Market
NAFTA = North American Free Trade Agreement
PTA = Eastern Southern Africa Preferential Trade Agreement
SACU = South African Customs Union

which builds upon the earlier Canada-US Free Trade Agreement (CUSTA) and promises a tariff-free zone for most commodities over a ten year period.

Prompted by these activities, several regional schemes have been revived or formed in Latin America and in Africa. In Latin America, the formation of MERCOSUR among the Southern Cone countries (excluding Chile), and the decision by the Andean Pact countries to form an Andean Common Market by 1995, has strengthened the often shaky level of economic cooperation in this region. The countries of the Central American Common Market have signed a framework agreement for free trade with Mexico by 1996, and can be expected to negotiate terms with the other NAFTA countries.[5]

In Africa which is riddled with regional trade agreements since the colonial days, a new sense of urgency is apparent. The continent (south of the Sahara) is now covered by four trade agreements: the Economic Community of West African States (ECOWAS) in West Africa, formed from the expansion of the Francophone West African Economic Community (CEAO) to include Anglophone countries; the Economic Community of Central African States (CEEAC) in Central Africa, a revitalization of the Central African Customs and Economic Union (UDEAC) arrangement of the 1960s; the Preferential Trade Area of Eastern and Southern Africa (PTA), which includes countries that were in the defunct East African Customs Union (EACM) as well as those in Southern Africa; and the Southern African Customs Union (SACU), which covers those countries closely aligned with South Africa. The ultimate objective has been agreed in the OAU to work towards an African Economic Community, on the basis of such sub-regional groupings, by the turn of the century.

Discussions among the Pacific Rim countries are also aimed at establishing a regional trade identity. The only true Asian regional association, the ASEAN, has had a political and security focus. These countries have now agreed to establish an ASEAN Free-Trade Area (AFTA), which would liberalize internal trade in 15 years. Broader economic groupings have been suggested, most prominently by Malaysia, as a way of reacting to European and North American regional blocs.[6] So far discussions held under the umbrella of the Asia-Pacific Economic Cooperation (APEC) meetings have not proceeded far.[7] Issues of membership and objective

[5] Among those facing a less certain future are the CARICOM countries, many of whom have preferential access to the US through the Caribbean Basin Initiative (CBI) and to the EC through the Lomé Convention, who face the prospect of an erosion of those preferences. These countries may also be obliged to join a widened NAFTA to remain in contention for investment funds and to keep access to the US market.

[6] The Malaysian suggestion would have led to an East Asian Economic Caucus, comprising ASEAN, Japan and several other countries in the region.

[7] APEC was formalised in 1989 to act as a forum for the discussion of trade and trade-related issues in the Pacific Rim. It was not envisaged at that time as a trade bloc. More recently, APEC has set up a Secretariat and called for a program to be prepared which would lead to regional trade liberalization. APEC includes the US and Canada, who are not in favour of a preferential regional trade agreement in this area.

seem at present insoluble, and a Uruguay Round outcome that will revive multilateral trade rules is still considered the most desirable option by countries in the Asian region.[8]

Proposition 2: Free Trade Areas can coexist within the Multilateral System

It would appear from their prevalence that Free-trade areas fill some kind of political or economic need not satisfied by the multilateral trade arrangements.[9] The political attraction of these trade blocs is that they can be portrayed as both a step towards more open trade and as a line of defence against competitors. They will still be opposed by protectionist elements, championing those whose jobs are threatened by freer trade, but are likely to have widespread support in the business community. As economic struggles replace the security tensions of the Cold War, alliances such as these may come to replace defence groupings as a focus for foreign policy. And in international forums, groups of states may come to play the role of the superpowers.

The economic case for free-trade areas is also a mix of liberal and neo-mercantilist objectives. The liberal case rests on the notion that the process of removal of trade barriers is easier in regional markets. This case is strengthened in such areas as services, where little multilateral trade liberalization has been evident until now, and in intellectual property rights, where new codes of conduct are needed to deal with new technologies. Service trade may expand much quicker within regional markets, where regulations which govern labour and capital flows can be more easily coordinated. In these areas, several of the FTAs are pushing ahead of the Uruguay Round. Should the Round be successfully concluded, their provisions will be less necessary. In the absence of a Uruguay Round agreement, regional trade blocs could well have a growing role in the facilitation of such trade.

The most significant aspect of regional liberalization is likely to be investment. The attraction to investors at home is that domestic firms can invest in the relative safety of the partner economy, with less chance of discriminatory action by the host government, to take advantage of cost differences such as lower wage rates. Overseas investors can be encouraged with the assurance of access for the finished product in an expanded 'home' market. As such, regionalism is a spin-off from the 'globalization' of business associated with the 1980s. In this respect, profitable invest-

[8] A central Asian bloc, including six former Soviet republics together with Afghanistan, Iran, Pakistan, and Turkey, is in its infancy as the Economic Cooperation Organisation (ECO). Another trade group links India, Pakistan, Nepal, Sri Lanka, the Maldives, and Bangladesh in the South Asian Association for Regional Cooperation (SAARC).

[9] For a recent discussion of the implications for the multilateral system of the increased interest in regionalism see K. Anderson and R. Blackhurst (eds), *Regional Integration and the Global Trading System*, New York: St. Martins Press, 1993, as well as Lloyd, *op cit.* and de la Torre and Kelly, *op cit.*

ment is encouraged by the reduction of uncertainty, though the alternative of multilateral agreements on investment could still be better if they were possible. When combined with general liberalization in a multilateral context, regional trade and investment liberalization serves to add to growth and employment, and to make better use of the world's resources. The phrase 'open regionalism' has been coined to denote this plurilateral liberalization.[10]

The problems posed by such alliances stem from the defensive nature of much of trade policy, and the likelihood that this might become manifest in the use of trade restrictions at the regional level. It is a fine line between encouraging partner investment and discouraging investment from third parties. The existence of a regional agreement, for example, against expropriation of property held by foreigners implies that the excluded parties have less protection. Investment costs for those countries will be higher to cover greater risks. At times of economic hardship, such subtle discrimination can easily turn to blatant protection. This highlights the need for strong multilateral institutions and rules to oversee the trade blocs and their relationship to one another. Agriculture is likely to be influenced by the extent to which trade blocs can fit into the multilateral system without becoming inward-looking and protectionist.

Proposition 3: Agriculture causes Problems for Free Trade Areas, and is Included Unwillingly

Agriculture has often been left out of FTAs, or treated in a way which has effectively excluded agricultural trade from their provisions. This may not be a possible solution in the future, if these arrangements take on greater significance in national trade policies. There are four major reasons to include agriculture in the provisions of an FTA. Firstly, exporter members will want access to importer markets for their agricultural goods. Only an alliance among food-importing countries is likely to be able to ignore agricultural trade altogether. Secondly, food cost differences among countries within the FTA, arising from different agricultural prices, could both distort trade and investment patterns and cause problems of wage comparability. Thirdly, if agriculture is excluded, the food sector will tend to remain national in scope, as a result of different raw material costs and regulations, and may not be internationally competitive. And lastly, it is not GATT-legal to exclude agriculture from free-trade agreements. Article XXIV requires that such agreements cover essentially all trade among the partners.

[10] For a discussion of Open Regionalism in a Latin American context, see C. Reynolds, 'Notes on the Enterprise for the Americas Initiative and the Andean Pact: Open Regionalism in the Andes', Americas Program Occasional Paper, Stanford University, July 1992. A recent argument for its extension in the Pacific Basin is contained in Sir Frank Holmes and C. Falconer, *Open Regionalism? NAFTA, CER and a Pacific Basin Initiative*, Institute of Policy Studies, Wellington, 1992.

There are in essence only two reasons to exclude agriculture from the provisions of a free-trade area. Most domestic agricultural price policies require protection at the border in order to be effective. As a consequence, free trade poses a threat to the operation of such programs. And negotiations are likely to be complicated by domestic farm policy considerations. Politicians cannot be blamed for taking the easy way out when faced with negotiating regional access to cherished domestic agricultural markets.

In the treaty establishing the European Free Trade Association (EFTA) in 1960, agriculture was left out at the insistence of the British, who did not wish to weaken preferences for the Commonwealth (Canada, Australia and New Zealand in particular). The EFTA-EC bilateral trade agreements (1973), again left agriculture out, as no EFTA preferences were being eroded by accession of Denmark and the UK to the EC. In the more recent negotiations leading to the creation of the European Economic Area (EEA) in 1992, agriculture has been largely left out of the EC/EFTA internal market agreement, to the chagrin of the Spanish who would like to have had better access to the rich Nordic and Alpine markets for mediterranean products. A series of preferential quotas is included in the EEA which only serve to highlight the current fragmented nature of the market for many agricultural goods in EFTA.

The various Latin American free-trade agreements have in the past been focussed on industrial products, though the new generation of more open agreements include provisions for agricultural trade liberalization. The bilaterals being negotiated under the framework of the Enterprise for the Americas Initiative (EAI) also are little concerned with agriculture. In Asia, regional groupings are less common, and hence have less direct influence on agricultural policy. ASEAN has operated a collective agreement on food security, involving the sharing of rice stocks at times of shortage, but otherwise has had little agricultural content. Agriculture is to be largely excluded from the recently negotiated ASEAN free trade area.

African free trade agreements have generally included provision for freer trade in agricultural goods, as these cover a large share of trade for the countries involved. However, a variety of revenue duties, coupled with the para-statal control over many of the export commodities, have made agricultural trade less than free, even when no tariff restrictions apply. Instead, the emphasis has often turned to the coordination of agricultural investment, and to common approaches to prospective donors.

In North America, the US-Canadian Free Trade Agreement (1990) included agriculture in the tariff-cutting activity, but not in the non-tariff barrier removal.[11] Neither the US nor Canada thought of the other as a big

[11] The exception to this was the liberalization of Canadian cereal import licensing, conditional on US protection levels being less than those in Canada. This condition was met soon after the implementation of the agreement. The discrimination against sales of foreign wine in provincial retail outlets was also curbed by the US-Canada agreement.

potential market, and the GATT Round seemed at that time to be taking care of agricultural trade issues. The NAFTA (1992) also has been overshadowed by the Uruguay Round. The negotiated agreement includes a set of trilateral provisions of a largely exhortative nature on the need to use less trade-distorting domestic policies and to abstain from export subsidies. The language reflects the GATT discussions, but no commitments are included. Instead, the NAFTA concentrates on the issues of market access for internal trade, avoiding conflict with domestic policies. Market access is improved by the provisions of two bilateral (US-Mexico and Canada-Mexico) access agreements for agricultural products (to supplement the US-Canada bilateral that already existed in the earlier agreement). Some substantial liberalization is to be achieved. A schedule of tariff reductions over the next decade will give Mexico better access into the US and Canadian agricultural markets, and vice versa. Non-tariff barriers are also to be phased out on US-Mexico trade, leading to a relatively free internal market for grains, oilseeds, meat and horticultural products. But, as if to reinforce the primacy of domestic policy, Canada is allowed to keep import quotas on dairy and poultry products (the 'supply managed' commodities), at least until forced by a GATT agreement to convert them to tariffs.

Among the range of free-trade areas that exist, perhaps only the Closer Economic Relations (CER) Treaty between Australia and New Zealand fully incorporates agriculture. This was made easier by the sharp reduction in the level of protection of the sector in New Zealand in late 1980s, and by the deregulation of marketing systems in the two countries in the last few years.

Proposition 4: FTA members will have to modify their agricultural policies to accommodate free intra-bloc trade

Intra-bloc agricultural trade problems arise for the same reasons as those within the GATT. Domestic programs require border measures to be effective; removing these border measures would make domestic programs difficult to work. The question is how to allow free trade within an FTA without eliminating needed domestic programs.

Free trade implies the absence of deliberate tariff barriers and such non-tariff trade barriers as quotas and parafiscal taxes. By extension, it can mean the absence of discriminatory policies that treat imported goods less favourably than those of domestic origin. If a truly 'level playing field' were aimed for, then all policies would have to be outlawed that give any form of assistance to domestic firms.[12] Taken to this extreme,

[12] It is conceptually useful to make a distinction between 'free trade', usually defined in the economic literature as the absence of restrictions on cross-border goods movements, and a 'single market' between two or more countries, in which all producers (and consumers) face similar conditions. In practice, many political discussions of free trade

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provision of most public goods by national authorities would be affected, as the quantity, quality, and method of financing of such government activities undoubtedly influence competition. Governments, however, are not likely to accept the argument that forming a free-trade area involves giving up all domestic sectoral, regional and industrial policies. In practice, the question is how to constrain policies that give a marked incentive to expand the production, or reduce the consumption, of a product of export interest to a trading partner.

In the GATT negotiations on agriculture, the concept of classification of policies has taken hold. Policies are categorized as to whether they are more or less trade distorting. A similar classification of policy instruments can be used to identify those likely to be of particular significance in free-trade area talks. For this purpose it is useful to make a distinction between 'coupled' and 'decoupled' policy instruments. In this context, a 'coupled' policy rewards or taxes producers (consumers) on the marginal unit of production (consumption). Output or use decisions, therefore, are directly affected by the policy.[13]

Four combinations of producer and consumer policy types are possible, as shown in Table 2. Policies that are coupled on the producer side are likely to cause the most problems for intra-bloc trade. These include primarily the set of policies that operate at the border, which are coupled to both production and consumption decisions. Policies decoupled on the consumer side include various producer subsidies paid in a way that allows market prices to find their own level. These will be somewhat less contentious, but still raise issues of competition among producers. Producer-decoupled programs include coupled consumer taxes and subsidies, which are unlikely to be of major concern in an FTA, and those fully decoupled instruments that do not directly affect market price and hence are likely to be broadly acceptable to all of the trading partners.

The issue of direct trade policies could be expected to be the most immediate concern in FTAs. The issue will emerge as a conflict between protected domestic producers and those wishing to gain access to that market through the provisions of the FTA. The natural focus of negotiations in the case of tariff protection is to agree on a reduction of such tariffs on intra-bloc trade, leaving members to run their own external commercial policy. The tariff reductions can be subject to safeguard provisions, which can act to 'snap-back' tariffs if imports rise too

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are concerned with issues of dissimilar regulatory burdens and their impact on competitiveness.

[13] This definition of a coupled policy is less rigorous than others that can be suggested. For instance, lump sum payments do not affect marginal decisions directly but may be enough to keep a producer in business, borrow to finance expansion, and choose one product over another. Too strict a definition of decoupled policies is probably unconstructive in the context of FTAs: too few policies would qualify, and the attempt to modify national policies could be abandoned.

TABLE 2
Classification of Instruments According to Degree of Coupling

	Producer Coupled	Producer Decoupled
Consumer coupled	*Incompatible with FTA Allowed on third-country trade*	*Likely to be tolerated in FTAs*
	Import taxes, levies	Consumer subsidies
	Import quotas	Storage subsidies (consumer level)
	Export subsidies	
	Voluntary export restraints	
	Home-market schemes and two-price schemes	
	Producer-financed export subsidies	
	State trading	
Consumer decoupled	*Likely to be challenged in FTAs as distortion of competition*	*Allowable under FTAs*
	Producer subsidies	Food stamps
	Deficiency payments	Crop insurance
	Storage subsidies (producer level)	Hectarage payments
	Set-aside payments (incentive component)	Set-aside payments (decoupled component)

quickly.[14] In the case of import licenses and quotas it is expected that there would be a relaxation of quantitative restrictions on partner trade over a period of time, or the conversion of non-tariff barriers to tariffs.[15] Domestic pressure groups will try to influence the time period allowed for adjustment and the transition period, as a consequence, may be much longer than the actual time needed for such adjustment. Firms will be keen to protect the value of their capital investment; a long transition period

[14] The use of snap-backs is widespread in the US-Canada Free Trade Agreement in the area of fruits and vegetables.

[15] The US-Canada Free Trade Agreement included liberalisation of Canada's import licensing arrangements for cereals, as noted above. NAFTA goes further to include tariffication of a large number of non-tariff import barriers.

preserves for a time the stream of protected receipts and hence prevents a free fall in asset values.

Export subsidies are also likely to be objectionable to producer interests in an FTA, on grounds that competition is distorted. Governments in general will have less difficulty reducing export subsidies on internal FTA trade, despite the fact that such subsidies offer protection to producers.[16] It is somewhat easier for an industry to claim protection against imports than to argue for export assistance. Quantitative controls on exports within the bloc, such as might be used to keep prices down in times of shortage, can also be outlawed with relative ease. Voluntary Export Restraints (VERs) have become a part of the commercial armoury of a number of countries: it would seem natural that FTA partners remove all VER arrangements between them, perhaps after a transition period.[17]

Among other export-related policies that are likely to cause problems for FTAs are home-market schemes (where a higher domestic price gives an implicit export subsidy as a result of revenue pooling) and 'producer-financed' export subsidies, paid from a producer levy rather than from the taxpayer.[18] Such policies distort competition and will be natural targets for negotiation. However, in so far as they are run by marketing boards there could be considerable resistance to change.

This problem of what to do with institutions that run policies counter to an FTA arises also in the case of state trading. A parastatal importer can offer protection without the need for a tariff or explicit quota. The effective quota is the amount imported, which can be less than would have come in under free trade, and the implicit tariff revenue is the profit made by reselling on the domestic market. Export agencies also can influence traded quantities, often giving an effective subsidy through trading losses. A country may be reluctant to give up its cherished institutions on account

[16] The US-Canada Free Trade Agreement removed export subsidies on intra-FTA trade in agricultural products, presumably because both countries have a similar export composition. The issue is not so clear-cut when one country is an importer. On occasions, an importing country may wish to keep the advantage of subsidized imports from the partner, at the expense of domestic producer interests. NAFTA, therefore, allows export subsidies on internal trade if the importer agrees to them, and in cases where the importer is benefitting from subsidised goods from third countries. This allows, for example, continued US government credit guarantees on sales of dairy and grain products to Mexico.

[17] This happened in both the US-Canada Agreement and in the NAFTA: each country exempted its partner(s) from the application of VERs on meat.

[18] Home-market schemes were in part responsible for a delay in incorporating certain agricultural sectors into the full application of the New Zealand/Australia CER Agreement. Domestic policy changes had to occur before this goal was realized. Australia eventually modified its dairy policy, for example, so that the domestic consumer price for dairy products corresponded to the price of New Zealand produce. 'Producer-financed' export subsidies should be more properly called consumer-financed export subsidies, as it can only be profitable for the producer to sell more cheaply abroad if the domestic price is raised above the world market price. As with the home-market scheme, such producer-controlled policies require import restrictions to operate and are usually associated with parastatal marketing boards.

of an FTA: in practice, some accommodation will have to be found to prevent conflicts arising within the FTA from state trading activity.

Producer subsidies raise problems for FTAs only slightly less serious than direct trade barriers. Competitors in other countries are likely to challenge producer subsidies as distortive of competition. The economic case for the removal of such subsidies is not clear-cut: the policies may be desirable responses to divergences of a specific national character. In terms of political economy, the success of the FTA may hinge on the willingness of governments to give up the right to distort competition even when national conditions might warrant such policies.

Deficiency payments are a special type of producer subsidy, triggered by the relationship between market prices and a pre-set guaranteed price. They add stability to farm prices (if not incomes) and are generally considered by recipients to be the next best thing to adequate market prices. To give up these policies in an FTA may prove difficult. It may be necessary to put limits on such subsidies, or to attempt to harmonize the levels of such assistance.[19] In the end, it is likely that attempts would be made to 'decouple' such payments, as has been done for the purposes of control of domestic spending.

Among the other forms of producer subsidy, storage subsidies (at the producer level) pose similar problems, in principle, but are in practice likely to be less provocative: they act to remove surpluses when prices are low and may be deemed helpful to the partner country in the FTA. This may not be the case with paid supply-control programs. The subsidy element in such supply-control programs however, is likely to be contentious. Set-asides, for instance, are usually ways of restraining the quantity of output that can benefit from support prices. Therefore, they should be judged as a part of a producer subsidy program. Conceptually it is possible to distinguish between that part of a set-aside payment that is production-neutral and that which is in effect a production-stimulating subsidy.[20]

Consumer subsidies are unlikely to generate significant problems within an FTA, even though they may distort competition. There is enough of a mercantilist flavour to most FTAs to welcome any trade-expanding measure. Schemes that encourage storage (at the wholesale level) in general will also be found unobjectionable. Stability from such storage will benefit all partners.

Similarly benign are programs that are effectively decoupled from output and consumption decisions, such as food stamps (which act much as an income supplement) and crop insurance (so long as it is not com-

[19] The US-Canada Free Trade Agreement attempted to deal with this issue in the context of opening up Canadian markets to US grain, as noted earlier.

[20] If P_s is the (marginal) support price, P_w the world price, and P_i the price at which the actual output would be the same as that with the policy (the 'incentive' price), then $(P_i - P_w)$ is the price incentive and $(P_s - P_i)$ is a production-neutral subsidy. See C. Bray, T. Josling and J. Cherlow 'Adjustments for Set-Aside Acres in Agricultural Trade Agreements: An Example from the Canada-US Trade Agreement', *Canadian Journal of Agricultural Economics* 40, 1992, p. 25.

modity specific). Payments per hectare, such as is envisaged in the MacSharry proposal for the EC, may raise some questions in an FTA, but if truly decoupled from current output decisions they may have a minimal impact on competition. The decoupled element of set-aside payments could also be deemed to be non-distorting within an FTA.

The implication of those observations is that over time one would expect to see a qualitative shift in domestic policies as a result of negotiations within FTAs. Moreover, members will tend to modify their policies over time even if not the subject of negotiations, as a way of adjusting to the reality of intra-bloc trade. The trend toward policies decoupled on the producer side is likely to be accelerated as a result of FTA negotiations on agriculture.

Proposition 5: FTA members will also change their third country trade policies over time

The problem of domestic instruments as barriers to market access for FTA partners is the focus of most attention in free-trade negotiations. On the face of it, members can remove those policies that cause the most trade friction within the FTA and still maintain their individual policies against non-members. But an equally important issue that has received remarkably little attention is the impact of freer intra-bloc trade on the effectiveness of trade policy instruments that might be used by member countries on third country trade.

The act of opening up the domestic market to an FTA partner changes the range of policy instruments that can be used on third country trade. The issue then arises as to which policies can survive best in an FTA. The range of policy instruments where the trade measures apply only to third-country trade are shown in Table 3. Significant changes in their effectiveness are apparent. The feasible commercial policy set in an FTA is much smaller once protection against partner trade is removed. The loss of policy effectiveness can be illustrated by considering the various instruments in the presence of free partner trade.

The problem of disparate tariffs on third country trade among FTA members is well known. Trade can be 'deflected' through the country with the lowest border protection and dilute the protection in the other countries. It is normal in FTAs to deal with trade deflection by means of rules of origin. To qualify as 'internal' a product must have undergone a substantial transformation (or acquired a particular value added) in the partner country. Unfortunately, this remedy is of limited use for agricultural products. Rules of origin are both more difficult to enforce and likely to be less effective for a homogeneous good: even if the origin could be traced of a particular bushel of wheat or gallon of milk, national supplies are fungible. The low-priced country could import up to its total consumption needs in order to free up exports to the high-priced market.[21] The

[21] For a detailed treatment of the issue of rules of origin in free trade areas, see Hirofumi Shibata, 'The Theory of Customs Unions: A Comparative Analysis of Customs

continued . . .

TABLE 3
Impact of FTA on Effectiveness of Third-Country Trade Policy Instruments

Policy	Impact of FTA
Tariff on 3rd country imports	tariffs above lowest partner level become ineffective
Quota on 3rd country imports	quotas become ineffective
Export subsidy on 3rd country trade	subsidies become more expensive
Voluntary export restraint on 3rd country trade	restraint becomes ineffective
Variable import levy on 3rd country trade	stability property lost

significance of this 'leakage' will depend upon the size of domestic production in the low-price partner relative to imports into the high-price region. The impact can range from the capture of some rents by the low-price partner exporters all the way to the erosion of the market price in the high-price country to that of the low-price market. Such arbitrage could only be stopped by interfering with the external trade policy of the low-price partner.[22]

Similar problems apply in the case of import quotas on third country trade. One country cannot effectively maintain such quotas if its partner with free access does not. Import quotas can be fully effective only if 'regionalized' to apply to both markets — in effect the introduction of a 'common policy' — just as tariffs will be fully effective only if harmonized. Third-country import policy can still be nominally independent in an FTA, but in practice pressures will mount for coordination in the case of homogeneous products.

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Unions, Free Trade Areas, and Tax Unions', in C. S. Shoup (ed.), *Fiscal Harmonization in Common Markets*, Columbia: Columbia University Press, 1967. Shibata demonstrates that the effect of rules of origin are to create 'an artificial product differentiation between the area-origin product and the non-area-origin product' (p. 177) which results in different prices for the two types of product. But for this result he needs to assume that 'the anti-trade-deflection measures work perfectly and that inflows of the product from the world [through the less protected country] do not take place at all.' If the low protection country sells its own production inside the FTA and imports an equivalent amount from outside, the result is as if the rules of origin did not work perfectly.

[22] The ease of arbitrage is in fact a continuum, with undifferentiated bulk products at one extreme and location-specific goods at the other. For location-specific products, rules of origin are not strictly necessary: for bulk goods they can be largely vacuous. For goods in between, these rules are of greater or lesser significance in influencing trade and preventing deflection.

Export policy fares no better. An export subsidy (on third country trade) may survive the negotiation of an FTA. But if there is free access into the market of the subsidizing country, and supplies are fungible, production from the non-subsidizing country will flow to the subsidizing partner and over time may cause the policy to collapse.[23] Voluntary export restraints suffer the same fate: there is little point in negotiating such restraints with third country suppliers at the front door if the back door is open.[24] Once again, the solution is either common policies or the abandonment of the instruments. Home-market schemes and 'producer-financed' export subsidies also lose their efficacy in a situation of free partner access, even if restricted to third countries. The ability of the marketing board to operate such schemes is impaired by lack of control of all sources of supply. Consumers in effect can choose not to subsidize exports: they merely buy partner products.

Also influenced by the operation of an FTA, as market access within the area is improved, is the stabilizing effect of the variable levy. If one member of the FTA has a fixed tariff and another a variable levy, the fixed tariff will come to dominate the levy. Prices in the country previously protected by the levy will tend to follow fluctuations of the world price plus the fixed tariffs, with arbitrage among the markets vitiating the effect of the levy. Other stability devices (such as variable export subsidies) potentially suffer the same fate. In general, it is difficult for one country to stabilize its market if it has free trade with a less stable partner: instability will flow across the border. This will tend to lead to either a departure from FTA principles or a common stability policy.[25] Independent stability policies will not survive for long a regional free trade regime.

Proposition 6: Domestic Policies in FTA Members are likely to Change even when they do not Conflict with Intra-Bloc Trade

The ability of countries within an FTA to run independent policies on third-country trade are de facto restricted by arbitrage; but surely they can still run domestic policies to maintain and stabilise farm incomes? Arbitrage, however, has a debilitating impact on even such 'domestic' policies (see Table 4.)[26] Take as an example the control of domestic markets through storage schemes. It follows from the arguments above that storage policies will become less effective, as one partner attempts to stabilize

[23] Concerns have already been raised over the *de facto* export of Canadian grains under the US Export Enhancement Program.

[24] One would expect, for instance, that the VERs on US meat imports from Australia and New Zealand will soon become NAFTA-wide VERs.

[25] To the extent that production fluctuations *within* the FTA offset each other, stability may be increased with free trade among partners.

[26] This phenomenon has a parallel in the concept of regulatory competition (or '*ex post*' harmonisation) as discussed, for instance, by Peter Lloyd. See P. Lloyd, *The Future of CER*, CEDA Monograph No. 96, Victoria University Press, Wellington, 1991.

the whole FTA internal market. There may be no objection from trading partners to such a scheme, but it might prove too expensive for one country to have to stabilize the whole FTA market. In addition, different policies toward trade with third countries will make such storage schemes even less manageable. The 'storing' country could attract imports through the lowest-price FTA member. If this member chose to buy at world market prices, the storage policy would in effect be attempting to stabilise world markets. Without some coordination of import regimes, it is not easy to see how any country could run its own independent storage scheme. The tendency will be to develop coordinated or collective storage policies.

TABLE 4
Impact of FTA on Effectiveness of Domestic Policy Instruments

Policy	Impact of FTA
Government financed storage scheme	storage scheme becomes less effective
Quantitative limit on domestic marketing or production	quota becomes ineffective as price raising device
Deficiency payments	not directly affected: cost may be raised or lowered
Consumer subsidies	not directly affected: cost may be raised or lowered
Crop insurance	not affected
Hectarage payments	not affected
Food stamps	not affected

The same result is even more evident in the case of the control of domestic supply through production or marketing quotas. Free partner trade will not in itself prevent such quotas from operating. The effectiveness of such quotas, however, will be significantly limited. It is clear both from economic analysis and trade policy practice that domestic supply controls need trade measures as support. If substitute production can be freely imported from an FTA partner, the supply control will be ineffective in maintaining price.[27] This is the reason behind the exception in the GATT to the rule of 'tariffs only' (Article XI), which allows quantitative restrictions when domestic production is controlled. It also lies behind the use of import quotas under Section 22 of the US Agricultural Adjust-

[27] Production could still be controlled to limit government expenditure. Political support for such limits could erode, however, if it was clear that no price enhancement was being achieved.

ment Act (as amended) which mandates such action in support of domestic policies. FTAs put to the test the issue of import barriers in support of domestic quotas.[28]

The relationship between the formation of an FTA and the ability to run independent domestic producer and consumer subsidy programs is less clearcut. Such subsidies could be ruled out on competition grounds, as indicated above. But those that survive might also be weakened by the free access provisions of the FTA. The problem arises from the lack of control over domestic market prices. As domestic market prices fluctuate, so the cost of deficiency payments will vary. Without the ability to influence the price level in partner countries, such programs could be vulnerable. In general, if the consumer and producer subsidies survive the 'competition' test of the FTA, they probably can survive the arbitrage that would follow the opening up of market access.

Decoupling such policies from output decisions, suggested above as the response to the intra-FTA competition issue, would also tend to free farm incomes from market prices. The set of decoupled policies listed in Table 4 will generally be left unaffected by freer intra-bloc trade. Crop insurance, hectarage payments (for the reduction in price support, tending the land, or abstaining from chemical dependency) and food stamps can all thrive in an environment of free trade. In some cases, there might be higher costs, if market prices fell or were more unstable, but such extra costs in effect would be compensation for the beneficial impact of lower cost supplies. It is no coincidence that the same set of policies are being proposed for the 'green box' in the GATT negotiations. Policies that are consistent with free regional trade are also likely to be acceptable at the international level. They are not only consistent with market access and competition needs of an FTA but also, almost alone among existing policies, they can be run effectively in the presence of free trade among partners. The re-instrumentation of policies towards decoupling and targeting may be the only way for farm groups to preserve benefits without facing head-on the movement to regional free trade.

Proposition 7: FTAs can be Complementary to a GATT Agreement on Agriculture: Each can Help the Other

The difficulties of including agriculture in an FTA, taken together with the realities of arbitrage in an FTA, as explored in the last two propositions, imply three options for agricultural policies. They can be preserved from the discomfort of regionally free trade by the exclusion of agriculture from the major FTA provisions, by allowing border interventions and discriminatory domestic programs to continue. As an alternative, there

[28] An indicated above, in the case of NAFTA the test was failed. The Canada-Mexico bilateral specifically reinforces the right of Canada to impose import quotas in defense of domestic supply restrictions for dairy and poultry markets.

could be a movement toward uniform bloc policies, involving 'common policies' or coordinated national policies and national treatment for partner supplies. Or the members of the free-trade area could change to policies which rely on simple border tariffs and decoupled payments.

The relation between regional and global attempts to liberalise markets will depend on which outcome materialises. Leaving agriculture out of FTAs does not itself help the process of finding a solution to the multilateral trade problems. It may be politically convenient to sell an FTA as having no impact on domestic farm support policies, but this places additional burdens on global talks to impose such constraints. By contrast, the development of harmonised or collective policies by trade blocs could make negotiation at a global level somewhat easier: problems might be internalised within a group that would otherwise slow down multilateral talks.[29] Policy change along the lines discussed above will also contribute to successful global negotiations. If FTAs move for internal reasons toward decoupled policies, then agreements at a multilateral level would be facilitated.

In this connection, it is interesting to consider the benefits of a GATT agreement for the internal FTA developments. As exclusion of agriculture from FTAs threatens to create the same trade conflicts within FTAs as it has in the GATT, a GATT agreement will tend to reduce these trade tensions. If agriculture is included, then external trade policies will be modified. Movement toward common bloc agricultural policies could pose a problem for trade, but is much less threatening in the presence of a strong GATT to referee the development of such policies. Internal policy change will be encouraged by a GATT agreement. The movement toward decoupled payments would be made much easier by a GATT agreement along the lines of the Dunkel Draft, as the move to 'green box' payments would simplify the negotiation of FTAs. A favourable GATT outcome would make negotiation of these agreements much easier. GATT decisions, such as on the definition of acceptable subsidies, could be incorporated which would have to be negotiated separately if there were no GATT deal. In the case of EC enlargement, for example, transition periods for tariffs and green-box payments could be envisaged, avoiding the confusion of policy harmonization of previous enlargement exercises. Paradoxically, a GATT deal could give a boost to regional trade arrangements for agriculture.

[29] Experience with the EC suggests that this benefit presupposes a clear mandate for negotiation on behalf of the bloc. If policies are *de facto* harmonised then some of the advantages may be lost.

Proposition 8: Free-trade Areas will not however Solve the Problems of World Agricultural Markets

The final set of issues relates to the links between the intra-bloc treatment of agricultural trade and policies and the situation on world markets. Among the analytical issues in this context are the impact of regional free trade on world market price levels and stability, and the conditions under which trade diversion may have an impact upon countries not part of trade blocs.

These questions do not have a straight-forward answer. The significance of the treatment of agriculture within an FTA on outsiders depends on a number of factors. Paramount among these are protection levels in the FTA countries and the trade interests (i.e. as exporters or importers of agricultural products) of the participants. Internal problems are most likely among the protectionist FTAs. Two high-priced importers will tend to have conflicts over trade deflection, each cautious about weakening its own internal market price. One would expect the protection levels in these countries to move together over time as a way to avoid such problems. An alliance between two high-priced exporters may also lead to internal conflicts, this time over the level of subsidies in each member, and there might be pressures to reduce such subsidies.

Trade impacts on the rest of the world are more likely if the partners have different commodity balances. A protectionist importer and a high-cost exporter will undoubtedly try to expand internal trade, at the behest of the exporter, though the importer will try to resist this pressure. Trade expansion will tend to be positive for agricultural markets, but the main benefits will be captured by the exporting partner. Trade diversion is likely to swamp any positive impacts from freer FTA access.

A different set of responses can be expected if protectionist and liberal countries are thrown together in an FTA. A protectionist importer paired with a liberal importer will be primarily concerned with avoiding trade deflection through the liberal partner's markets. Agriculture may well be left out of the agreement, as a way of avoiding this problem. A protectionist importer paired with a liberal exporter will be more likely to include agriculture in the FTA agreement. The exporting partner will argue for more liberal access and lower prices in the importer as a condition of membership.[30] Trade creation is likely, but third countries may gain little: the improved access would go to the exporting partner, as envisaged in the intra-bloc trade deal.[31] A liberal importer paired with a protectionist

[30] The issue of a liberal exporter joining an already established union between protectionist importers is of some interest. Will the exporter be able to change the trade stance of the importers? Or will the exporter be content to turn protectionist, knowing that the size of the 'home' market will be increased by such a policy? The Netherlands faced this dilemma when it joined the Belgium Luxembourg Economic Union (to form the BENELUX Union) in the immediate post war period.

[31] This appears to be the case analysed recently by Tweeten. By confining FTAs to be trade-neutral, harmonising internal policies at a level that reproduces the present level of external trade, Tweeten estimates the internal welfare gains in the absence of any

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exporter will be concerned over the level of subsidies employed by its high-priced partner. Competition rules are likely to be high on the internal agenda. However, internal trade may not increase, and the main impact could be on third country trade, if the liberal importer becomes a 'trojan horse' for reduction in internal prices in the exporter.[32] In this case there would be negative trade 'diversion' which would be positive for world markets as subsidized exports were reduced.

With this set of possibilities in mind, it is useful to consider some of the major commodity markets and the situation in existing trade blocs and regions in discussing such arrangements. This is attempted in Table 5, which indicates in summary form the net balance of some of the major (mainly developed country) trade groups. The major trade problems of agricultural markets are represented in this matrix. The EC, North and South America, and Australasia are net exporters of wheat, seeking access into somewhat protected markets in East Asia (and in other regions not in the Table). It follows that the wheat market is not likely to be benefitted by alliances between low-cost exporters (as in NAFTA) and only somewhat indirectly by an FTA between the EC and other European countries.[33] If East Asia joined with either Australasia or North America (or even South America), some net liberalization of world trade might be expected. But most of the improved access into protected importer markets would be reserved for partner suppliers. The key relationship between the competitive exporters and those who export with large subsidies looks unlikely to be resolved in the context of an FTA.[34]

The situation for rice is somewhat similar, since the East Asian market holds the key. In this case, the key relationship would be between the US and Japan. If free trade were proposed between the two, the issue of rice would have to be faced. Any liberal solution to this problem would have world market benefits, even if the US rice producers obtained the major benefit. Corn trade into Asia is less restricted. In this case only a US-EC free trade compact is likely to have major impacts on world markets, although internal impacts of FTA arrangements could be significant for corn-consuming economies.[35] Oilseed markets are also

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external impacts. These gains are substantial in cases where high and low price countries form FTAs (and harmonise prices). See Luther Tweeten, 'Trade Regionalism: Promise and Problems' (unpublished) 1992.

[32] The accession of the UK to the EC was expected in some circles to bring a liberal influence to bear on the CAP. In the event this hope was not realised.

[33] An exception could be increases in wheat exports from Argentina to Brazil, as a result of a bilateral between those two countries. See B. Krissoff and J. Sharples 'Preferential Trading Arrangements: Wheat Trade in Western Hemisphere Countries,' (unpublished) 1992.

[34] It seems safe to assume that in any FTA between the US and the EC, the Community would ask for an exclusion of agricultural trade. Inclusion of such trade would have major repercussions for other countries.

[35] This is particularly true of Mexico in the context of the NAFTA, where inclusion of corn as an item to be liberalized will have major impacts on the rural economy.

TABLE 5

Representation of Commodity Balance and Regional Trade Blocs

Commodity	South America	North America	European Community	EFTA and EE	East Asia (inc. Japan)	Australia & New Zealand
Wheat	+	+	+	=	–	+
Rice	=	+	=	–	+/–	=
Corn	+	+	+/–	–	–	=
Oilseeds	+	+	–	–	–	=
Dairy	=	= /–	+	+	–	+
Meat	+	=	+/–	+	–	+
Sugar	+	–	+	=	–	+
Fruits and Vegetables	+	+	–	–	–	+

Key:

+ indicates export surplus

– indicates import deficit

= indicates approximate self-sufficiency

+/– indicates import possibility with lower protection

likely to be only affected by free trade agreements between the US and the EC, although freer trade in oilseeds between South America and the EC would have an impact on world prices.

The situation is somewhat different for dairy products and meats, where the US is not a major exporter. In the case of dairy, it is not easy to see an FTA putting significant pressure on dairy protection in the EC, except as a result of some EFTA surpluses.[36] Australia and New Zealand once had an FTA with the UK, which stimulated beef, sheep, and dairy exports to that country. New Zealand has special access still in that market. Even a free-trade pact between the EC and Australasia would be unlikely to bring relief to the dairy market. The beef and sheepmeat markets could be helped by regional free trade agreements, as between Australasia and East Asia.

Sugar is one of the few commodities in which regional free trade could take significant pressures off the international market, if domestic producer interests would countenance such a move. In particular, the US market could expand to absorb exports from the Caribbean, Central and South America.[37] At present, sugar trade policy is designed to protect the workings of domestic price support systems. If this protection were removed in regional negotiations (or in the GATT), there would be benefits to world markets.[38] Similar benefits could be achieved in some fruit and vegetable markets, where regional trade flows are both complementary and significant in terms of world trade. The trade relationships between the EC and Eastern Europe and the Mediterranean, and between the US and Central and South America, each have the potential for influencing world markets for certain fresh fruits and vegetables.

Conclusion

In this paper an attempt has been made to expand the discussion of agricultural trade policy and free trade areas by emphasising the dynamics of policy choice. Including agriculture in a free trade area sets up a series of pressures both direct, through the need to negotiate about agricultural trade, and indirect, as arbitrage puts limits to domestic autonomy. The impact of the establishment and strengthening of trade blocs on agricultural trade will be felt most directly through their effect on the external

[36] There could however be pressures arising from the impact of trade-liberalisation in other commodities. Reduction in cereal protection, for instance, could stimulate changes in dairy policy as farmers switch resources to livestock activities.

[37] The NAFTA includes the incorporation of Mexico into the US sugar market, after a transition. This could provide the basis for the negotiation of a regional free trade agreement.

[38] See S. Neff and T. E. Josling, *Economic Effects of Removing US Dairy and Sugar Import Quotas*, NCFAP Discussion Paper No FAP 92-01, Resources for the Future, Washington, D.C., 1991.

policies of the members. To the extent that these become more liberal as a result of intra-bloc arbitrage, the impact will be positive.[39]

It may be that in the longer run the most important link between FTAs and world agricultural markets will be the impact on national domestic policies. At present the trade implication of such policies are being negotiated in the GATT Uruguay Round. The anticipated outcome is a move toward less trade-distorting domestic policies. The argument in this paper is that a similar outcome may be possible with the full inclusion of agriculture, including a strict adherence to the principles of free access, within FTAs. If this is true, agricultural trade in a world of trade blocs could be more liberal than at present.

[39] It should be recalled that these liberal tendencies do not necessarily apply to economic unions where budgetary resources and market regulations are centralised. Under such circumstances the individual countries may have an incentive to argue for an increase in external protection for their own exportable products, in the knowledge that other members will pay much of the cost. Thus the Common Agricultural Policy is not necessarily a foretaste of the level of protection likely under a trade-bloc regime.