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GATT AND AGRICULTURE: THE ROLE OF SPECIAL INTEREST GROUPS*

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The general perception is that world agriculture is in disarry and there is an urgent need for reform (Johnson). One such avenue is trade liberalization through the General Agreement on Tariffs and Trade (GATT). The stage is clearly set by the following passages:

1. "The 1980s have been a decade of crisis for much of world agriculture. Following a period of unusual growth in world demand and trade, the 1980s have witnessed a decline in exports, plummeting agricultural prices, widespread economic distress in farming and associated industries, and rising trade tensions as nations have sought to protect their farmers" (Institute for International Economics, p. 1).
2. "The playing field in world agriculture trade is uneven. Some countries subsidize their exports, some tax imports; others tax exports. Most nations try to help their farmers through domestic farm programs. All these influences converge to distort the price signals that would otherwise govern supply and demand in a freer trade environment. The resulting hodgepodge has disadvantaged many producers in the United States and other countries, even though their farm products are among the least expensive to produce" (Ballenger et al., p. 1).
3. "The problems of agriculture have engaged the attention of world leaders and have become a major issue in the Uruguay Round of multilateral trade negotiations under the General Agreement on Tariffs and Trade (GATT). . . . A number of fora, including the GATT Ministerial Meeting at Punta del Este in September 1986 that

> launched the Uruguay Round, the Organization for Economic Co-operation and Development (OECD) Ministerial Meeting in May 1987, and the Venice Summit of industrial country leaders in June 1987, have issued declarations which support liberalization of agricultural trade and reform of domestic farm policies. . . . Trade Ministers of the GATT countries will also meet in December 1988 in Canada, for a mid-term review of progress in the Uruguay Round. These opportunities to establish a framework for the negotiations and begin a process of agricultural policy reform through trade negotiations must not be lost" (Institute for International Economics, pp. 1-3).

This paper discusses the role of special agricultural interests in GATT by addressing the broader issue of the distributional effects of freer trade. These interest groups comprise both winners and losers from the trade process. Policy changes generally involve losers and gainers. As a result, to implement a policy change often requires recognition of this fact and the need to explicitly address the losers from change. While freer trade for agriculture may be in the public interest, significant losses could result for certain agricultural sectors. Those special interest groups which would lose from trade liberalization will clearly attempt to block reform recognizing that these groups were instrumental in seeking protectionism, government assistance, and the like in the first place. The reason used to persuade governments into giving protection in the first place will be used to ensure that the same governments do not pull the support system.

The focus on GATT stems from the general belief that free world trade is preferred to protectionism, a view which is consistent with the many theoretical treatises in the pure theory of trade (Letiche, Chambers, and Schmitz). However, the reasons for protectionism have also been clearly stated, some of which fall under the "scientific tariff" (e.g., food security and infant industry protection). Also, gains from trade theory under uncertainty takes on a different dimension than propositions derived from standard trade theory (Feder, Just, and Schmitz). Here, free trade propositions need no longer hold. Often, in agricultural trade debates over tariff and nontariff barriers, these later type arguments prevail and have been used very effectively by special interest groups to obtain economic rents which would not be available under free trade. It is also important to keep in mind that, even in the presence of a free trade world, government policies for agriculture can still be justified (e.g., optimal storage programs and income stabilization mechanisms); those who support the GATT process are generally in favor of government programs but would like to see those programs implemented which are neither output nor trade distorting.

CONCEPTUAL FRAMEWORK

Freer trade negotiations through GATT involve many countries and farm groups within--often with conflicting interests. It is impossible here to develop and analyze the conflicts that arise in each of the major participating regions. The following provides a theoretical analysis of some of the major GATT players of the high-income world (the EC, Australia, the United States, and Canada). This adds to the material on

less-developed countries presented, for example, by Valdéz. The conflicts over freer trade are region specific. As a result, the free trade debate over agricultural trade has a very different gainers-losers structure in the EC as compared to, for example, Australia.

The following section derives theoretical conclusions about the special interest groups involved in the GATT process and shows how difficult it will be to achieve trade liberalization. Two criteria are considered: the Pareto Principle (PP) and the Compensation Principle (CP). In the former, a policy change is recommended if no one is made actually worse off and at least someone is made better off from a policy change whereas, with the latter, only hypothetical compensation is needed (Just, Hueth, and Schmitz). Gains from trade theory recognizes that there are potential gains from free trade but, in the absence of compensation, there will be losers. Free trade can meet either the CP or the PP test. To satisfy the PP test, actual compensation is required.

In the early 1970s, Schmitz and Seckler used this framework to analyze the impact of the introduction of the mechanical tomato harvester in California. The PP was not met but the CP was satisfied since a sufficiently large economic benefit was generated from the harvester to potentially make everyone better off. However, since compensation was not actually paid, certain sectors, especially farm workers, were made worse off. In this particular case, the CP was a sufficient criterion upon which to base the introduction of the harvester largely because the losers were both politically and economically vulnerable. However, this is not always, nor generally, the case for agricultural interest groups adversely affected by change, especially when those negatively affected

have strong political support. The potential losers can often block change unless compensated--hypothetical compensation is not always a sufficient criterion upon which to base policy choices. The freer trade debate appears to be falling in the latter camp in that, while potential gains from free trade may well exist, the question of how to deal with losers is unclear.

Special Interest Groups

1. The European Community (EC)

Much discussion has focused on the EC and how the size of its sins are to be judged when entering the GATT gates. The EC has accomplished major increases in production, especially in grains. For example, from 1960 to 1985, it changed from a significant wheat importer to the third ranked exporter. But these gains have been accompanied by high price supports and protectionism. Why is the EC so reluctant to give up its protectionism and export subsidy system for free agricultural trade?

Figure 1 shows clearly some of the major issues surrounding freer trade for EC agriculture. The supply curve for EC wheat is S, and the domestic demand is D. At support price P_s, the EC exports wheat equal to Q_1Q_2 (Hayes and Schmitz). At the world price P_u, which includes the effects of tariff and nontariff barriers, EC restitution payments on exports equal the cross-hatched area, abcd. The magnitude of restitution payments depends on the level of world prices.

Consider now the effects of freer trade. Suppose free trade caused prices to rise to P*. Without compensation, producers would lose $P_s$dd'P*, consumers would gain $P_s$aa'P*, and the government would gain abcd because export subsidies in the form of restitution payments are not needed. The

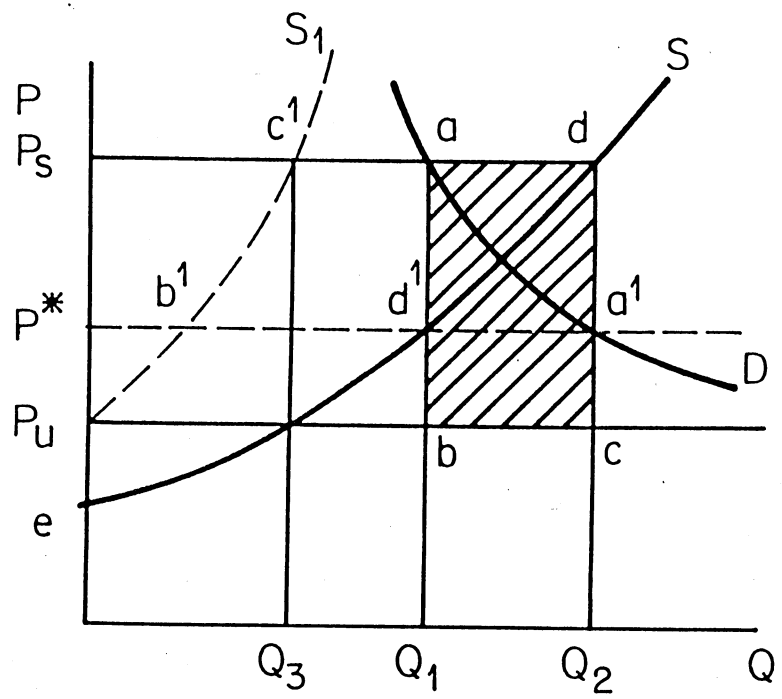

Figure 1. Free trade conflicts in the EC

end result is that there is a net gain from free trade of area abcd since the consumer gain offsets the producer loss. Therefore, using the CP, free trade is a first-best policy for the EC.

Because of the intense opposition of free trade by EC agricultural groups, it is interesting to explore further Figure 1.

1. The argument often made for protectionism under the "scientific tariff" is food security. If this argument is legitimate, then consumers do not gain the surplus from free trade referred to earlier. Consumers may prefer output Q_2 to Q_1 through higher prices from import protection. As a result, consumers may lose from free trade depending on the value they place on food security.[1]
2. Without compensation--because of their losses--producers will attempt to block actions toward freer trade.
3. The taxpayer gains from freer trade in terms of treasury savings. However, some may view this as a cost rather than a savings if freer trade increases food insecurity and furthermore threatens the rural fabric of European agriculture. Using such arguments, one could attach zero welfare weights to consumers and taxpayers and positive weights to producer groups. In this case, there are no groups which gain from free trade; there are only losers. Neither the PP nor the CP is then met by moving to freer trade.

There are other interest groups involved including input suppliers of fertilizers and chemicals. These clearly favor protection. In addition, grain companies and processors would support protectionism, especially those which do not have a multinational status since they have a larger output to process and market than under free trade.

Then there is the political process where politicians confront the electorate. They ultimately attach the welfare weights to the different interest groups. Using the arguments above (such as food security and the disruption of rural communities), politicians can and have obtained political support for protectionism from producers, consumers, and taxpayers. Through persuasive arguments, politicians can place small welfare weights on consumer and government revenue effects in favor of producers. In terms of the latter, it has often been said that French politicians, for example, would give extra money to French farmers to avoid a farmer-led street riot in Paris. Farm groups in the EC have extremely strong lobbyists and enjoy strong political support. This in itself shifts the relative welfare weight toward protectionism.

While the above analysis is a snapshot of one point in time, looking at a different time snapshot is also important in determining the effects of protectionism and the reasons for increased protectionism in the first place. In Figure 1, consider the EC when it was a major grain importer rather than an exporter. Prior to the formation of the EC, the world price was P*; given supply S_1, imports were b'a'. Producer rents were P*b'P_u. At a price support of P_s due to the EC formation, short-term rents increased to P_sc'P_u. Using traditional measures, consumers lost but the government gained tariff revenue. Depending on the argument used, protectionism could have resulted in short-run net welfare gains. Carter and Schmitz, for example, have argued that the EC pursued an optimal tariff strategy early in its history. In this case, there is a net gain from protectionism since the producer gain plus the intake of tariff revenue by the government are more than the consumers' loss. In the optimal tariff argument, the CP test is met. In addition, if food

security arguments are used, a further discounting of consumer losses strengthens the net gain result.

Note in Figure 1 how the production and distributional effects change through time. Production shifted from S_1 to S for several reasons including high price supports. Consumer welfare on a per capita basis was unaffected through time because of the relatively stable prices internally. There was a continuous substitution in favor of domestic production away from imports. The large impact was on producers as they gained rents equal to $P_u c'de$. However, governments totally reversed their role from collecting revenue on imports when the EC was formed to providing export subsidies when the EC switched from net importer to exporter.[2]

What is important is the demonstration that the initial steps taken by the EC for protectionism can be justified using the CP. However, for a much later period after a phenomenal increase in supply had occurred, the CP supports not protectionism but freer trade.

As the previous discussion illustrates, there are generally losers from a policy change even though the net gains may be positive. These potential losers create stumbling blocks for the GATT process. An important point is how to deal with the losers from trade which, as Figure 1 suggests, are largely producers (recognizing that this will not be the case under strong food security arguments). The loss in rents can be significant as their absolute size, under protectionism, increased over time. The form compensation should take, if it is to be made at all (actual compensation is a value judgment; hence, the choice between the CP or the PP is a value judgment), is not clear.[3] In the model illustrated, there are insufficient Treasury savings from free trade to compensate producers; hence, part of the compensation package has to come

through an explicit tax on food. This may create a backlash for politicians worse than the high price of food due to implicit taxes from high producer protection. Also, money compensation creates a problem for many producers in the EC. The small producers are unlikely to be able to cover costs at free trade prices. As a result, to maintain the existing rural-community small-farm structure in the EC (although this would not apply to large farms in England), compensation would have to be used each year to provide income support. This has attached to it significant long-term problems. Compensation, while conceptually appealing, can in reality be fraught with difficulties. Compensation packages can also create problems among farmers of different EC countries. For example, wheat farmers in England have a much different farm size distribution than in Germany. Large farmers in England may, for example, be compensated less per acre than the relatively small farmers in Germany. As Hayes and Schmitz point out, most forms of compensation will favor small farmers relative to the large specialized grain producers. This obviously creates strong lobbying pressures (away from freer trade under this form of compensation) from large size farmers. Lobbying from large farmers can be effective because of the large income base which these farmers possess.

2. Australia

The conflicts in Australian agriculture over freer trade are, for several reasons, much less apparent than those in the EC. Consider Figure 2 where S is the supply curve for grains and D_d is domestic demand. At world price P_1 (a price which includes distortions prior to GATT talks), exports are Q_1Q_2. Under free trade, given price P_2,

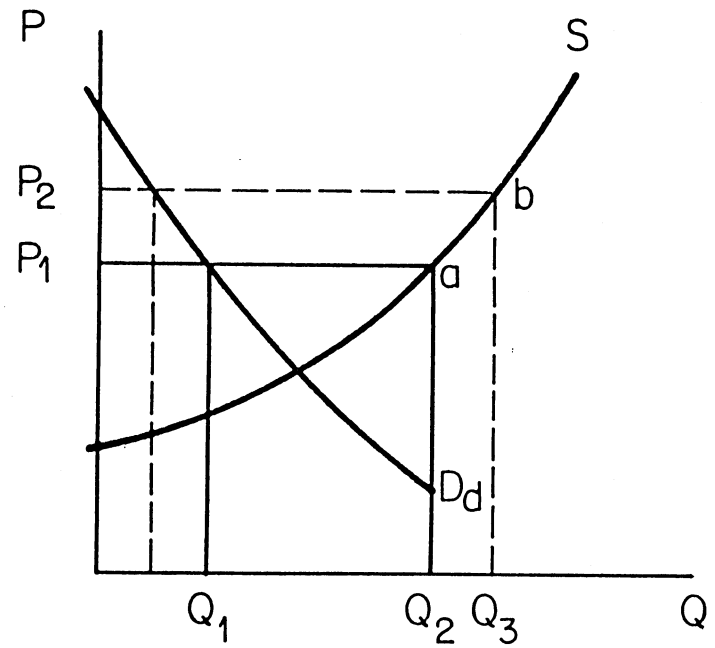

Figure 2. Australia and exports

producer rents increase by P_1abP_2 along with an increase in exports. The gain to producers far exceeds the loss to consumers. This is because, for the aggregate of the major export commodities, such as wool, wheat, and beef, domestic consumption is only a small percentage of production. For Australian agriculture, the CP test can easily be met in favor of free trade.

Historically, even during the period of low prices in the 1980s, Australian producers have not been the recipients of sizable government income transfers. For example, in wheat the government absorbed a loss in the Wheat Board's pooled account in the late 1980s, but the magnitude was not large. Because of the minimal level of government transfers to Australia producers, the increased prices from freer trade benefit producers directly since there are little or no government transfers to be terminated.[4]

3. The United States

The important feature in modeling U. S. agriculture and freer trade impacts for grains is the combination of target prices and acreage set-asides. In Figure 3 the free market supply curve is S and total demand is T_d while domestic demand is D_d. The total demand is "shrunken" because of trade distortions (Schmitz, Sigurdson, and Doering). The distorted world price is P_1. For simplicity let P_1 equal the U. S. loan rate for a specific exportable. Because of acreage set-asides, production is reduced to Q_1 for a given support price P_s. In this model, the government deficiency payments to producers equal the cross-hatched area P_sabP_1 while producer rents total P_sabc.

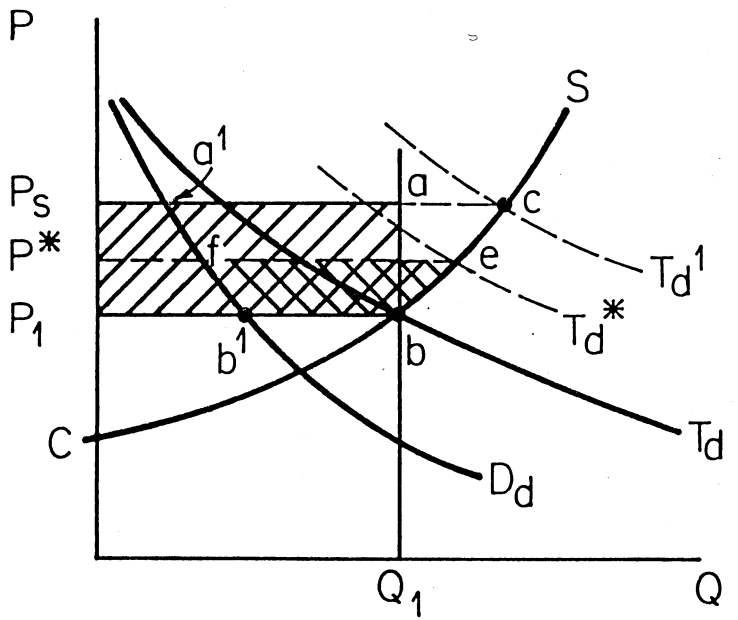

Figure 3. The United States target price and loan rate

Consider now the effect of freer trade. What if export prices rise to P_s due to a shift in demand to T_d'? The effects are as follows: (1) producer rents increase by abc, (2) deficiency payments are reduced to zero, and (3) consumer costs rise by an amount $P_s a'b'P_1$. Clearly, the CP test is met in moving to freer trade. The only losers are consumers. If this model were correct, U. S. producer groups would rally behind free trade. However, generally, they do not.

Suppose, however, that the export price does not rise to P_s from free trade but instead only increases to P* (i.e., demand shifts to T_d^* because of trade liberalization). In this case (1) consumers lose; (2) producers lose since their increase in rent from higher market prices due to trade is more than offset by government deficiency payment reductions; and (3) taxpayers gain. However, even in this case, there is a net gain from free trade of bb'fe. Here, as in the earlier case, the CP test is also met. However, the distributional effects are quite dif- ferent. Before, there was a net gain to producers from free trade since the gains from higher market prices more than offset the reduction in de-

ficiency payments. In this latter case, however, producers lose since the trade gains to producers are less then the loss in deficiency payments. On the basis of the CP, clearly producers support free trade if the first outcome were possible but do not favor it if the second result were predicted.

The opposition to free trade by major producer groups in the United States generally resides in the belief (supported by empirical evidence) that producer rents will decline under free trade since the gain in private market rents is insufficient to offset the reductions in deficiency payments (Schmitz, Sigurdson, and Doering). In this case, the motivation

for free trade would have to come from government since producers would be unenthusiastic knowing that there are no net gains for them--there exists only a trade-off between government transfers and private rents.

There are those groups in the United States who oppose free trade because of the resultant rise in food costs. Low-income consumers are adversely affected relative to the case where farmers are supported through general tax dollars.

4. Canada

Conflicts over free trade do rise among commodity groups. To this point they have been ignored. These are illustrated with reference to Canada but apply also to other countries. Like Australia, Western Canada is highly dependent on export goods because of its small population relative to its large resource base. Its export orientation is much different from Eastern Canada, which derives a much greater portion of its farm income from supply-managed commodities, such as eggs, broilers, and turkeys for the domestic market.

Figure 4(a) shows an export good from Western Canada, such as wheat; and Figure 4(b) gives a supply-managed industry (e.g., turkeys). Consider first the exportable sector where S_W is the supply curve for wheat and D_W is the domestic demand. At a distorted world price, P_W, output is Q_1. On top of this are government payments of the cross-hatched area $P_S abP_W$. (In recent years the Canadian government has made sizable transfers to Canadian producers largely in response to the drop in the loan rate under the 1985 Farm Bill.) Total producers rents are Pabb'. Support for free trade by grain farmers (as in the United States) depends not only on the price increase expected due to shifting export demand but

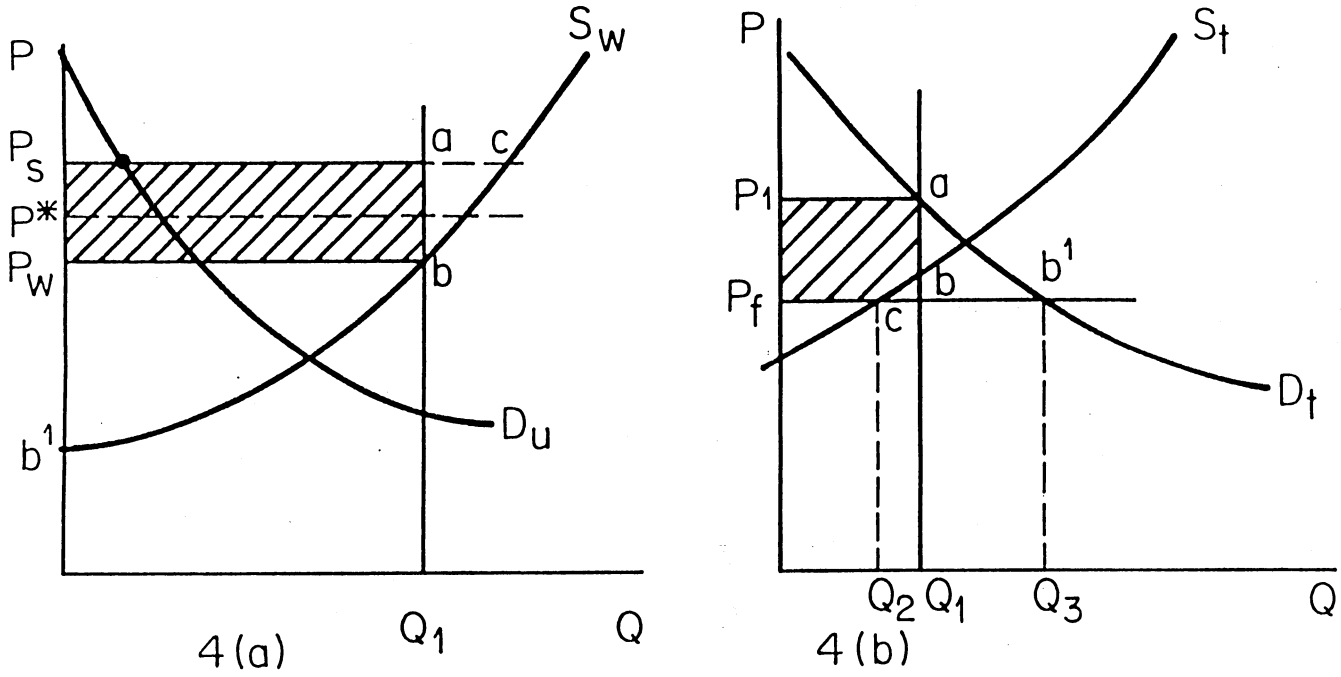

Figure 4. Canadian exports and imports

also on the reaction from government as to whether or not lower payments of a decoupled form will result due to higher prices from free trade. If price rises to P_s from free trade, then there is a net gain to producers of abc, given that government reduces its support to zero. However, if price only rises to P*, then producers lose from free trade if government support drops to zero. Regardless of the price effect, however, free trade meets the CP test. This model suggests that the largest supporter of free trade has to be the general taxpayer since producers are likely not to rally under the free trade umbrella unless a certain level of government support remains so as to make producers, using a combination of market rents and government transfers, better off under free trade. As in the U. S. case discussed earlier, producers' perceptions of the trade-offs between government and private rents brought about by higher prices from free trade is crucial to determining producer support for free trade.

In Figure 4(b), S_t is the supply curve for turkeys and D_t is the domestic demand. At the free trade price, P_f, imports would be Q_2Q_3. However, if supply management is successful in curtailing imports and setting production at Q_1 at price P_1, then producers gain P_1abcP_f, but consumers lose $P_1ab'P_f$. In this case, the CP test is not met in supply-management arrangements since what the gainers gain is less than what the losers lose. Note, too, that there are no explicit government transfers to producers. There are, however, implicit producer transfers from higher consumer prices.

From the above, the CP test is met in moving to freer trade for both the export- and import-oriented sectors. However, in the absence of compensation, producers of supply-managed commodities lose from free trade

while producers of the exportable good gain or lose depending on the price effect from free trade and the impact higher prices have on government transfers to the producing sector.[5] The models suggest that there may be general support from producers in Western Canada for free trade but strong opposition from producers in Eastern Canada. This poses a serious dilemma for Canadian negotiations at GATT even though consumers and taxpayers stand to gain from freer trade.

5. A Comment

For the cases examined (five in total) which range from the EC to supply management in Canada, a movement to free trade satisfies the CP test in that the net gains from free trade are positive. If these models are correct, then, clearly, negotiators are negotiating for the "public good." However, success depends on the ability of special interest groups to block progress. In all five cases, these interest groups generally turn out to be producers in addition to others, including fertilizer dealers, input suppliers, and the like. In negotiating for the public good, it is unclear, however, as to whether the CP or the PP should be used. If the latter is not used, however, then the success for freer trade outcomes will be severely restricted.

MAGNITUDE OF GAINS AND LOSSES

What are the magnitudes of the gains from free trade in agriculture? Is it worthwhile negotiating freer trade even if this outcome were possible? Ideally, one would like estimates of the net gains from trade and the distributional effects.

Numerous models exist which have estimated the price and trade flow effects from free trade in major commodities.[6] Little has been done on the distributional effects. There is a wide range of numerical results reported. For wheat, for example, the price from freer trade ranges roughly from a zero impact to a 30 percent price increase above a specified base period.[7]

Let us assume a 25 percent increase in the export price for wheat due to total liberalization. The net gain to Australian producers will be positive. If governments significantly drop their support by cutting back transfers, producers in the EC will clearly lose; it is less clear for U.S. and Canadian producers--the effect depends on the magnitude of the cutback. As stated earlier, if the Canadian government eliminated all transfers in a free trade world, producers would probably lose because the the gains due to a rise in price from freer trade appear to be less than the reduction in government transfers resulting from removing government support. The magnitudes involved for the United States tell the same story. Because of the large percentage of net farm income that is due to transfers (which, for a country such as Canada, is of only recent origin), price rises due to trade liberalization are not large enough to fully compensate for reduced government support. Of course, if instruments such as the Western Grain Stabilization Act (WGSA) could remain in the presence of free trade, then Canadian grain producers could well gain from free trade.[8] One has to keep firmly in mind that it is likely that many of the programs in place would exist even if a free trade world in agriculture did exist! For example, WGSA was put in place in 1976 during the free trade boom. As a result, it is not clear to

producers what programs and what size of government transfers would exist with free trade.

TYPES OF TRADE DISTORTIONS

Identifying the tariff and nontariff trade barriers is no easy task. In discussing the empirical modeling on the impacts of freer trade, one of the reasons for the wide range in results is the lack of clarity on what distortions are being removed. In addition to trade barriers such as tariffs and quotas, the effects of additional programs have to be considered. Examples of the latter include crop insurance, drought relief programs, low-interest loans, special grain programs, and commodity price and income stabilization programs. The types of programs and the magnitude of the transfers involved have increased significantly since many of the empirical studies have been done. This proliferation, which is partly a result of export subsidy wars, is a major reason for explicitly putting agriculture on the GATT agenda in the first place.

Even though governments transfer large sums of money to agricultural producers in various forms, it is not clear the extent to which these transfers are trade distorting. As we all know, changing income distribution does not need to result in an inefficient use of resources. The general feeling is that GATT should result in a "decoupling" of farm programs from production--not that governments totally abandon the farm sector (Resources for the Future; Warley; Carr, Meyers, Phipps, and Rossmiller). However, who has determined what programs need decoupling? This issue can be illustrated by referring to Figure 5(a) where a model is discussed for the U. S. grain sector. The supply of wheat under free market conditions is S and demand is D. At a target price of P_s,

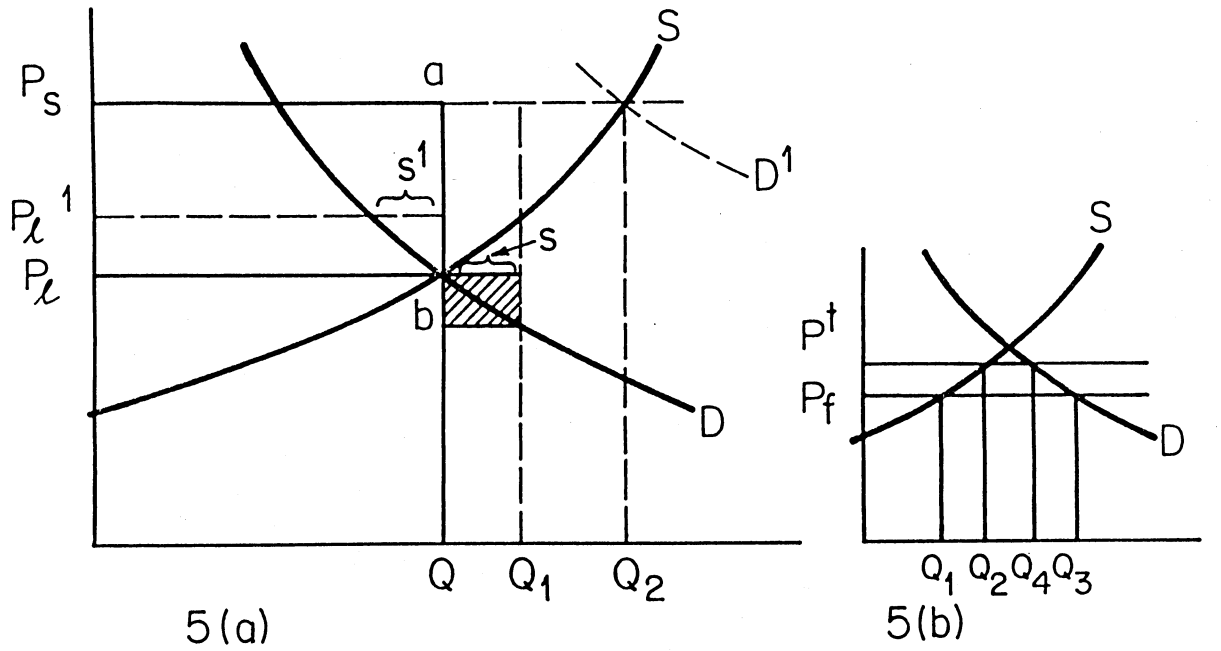

Figure 5. United States and EC farm programs

coupled with an acreage division program and a loan rate P_ℓ which generated output Q, the U. S. farm program would not be trade distorting. However, it would be at output Q_1, but only if stock levels of size S were released. On the other hand, at output Q, given a loan rate P_ℓ', even if stocks S' are released, the program in place is not trade distorting, even though transfers to producers from the government may be sizable.

The immediate question is this: What does the U. S. "free market" supply curve look like? How does one estimate S, given the acreage set-aside provisions of the 1985 U. S. Farm Bill? A further question is: What does the free trade demand curve look like and where would the free trade price and quantity lie? The demand schedule D is a distorted demand curve brought about from protectionism outside the U. S. borders. For example, if the free trade demand curve is D', then U. S. output would increase under free trade and prices would remain at the support level P_s.

The above raises the question as to what the trade distorting effect of a policy implies. In the example, is a program which generates output Q_1 (compared to a distorted market outcome of output Q) trade distortionary or is it not? Compared to the free-trade solution rather than the trade distortionary situation, output had been curtailed. As theoretically constructed, the program clearly has not had an output-increasing effect relative to a free-trade position so, in some sense, the program is decoupled.

Contrast this to the EC in Figure 5(b) where the free trade price is P_f and production is Q_1 with imports of Q_1Q_3. A tariff or quota which causes price to rise to P^t is clearly output increasing (Q_1 to Q_2) and

trade distorting (imports decrease from Q_1Q_3 to Q_2Q_4). The important point is that, relative to free trade, this type of policy is both output increasing and trade distorting. At least conceptually, there is no reason this should be the case for the U. S. major grain sectors, such as wheat and corn, because of the acreage set-aside requirements to qualify for target prices.

Consider another major exporter--Canada. As shown earlier, in recent years the Canadian Government has provided significant income transfers to producers under various programs, including the Special Canadian Grains Program (SCGP), the Western Grain Transportation Act (WGTA), and the Western Grain Stabilization Act (WGSA). To date, data are unavailable to rigorously determine whether or not these programs are output increasing and trade distorting, but the research to date shows that they are not.[9] This partly depends on the nature of supply response and the producers' perception of the permanency of these programs. SCGP, for example, was introduced in response to the drop in the U. S. loan rate under the 1985 Farm Bill. The payments have also been announced after planting, which is markedly different from U. S. and EC support programs where support levels are known at planting. Actually, payments under all three of these programs have been of only recent origin. As a result, if they do have an impact on production, the long-run effects have to be markedly different than for an area such as the EC where major programs have been in place since at least 1960. In the Canadian case, as with the United States, even if the programs in place are output increasing relative to the situation without them, they are not necessarily trade distorting; the comparison has to be made to Canadian output under a freely competitive world trading environment.

The above discussion clearly indicates that the standard PSE measures of producer support can grossly misrepresent the trade-distorting effects of government programs. A high degree of support for producers does not necessarily imply that the support programs are output increasing and trade distorting (McClatchy).

RENT SEEKING AND INSTITUTIONS

Rent seeking on the part of producer groups and its impact on the political process has been documented in case studies (Rausser), and the results apply to GATT (Bredahl, Schmitz, and Hillman). Consider U. S. sugar producers and their lobbying for the 1985 Farm Bill. Sugar quotas were maintained, bolstering up sugar prices for producers at the expense of the consumer. Since these were invisible subsidies as no government deficiency payments were involved, rents were easily obtained by sugar producer lobbyists (Leu, Schmitz, and Knutson; and Lopez). The case of wheat growers was also examined for the 1985 Farm Bill (Babcock, Carter, and Schmitz). Lobbying efforts were consistent with the Becker-Peltzman hypothesis of rent seeking for self-interest concerns. High target prices were left in place under the Bill. The problem, farm groups argued, was not high support prices but rather the loan rates that were set too high, making the United States uncompetitive. The solution, many argued, was to lower the loan rates and increase deficiency payments.[10] Babcock, Carter, and Schmitz argue that, under the 1985 Farm Bill, the fact that taxpayers lost suggests three things: "First, policies that have less per capita impact than $15 most likely will not generate much effective political pressure against them by either taxpayer groups or consumer groups. Second, deadweight losses may not play as central a

role in determining policy outcomes as might be expected. This is particularly true when the high deadweight losses are associated with policies that adversely affect the interests of potentially well-organized opposition groups such as agribusiness concerns or automobile manufacturers. And third, it is important to look at marginal gains and losses at the different proposed policies to predict which policies are more likely to be politically defensible."

In 1988, additional clouds have covered the scene which will make the GATT process difficult. The 1988 drought resulted in higher export prices, thus reducing the level of trade distortions. The U. S. government called for a reduction in wheat set-aside requirements for 1989 but leaving in place export enhancement and adding export-targeted assistance under the U. S. trade bill. Also, in a short period of time, a U. S. drought relief bill was passed. In this context, it is difficult to comprehend statements which suggest that the United States will remove all farm subsidies by the year 2000! On this issue, the conflict that arises between Congress and the Administration over agricultural policy should be kept firmly in mind. What it shows is that, especially during an election year, U. S politicians are quick to respond to the general perception that assistance is needed because of the drought, even though the type of support sought by the U. S. farm groups and banks is not clear (farm groups generally agree that payments on a per-farm basis are too small to be of use). In the political process, especially at election time, it is easier for governments to put more money into agriculture than it is to remove support.

In Canada, a heated discussion has taken place concerning U. S.-Canadian free trade, including agriculture. Supply-management boards in

Canada want to be exempt. They contend that Aricle XI under GATT exempts supply-managed industries. If this is true, then one sector of Canadian agriculture will be immune from free trade impacts. Recently, the Advisory Committee to the Canadian Wheat Board determined that the proposed Free Trade Agreement will (1) undermine the ability of the Canadian Wheat Board to be an effective marketing agent on behalf of Canadian grain producers, (2) create an environment in which it will be increasingly difficult to maintain the quality and uniformity of Canadian grains, and (3) not provide enhanced and secure access to the U. S. market.

In July of 1988, the Advisory Committee recommended to the Prime Minister; the Minister of State, Grains and Oilseeds; and the Canadian Wheat Board that the total grain industry be exempt from the Free Trade Agreement.

From the above, it is clear that the impact of freer trade on institutions has to be considered--a sadly neglected area in standard economic arguments on the gains from trade. If freer trade under GATT, for example, means dismantling both supply-managed marketing boards and the Canadian Wheat Board, the probability of Canada's participation in GATT, at least with respect to agriculture, is in all likelihood zero. To many, those institutions are part of the "public interest" in Canada.

If it is impossible for Canada and the United States to agree on a free trade package for agriculture, what hope is there for GATT? It is interesting that the problems between the United States and Canada have been discussed in a rent-seeking context involving the vegetable trade between the United States and Mexico (Bredahl, Schmitz, and Hillman). While the cooperative solution seemed quite apparent in theory, special interest groups continuously attempted to block free-trade outcomes.

CONCLUDING OBSERVATIONS

Freer trade in agriculture will result in sizable transfers of economic rents out of the agricultural sector unless compensated for by governments. Of the countries considered, the loss in rents appears to be the greatest for the EC. Who should absorb these losses? The answer involves value judgments. However, if some form of compensation is not made, then the special interest groups that are adversely affected from freer trade will in all likelihood block freer trade initiatives. Clearly, the idea is to replace current programs with decoupled programs in the compensation package. However, whether programs can be completely decoupled is open to debate; some have even gone so far as to argue that the term "decoupled" be scrapped from the economists' vocabulary! Also, there is little agreement over many of the programs now in existence as to their decoupled nature. The dilemma is clear. Countries have to give up programs to get free trade but, to get the result, they have to replace these programs with others because of the special interest groups. How to do this and what type of programs supporting farmers fit the free trade bill has to be mind-boggling. Maybe the sorting out required would best be left to magicians rather than to academic economists, government bureaucrats, and politicians.

Because of the major focus on GATT, it is easy to forget some of the basic characteristics about agriculture and the implications these have for policy. Suppose the free-trade world were to happen overnight and nations started over again using free trade as the reference point. Would major problems in agriculture persist? Theoretically, at least, instability would be reduced under free trade. However, agriculture

would still remain a high-risk business. Droughts, technology, inelastic demand for food, etc., would still cause major problems for farmers. Remember that the 1970s were buoyant times and very few farm programs of the price support nature were in place or binding.[11] Ironically, the free trade era of the 1970s was partly responsible for the problems of the 1980s to which farm programs in the 1980s are responding. It is these types of forces which once again would lead farm leaders to demand political action to solve the farm problem. This could well take the form of more decoupled programs if indeed such programs could be devised. However, they could well take the form of nontariff barriers (as a substitute for tariff barriers) which also act as trade distortions. Unfortunately, these types of programs are worse than explicit distortions.

Given the rent-seeking activities of major farm groups and other special interests, it is unlikely that much progress will be made toward freer trade unless ingenious compensation schemes are forthcoming. This requires much more thought and analyses by the profession. In addition, a backup system is needed if GATT fails. As shown elsewhere, export cooperation not necessarily of the free trade form may be all that can be achieved; but, at least, it is preferable to the current situation.[12] No one ever claimed that export cooperation-type arrangements where all major participants engaged in, for example, acreage set-aside requirements, are easy to achieve; but it may be easier to achieve and perhaps more acceptable than free trade, given the inelastic nature of export demands. Regardless, any of these two forms has to be far superior to the current situation. The 1988 drought clearly has taught us that a reduction in quantity increases price but, unfortunately for North America,

the gainers were other countries which grew large crops. The free-rider problem is well known to cartel theorists but, with ingenuity and determination, it could be overcome.

Footnotes

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[1]Of course, if the concern is over food security, then clearly optimal storage policies can achieve this result even in the presence of free trade (Feder, Just, and Schmitz).

[2]In reality, support prices in the EC change through time and are set in relation to technological change.

[3]If compensation is not part of the free trade package, GATT will be unsuccessful.

[4]Because of the relatively small government transfers in Australia, producers and producer groups are strongly supportive of free trade for agriculture since the increased private rents from freer trade result also in a net increase in total producer rents.

[5]The general public and producers in Western Canada stand to gain since both producer rents could be made to go up along with a reduction in government payments. The government could reduce its transfers because of the trade gain.

[6]Some of these are reviewed in Carter, McCalla, and Schmitz; Sarko; and Hathaway.

[7]The greatest price impact for wheat was found, for example, by Schmidt, Frohberg, and Maxwell.

[8]In speaking at the Australian Agricultural Outlook Conference in 1988, it was generally agreed that a significant step forward under GATT would be a 30 percent reduction of tariff and more tariff barriers. In this case, export prices would rise by less than 10 percent for major exporters.

[9]See Fulton, Rosaasen and Schmitz. Professor Warley contends, in an excellent paper, that Canadian programs are generally not output increasing except, perhaps, for WGTA.

[10]There remains the unanswered question on the type of rent-seeking instrument as producers can switch from visible tariff barriers to implicit transfers, such as quality licensing and the like.

[11]However, the statement has to be modified to the extent that exchange rate distortions played a role in creating distortions and wrong expectations (Schuh).

[12]See export cooperation under supply-management rules in Schmitz (1983, 1986, and 1988).

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