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Agricultural Trade Liberalization: The Ever Elusive Grail*

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I. Introduction

"World Trade Negotiators Fail to Resolve Farm Issue; Suspension of Talks is Likely," so read the Wall Street Journal headline of December 7, 1990. Today, August 3, 1993, the Uruguay Round is still not complete. Thus the title of this lecture. According to my Webster's dictionary a grail is ". . . an object of an extended or difficult quest." Agricultural trade liberalization attempts certainly seem to qualify. The Uruguay Round of General Agreement on Tariffs and Trade (GATT) negotiations has dragged on for 7 years, 3 years beyond the planned duration of the 8th Round of GATT negotiations. It is by far the most comprehensive attempt to liberalize manufacturing and non-manufacturing trade ever undertaken. Agriculture, textiles, services, investment, and intellectual property rights are all on the agenda.

Much of the delay in completing the Round has been laid at the doorstep of agriculture. As was the case on the Dillon, Kennedy, and Tokyo Rounds, which preceded the Uruguay Round, liberalizing agricultural trade has turned out to be incredibly difficult. Why should an activity which is a declining share of world trade--it is now less than 10%--cause so much trouble? One also must ask additional questions: What causes nations to have so much difficulty in freeing agricultural trade? Will it ever change? If it doesn't, does it really matter? This last question begs a further question about how well economic analysis does in defining potential benefits and costs of liberalization.

It is to some of these questions that this lecture is addressed. For people steeped in the neoclassical economics, market oriented paradigm, there is little disagreement that agricultural trade is a mess. Gale Johnson has said so three times, first in 1950 when he

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documented the inconsistencies of trade and domestic agricultural policies. Two editions of *World Agriculture in Disarray*, published in 1973 and 1991 tell a story of resource misallocation, high consumer and fiscal costs, and distorted domestic and world markets. Johnson laments in the second edition that, if anything, the situation he described in 1973 has gotten worse. Tyers and Anderson also liked the term "disarray" so much they used it in the title of their recent book, *Disarray in World Food Markets*. Paarlberg, in his book *Fixing Farm Trade*, titles his first chapter "Agricultural Trade in Disarray". Warley notes that the 1958 Haberler GATT report (GATT), which documented the distorting effects of domestic agricultural producer support, ". . . is as germane today as it was 31 years ago" (Warley, p.4).

These are but a small sampling of books and monographs produced over the past decade that have documented the major trade distortions caused by domestic agricultural support programs. Others include Anderson and Hayami; Avery; Becker, Gray and Schmitz; Blandford; Hathaway; Islam and Valdés; Libby; Miner and Hathaway; OECD; and Sanderson. On top of this there are literally hundreds of articles, papers, and speeches which address the problem.

Why then yet another paper on the same subject? In my mind there are three good reasons. First, many writers focus on the Uruguay Round, or at most the last three rounds of GATT negotiations, but problems of agricultural protectionism have much deeper historical roots. Reviewing that history every so often is instructive in terms of identifying recurring issues. Second, it is worth exploring the wide diversity of explanations as to why agriculture is so problematic. Is there an emerging consensus on why countries do "economically irrational" things in agriculture? Third, it is hard to find an agricultural economist who disagrees that agricultural policies grossly distort international markets. There also has emerged a growing number of empirical models which purport to show the

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gains from liberalization. Thus we must ask why all of this economic fire power has apparently had so little effect on policy outcomes.

The lecture is organized around these three issues. First, a brief review of the history of agricultural protectionism, then a look at proposed explanations of why, and finally a hard look at how economic analysis has been used to address the issue. In thinking about a title for this paper, an alternative I considered was "Agricultural Trade Liberalization: Live Quail or Dead Duck?". I close by trying to address this question in the context of what might happen next.

II. A Stylized History of Agricultural Protectionism

Twenty-five years ago I wrote a paper on "Protectionism in International Agricultural Trade, 1850-1968" (McCalla, 1969). I chose, as a beginning point 1850, because it coincided with the throwing off, by the United Kingdom, of the last vestiges of mercantilism. The Corn Laws were abolished in 1846, and the Navigation Acts were repealed in 1849. This initiated what has become known as the "Golden Era of Free Trade," 1850-1914. The article recounts how there was a brief period between 1860 and the late 1870s when tariff and quantitative barriers to agricultural trade were lowered, but never removed. The reductions followed the signing of the Cobden-Chevalier Treaty between the United Kingdom and France in 1860. In the late 1870s most countries of Europe responded to falling grain prices, in part induced by greatly increased exports from the newly settled areas (North and South America, Australia, and South Africa) into European markets, by raising tariffs on imports of agricultural goods: Italy, 1878; Germany, 1879, 1885, and 1887; France, 1881; Belgium, 1887; and Switzerland, 1891 (Tracy). Japan increased their tariffs in 1904 (Hayami). Only the United Kingdom, Denmark, and the Netherlands retained lower barriers.[1]

World War I was followed by a severe depression in agricultural prices. There was some recovery by 1925, but then began a steady decline in prices which eventually crashed in 1929-30. The US raised agricultural tariffs in the Emergency Tariff Act of 1921 and formalized them in the Fordney-McCumber Act of 1922. Germany and France raised tariffs and implemented quantitative restrictions in the period of 1925-1930. Attempts to raise agricultural tariffs in the United States led to the Smoot-Hawley Act of 1930 which introduced the highest level of tariffs in history (Lake). Even the United Kingdom began introducing trade barriers on a wide range of products in 1931. By the end of the decade "beggar-thy-neighbor" policies were pervasive and trade in all products had contracted substantially.

Not wanting a repeat of the international chaos of the interwar period, the Allies began planning for a stable new international order before the end of WW II. The new regime had to allow for adjustment to changing economic conditions while recognizing the sovereignty of nations over their economic policies. Initiated by the United States and Great Britain, the Bretton Woods Conference (1944) led to the establishment of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (World Bank). The former provided a mechanism for fixed but adjustable exchange rates, the latter a means to facilitate long term capital movements. A third dimension of international order, dealing with international commerce, was also envisioned. There were three international conferences, the last in Havana in 1947, which produced a charter for the International Trade Organization (ITO). The United States refused to ratify the ITO, but the chapter dealing with commercial policy was largely salvaged as the General Agreement on Tariffs and Trade (GATT).

US ratification of the GATT charter depended upon the insertion of several escape clauses, e.g. Sections 11 and 16, which exempted nations pursuing domestic agriculture support program from the strictures of GATT against quantitative restrictions to trade, and export and internal subsidies. Section 11 was needed so that the Secretary of Agriculture could continue to use non-tariff barriers under Section 22 of the Agricultural Adjustment Act (AAA).

Therefore from the very beginning of GATT, agriculture was treated as a special case. Warley, in an excellent history of Agriculture in GATT, argues persuasively that agriculture has always been difficult.

> "From the very beginning there were differences between those who thought that trade in agriculture should be liberalized and subject to normal GATT rules and those who thought it should be managed under special provisions, and parallel differences between those who thought that domestic policies should permit observance of GATT's trade norms and those who thought that the articles of the international trade agreement should be written to accommodate the requirements of national farm policies." (p. 2)

Agricultural trade issues were constantly before the "Contracting Parties" in the 1950s but were sufficiently contentious that they were never put on the agendas of the first four Rounds for formal negotiation. The only agreed upon action was a comprehensive study of the problem. The 1958 study, known as the Haberler Report (GATT) documented the agricultural "problem" as was already noted.

Dillon Round - 1960-62

It was not until the Dillon Round (1960-62) that agriculture appeared on the agenda at all. This Round was narrowly focused on binding newly established tariffs for the European Community at levels not to exceed existing tariffs of individual members. As you will recall, the Treaty of Rome signed in 1958 only agreed to the future establishment of a Common Agricultural Policy (CAP). By 1962 all that was known was that Europe wanted to use a system of internal price supports (target prices), variable import levies, and export subsidies (restitutions) without supply control. The latter two policies were decidedly illegal under GATT rules. However, the proposed policy was quite consistent with the waiver granted to the US in 1955 to allow it to use import quotas in dairy. The waiver was subsequently unilaterally extended to peanuts, tobacco, meat, and various other commodities. The only agricultural action in the Dillon Round was to bind a zero tariff on oilseeds and a 6% tariff on non-grain feeding stuffs. In 1961 intensive livestock feeding was not important in Europe so the Community agreed to these bindings in exchange for the US acquiescing to the trade distorting characteristics of the evolving CAP.

The oilseed issue is interesting in two ways. First, oilseeds and meal remain now as the only agricultural imports of significance to the Community. Second, attempts by the Community to provide internal incentives to increase oilseed production led to the protracted "Oilseed Dispute", finally settled with the Blair House agreement in November-December 1992 after the US had taken the EC to GATT tribunals twice.

Kennedy Round - 1963-67

Following the passage of the Trade Expansion Act of 1962, which substantially broadened Presidential powers to negotiate trade reductions, a new Round of GATT negotiations bearing his name was initiated by President Kennedy. The United States wanted agricultural trade on the agenda and stated that a successful conclusion on agricultural liberalization was a necessary condition for success in the overall Round. The US proposed that EC variable levies be converted to tariffs (tariffication), reduced by half, and bound. The US asked further for minimum access guarantees to prevent the yet to be finalized CAP regulations for individual commodities from reducing trade. The EC countered with a series of proposals to bind margins of support ("montant de soutien") then, when that was unacceptable, vague concepts of minimum access guarantees and a binding of maximum self-sufficiency ratios. None of these approaches, variously known as Mansholt and Pisani-Baumgartner plans, were acceptable to the US. The EC, with a yet unfinished CAP, was simply unwilling to commit to converting and binding yet to be determined variable levies. The result was a stand-off which in the end led to a US capitulation on agriculture to get an overall GATT agreement.

Despite Warley's argument that we should not criticize negotiators for not seriously discussing the proposed binding of margins of support or self-sufficiency ratios, it is interesting to speculate what might have happened if the US had negotiated these propositions. During the period of the Kennedy Round (1963-67), Community imports of grain averaged about 20 million metric tons (mmt) per year (Hathaway). By 1981-82 the EC was a net exporter of 6 mmt of grain. By 1992-93 the net grain exports of the Community totaled almost 27 mmt of grain (FAO 1992, 1993), an enormous shift of 47 mmt in a global market for wheat and feed grains of around 200 mmt. Also, over the period of 1970 to the 1990s, the enlarged Community shifted from being a major importer of dairy products, meat, and sugar, to being the world's largest exporter of each. In 1973-74 European self-sufficiency ratios for cereals, sugar, and beef and veal were 91, 91 and 96 respectively. In 1990 self-sufficiency ratios for these same commodities were 120, 128, and 108 respectively (Tracy). But as a result of the new E.C. policy, the self-sufficiency ratio for oilseeds only increased from 47 to 65 between 1985 and 1990 (Tracy). Clearly in the 1960s no one in the US policy process foresaw the implications of the high prices institutionalized into the CAP for European agricultural production and the emergence of the expanded EC as a major exporter. If history could be relived, what would the United States do now?

Tokyo Round 1973-1979

The Tokyo Round was initiated in the turbulent period of the early 1970s. The system of managed exchange rates under Bretton-Woods had broken down and non-tariff barriers to all types of trade were becoming more pervasive. The Round therefore was focused on non-tariff barriers and the development of new codes of conduct. The United States again argued that progress in agriculture was essential for any final agreement and demanded that agriculture be treated like any other sector in the negotiations. This position led to a four year procedural wrangle with the EC which argued for agricultural trade being negotiated on a sectoral basis. In July 1977 the US gave in and agreed to proceed on a commodity group basis. Little progress was made and says Warley ". . . agriculture emerged as it entered, the most highly protected sector in national economies, the most undisciplined area of international commerce, and the cause of some of the most dangerous frictions in international economic relations" (p.12).

Uruguay Round - 1986 - ?

The sharp fall in world commodity prices in the early 1980s, coupled with major loses of market share led the United States to call for an Eighth Round of GATT negotiations. This Round, initiated in Punta del Este, Uruguay in September 1986, began with lofty expressions by the United States, and the newly formed Cairns Group[2] of smaller agricultural exporters, that progress in reducing agricultural trade distortions was absolutely essential to agreements in any of the other 15 negotiating areas on the table. This time was going to be different because domestic as well as border policies affecting agriculture were to be negotiable.

We all know the history, so I will brief it. Interested parties were to make proposals for comprehensive agricultural reform by mid 1987, there would be a Mid-Term

Review in December 1988, revised proposals by the end of 1989, and a final agreement by December of 1990.

The most far reaching proposal was by the United States who proposed eliminating all subsidies to agriculture over a ten year period--the so called "zero option". The Cairns Group proposed only slightly less radical reductions in internal supports and border protection, and the elimination of export assistance. The countervailing propositions from the EC, the Nordic Group and Japan were radical in the opposite direction--basically business as usual. In the eyes of almost everybody, the US proposal was not credible. Thus others were unwilling to seriously bargain until a more credible proposal came forward.

When such was not forthcoming, the Mid-Term Review in Montreal ended in an acrimonious stalemate. A new commitment to serious negotiations was forged in Geneva in April of 1989 with a commitment now to a long-term objective which ". . . is to provide for <u>substantial progressive reduction</u> in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in agricultural markets." Another round of proposals emerged in late 1990 in time for the final meeting in Brussels in December 1990. Finding the EC unwilling to negotiate separate disciplines in access, export assistance, and internal support, Latin America agricultural exporters, followed by the US, Australia, Canada, and other agricultural exporters, walked out, leaving the Uruguay Round in suspended animation.

Charges and counter charges as to whose fault the agricultural breakdown was continued through 1991 and most of 1992 along with periodic technical negotiations. Finally in the dying days of the Bush Administration, the US reached agreement with EC negotiators on two issues--the oilseed dispute and differences in the Uruguay Round on agriculture. The Blair House agreement regarding the Uruguay Round is basically a set of amendments to the so-called Dunkel Text (proposal developed in 1991 by GATT Secretary

General, Arthur Dunkel). In the three areas of particular interest--import access, internal support, and export assistance--modest reductions were proposed. As summarized by Sumner the basics are as follows:

- import access -- non-tariff barriers are to be converted to bound equivalent tariffs, then reduced by an average 36% over six years with any tariff subject to at least a minimum reduction of 15%. Minimum access of at least 3% of domestic consumption is required. This will grow to 5% over the six years.
- internal support -- the Blair House agreement here changed the Dunkel text the most and simply agreed to limit the cross-commodity average subsidy level to 80% of the 1986-88 levels of support. Sumner notes the changes in both US and EC policy already in place render this requirement non-binding primarily because MacSharry payments and US deficiency payments were already exempt.
- export assistance -- the value of export subsidies must be cut by 36% and the quantity of exports subsidized by 21%.

These agreements are a far cry from the initial positions of the US and the Cairns Group but were still resisted strongly by the French.

It was felt however that this would unlock the agricultural deadlock and allow the completion of the Uruguay Round. However the new Clinton Administration changed course several times and no agreement was forthcoming. The final event in this unhappy saga was the G-7 meeting in Tokyo in July 1993. While high sounding agreements were announced, supposedly unlocking the gridlock, the Wall Street Journal noted "making matters even more difficult, GATT negotiators still must complete negotiations over contentious agricultural subsides, an issue not even raised in Tokyo" (WSJ, July 8, 1993).

So where do we stand? No one knows for sure. Some argue that the Blair House agreement will stand and as soon as other remaining issues are clarified, there will be an agreement to end the Uruguay Round, by the target date of December 15, 1993. Others, more skeptical, are pessimistic that unless the US takes a stronger position by supporting the Blair House agreement it too will unravel and the Round may end with a repeat of Dillon, Kennedy, and Tokyo--namely little or no progress on agricultural trade liberalization. Only time will tell the real outcome.

What conclusions can be drawn from this history? At least five come to mind:

1. Agricultural trade in the last 150 years has never approached anything resembling free or even liberal trade.
2. Agricultural trade issues were deliberately left out of GATT because a major player, the US, insisted on it. They have yet to be re-included because other new major players, the EC and Japan, do not want them in.
3. GATT approaches, particularly in the Kennedy, Tokyo and Uruguay Rounds, have failed to bring about significant changes even after strong statements that progress in agriculture is an essential prerequisite to broader agreements. The Uruguay Round could well end up the same way.
4. While all this rhetoric has been going on, the levels of agricultural protectionism have risen in many years of the last decade and new players--e.g. Korea, Taiwan, and Canada--have joined the Agricultural Subsidies Club (OECD).
5. Nevertheless, domestic agricultural policies change as primarily domestic budget imperatives force adjustments, as for example, has happened in Europe, Canada, and the United States. But as these policies change, they become more complex and the degree of government intervention is increasing.

In the end one must ask a hard question. Even if the Uruguay agreement on agriculture is announced along the lines of the Blair House agreement, will it really make much difference to increasingly distorted agricultural markets? I return to this question at the end of the lecture.

III. Why is Agricultural Trade Liberalization Such a Tough Nut to Crack?

The just completed history begs the question of why agricultural protectionism is so deeply ingrained. Everyone agrees that the fundamental problem in agricultural trade is that domestic agricultural policies are by necessity interventionist and are fundamentally inconsistent with the policy requirements of a liberal trading system. A freer trading regime is ". . . predicated on an ascendent role for competitive market forces and a diminished role for government" (Warley, p.15). Farmers and governments in general prefer to transfer income to farmers through the market place, via higher prices, rather than by direct (welfare) payments. This preference leads to border measures which insulate domestic prices from world markets. This insulation must include import barriers, and, in the case of exporters, export subsidies.

There are but three options to resolving this conflict. The first is to abandon the notion of freer international markets for agriculture and confirm inward looking beggar-my-neighbor domestic policies. This option is totally offensive to neoclassicists and exporters. Implicitly it is already the policy of Japan and the EC. This I call the "forget it" option.

The second option is to redesign domestic income transfer policies to make them less trade distorting. Movement in this direction has already occurred--in the United States beginning in 1965 and is now emerging in the EC under MacSharry reform. This option recognizes the right of nations to subsidize farmers, but asks them to do it in a way that does not distort world markets. The basic problems with this approach are that it is transparent, fiscally costly, and codifies global resource misallocation. This I call the "you want to do it, you pay for it" option.

The third option is of course to adjust domestic agricultural policy to make it consistent with a liberal international order. This would essentially limit domestic policies to tariffs, non-distorting income transfers and decoupled policies for research, resource conservation, and infrastructure which are unrelated to production decisions. Gone would be quotas, variable levies, export subsidies, supply control marketing boards, and a host of other non-tariff barriers which are imaginatively used in agricultural trade.

Virtually all of the literature on agricultural trade liberalization is devoted to this option and is therefore focused on the question: Why are trade distorting domestic and border policies so difficult to reform? If one could understand the "why" of domestic protectionism we would be in a better position to advise on its dismemberment.

From the wide selection of literature reviewed there is a rich menu of diverse and often conflicting candidate explanations for developed country agricultural policy.

1. Traditional Explanations

Agricultural fundamentalism, coupled with the notion of an inherently unstable sector producing an essential good, supports public intervention to stabilize prices and assure supplies. This is the milk argument of the 1930s and more broadly is part of food security arguments used so effectively in Europe and Japan. In addition, agriculture historically has had political power to get what it wants. Once a policy is in place, inertia keeps it in place. This is a mixed collection of partial explanations, each of which is discredited by itself, but collectively they probably contribute to making policy difficult to change.

2. Adjustment and Transaction Costs Explanation

Related are notions of the high transaction costs to change policy. The benefits of change are so widely dispersed that no one would notice, but costs are highly concentrated.

Further program benefits from market distortions are quickly capitalized into asset or quota values which, after intergenerational and interpersonal transfers, are capital costs not capital gains (Bonnen and Browne). Therefore the removal of the program would impose uncompensated capital losses on current program participants, e.g. sugar and tobacco, leading to strong political opposition on equity grounds

3. <u>The Vicious Cycle-Bottomless Pit Explanation</u>

The inherent instability of certain agricultural markets--inelastic supply and demand functions with production lags--leads in extreme circumstances to demands for government stabilization policies. Stabilization policies require border measures which in turn can easily be used for price enhancement or trade expansion. This individual country intervention, particularly by a large country, destabilizes international markets (makes excess supply and/or demand functions more inelastic) and causes world prices to fall because of increased domestic output. Other countries react to prevent international instability from damaging domestic farmers by intervening to support prices which usually include border measures. This further destabilizes world markets, depressing prices, and contracting trade volumes. Higher domestic prices induce increased output which needs to be dumped on world markets using export subsidies. And so it goes, a vicious downward spiral which eventually escalates into a trade war. In a war of export subsidies and import barriers, you either join the battle (Canada) or wither away on the sidelines (Australia?). There is no way out, but by collective action, because unilateral liberalization clearly hurts only your domestic producers.

4. Structural and Comparative Advantage Explanations

Various authors (Honma and Hayami; Tyers and Anderson) have argued that the transformation of an agrarian economy to an industrial economy contains in it the necessary conditions for agricultural protectionism. The argument is as follows: technological change and capital expansion with industrialization leads to income growth. Engels law leads to a declining share of income being spent for food. This coupled with equal or greater rates of productivity increases in agriculture relative to industry, leads to declining terms of trade for agricultural products, a declining share of GNP, and declining comparative advantage. This inevitable result causes increasing pressure to protect agricultural producers from declining incomes. The model would explain why, as developing countries get richer, they stop taxing agriculture and become protectionist (e.g. South Korea and Taiwan). It would also be consistent with rising levels of protection in OECD countries (OECD). In the more recent writings of Tyers and Anderson they go on to use a political economy explanation for why farmers are successful in achieving and retaining protection. But this part is more appropriately dealt with in the next section.

5. Political Economy Explanations

Political economy explanations for the persistence of domestic agricultural policies have become numerous in recent years. Here only a brief sampling (see Young, Marchant and McCalla for a fuller treatment). Tyers and Anderson use the theory of regulation to craft an explanation as to why agriculture is successful in gaining protectionism. Many other authors buy into the Mancur Olson small group argument which argues that producers in general are growing larger individually and small in numbers collectively. Therefore the benefits of protectionism are concentrated among a few who are willing to invest politically to get and retain them. The benefits of liberalization are widely dispersed in small amounts across many consumers and taxpayers. Therefore they have no incentive to organize and invest politically in free trade.

In an interesting book edited by Avery, a two level game theoretic approach is explored by a number of authors regarding agricultural trade negotiations. One game is played internationally between trade negotiators who reach a tentative solution. The second game is played nationally between a country's trade negotiators and domestic agricultural interests. The more diverse and powerful the domestic interests, the more difficult it is to reach a consistent solution between the two levels. It is noted that it is more complex for the European Community which must find a solution to a three level game--global, community, and national. Another recent work deserves comment. Libby argues that politically what is really happening is that the US is using the Export Enhancement Program (EEP) to increase the international costs of the CAP thereby forcing internal policy adjustment in the EC. However, Anania, Bohman, and Carter looked at this proposition empirically and found the impact on the CAP budget to be relatively small.

While all of these approaches are illuminating none seems to provide a satisfactory explanation of the staying power of agricultural interests nor do they give many clues for resolving what is now a nearly fifty year impasse in GATT.

6. GATT Specific Explanations

Warley argues that agricultural negotiations were unsuccessful through the Tokyo Round for two additional reasons. First, negotiators were attacking the symptoms of the problem (border measures and subsidies) not the root cause--domestic support policies. Thus, because domestic policies were on the table in the Uruguay Round, he was optimistic that the Uruguay Round would be different. Four years later, Sumner argues that the main reason a Blair House agreement was possible was because it was finally realized that GATT was <u>not</u> the place to negotiate domestic policy. Second, argues Warley, we have not had full information about the magnitude of income transfers to agriculture, the deadweight loses caused by distortion, nor the negative growth effects of domestic policies. As I argue below there is now much better information on the costs of policy distortion, but liberalization still remains elusive.

The first five "explanations" are potentially useful in understanding why countries begin to protect agriculture and why they persist in doing so. However they give few clues as to how one gets out of the vicious cycle. The last "explanation" written at the beginning of the Uruguay Round has not been confirmed by subsequent events. Thus we are left feeling somewhat wanting about how one could go about reforming domestic policies to make them more consistent with a liberal global trading regime.

One can be pessimistic and argue that as long as domestic agricultural interests are the principle involvees in international negotiations, little will change. It is interesting to note for example that the only Directorate of the EC Commission which is directly involved in trade negotiations is Agriculture--all other trade negotiations are conducted by the External Affairs Directorate (Avery). Some argue that only when the fiscal and/or consumer costs become very oppressive will <u>external</u> forces intervene to change the policy despite agricultural opposition. But this argument has been around for at least two decades during which time costs and levels of intervention have increased. Others have argued that only when the agricultural impasse threatens broader GATT or diplomatic objectives will Presidents and Prime Ministers step in and correct the mess. So far evidence from meetings of the G-7 and the European Council of First Ministers offers little evidence to support a willingness of national leaders to take on entrenched agricultural interests.

IV. Does Economics Matter?

So we are left in a quandary of why, when it appears so obvious from economics that change is desirable, it does not occur. Perhaps we should look more carefully at the economic evidence.

Few self-respecting agricultural economists would disagree with the following three propositions. (1) Economic theory since Adam Smith has clearly demonstrated the unequivocal gains from specialization and exchange. (2) International trade theory since Ricardo, and amplified by Heckscher and Ohlin, has confirmed the benefits of free trade to all nations. (3) The overwhelming consensus of empirical analyses of the impacts of removal of agricultural trade distortions is that consumer and taxpayer benefits always exceed producer loses and therefore the nation is better off. Game, set, and match, right?

Wrong! Modern trade theory does not say everyone is better off with free trade. What it says is that in moving from a position of autarky to free trade, nations are on a net basis made better off. But the theory clearly shows that within countries, some gain and some lose. The net benefits statement comes about because gainers could potentially compensate losers and still be better off. In exporting countries, efficient export producers gain while domestic consumers of exportables lose. In general benefits are concentrated on a few producers while costs are widely dispersed across consumers. In importing countries, import competitive producers lose and consumers gain. Thus the costs are concentrated in a few producers and benefits are distributed across many consumers.

This should give us our first clue for any political economy model. Producers are much more likely to be concerned about trade policy than are consumers. In fact consumers are rational to remain ignorant of commodity specific issues. The second clue is that export oriented producers will favor free trade (self-interest) and import competitive producers will favor protection. The third clue is that in most countries there will be strong producers groups of both types. As evidence I simply note that US producers of grains and oilseeds espouse free trade except when somebody encroaches on their domestic market (witness US wheat producers' growing anger with Canada for increased durum and spring wheat exports to the US). On the other hand, US producers of milk, peanuts, and sugar strongly favor import protection.

Further, recent modifications of trade theory, which relax assumptions of constant returns to scale, homogenous products, and perfect competition (small country) yield results which in fact appear to give theoretical blessings for strategic trade policy interventions by government (Brander and Spencer; Helpman and Krugman). Since these developments there has been much debate as to whether they invalidate economists' widely held presumptions in favor of a policy of free trade (Krugman, 1987; Bhagwati). More recent exchanges suggest that neither traditional trade theory nor the new trade theory provide unconditional support for or against a policy of free trade (Baldwin; Krugman, 1993). Both Baldwin and Krugman now seem to agree that for more pragmatic reasons freer trade remains a likely best policy even if it is not optimal. The implications of the new trade theory are judged to be limited for agricultural trade policy (Carter, McCalla, and Sharples).

Finally, it must be noted that actual trade policy is never about moving from no trade to free trade. It is about moving from one set of interventions (distortions) to another. As such it is a second best world where theory has very little to say about which second best situation is better (McCalla, 1992). The answer about "who is better off, who is worse off, and by how much?" is, to use a time worn economic cop out, "an empirical question".

Relative to earlier Rounds of GATT, negotiators during the Uruguay Round were provided with more empirical estimates of the consequences of trade liberalization than ever before. While it would be excessive to say models abound, there are many. A sampling follows:

(a) The Tyers and Anderson model which continues to evolve and grow

(b) SWOPSIM - Static World Policy Simulation Modelling Framework - ERS/USDA

(c) FAPRI - a family of Food and Agriculture Policy Research Institute models housed at Iowa State which includes the IIASA model

(d) OECD - Organization of Economic Cooperation and Development trade mandate study model

These models are "global" but vary in commodity coverage, degree of country aggregation and details of country policies. Nevertheless each allows the broad simulation of the consequences of removal of domestic and border policies under various trade liberalization scenarios. These are non-spatial equilibrium models which solve to produce world prices and individual country exports or imports aggregated to yield a global market quantity. Thus most allow for broad computation of benefits and costs to individual country producers and consumers. However, none of these comprehensive models are sufficiently diaggregated in policy/program detail to make them very useful in actual negotiations.

Though the models differ in many ways, they produce similar results for scenarios when developed countries (DCs) liberalize agricultural trade. Generally the results suggest:

(1) World prices of most commodities will generally rise, though the degree of increase is modest and highly variable across commodities within models and for the same commodity across models. Primarily this increase results from significant drops in EC production resulting from lower internal prices, an unlikely outcome in reality;

(2) the volume of world trade increases;

(3) world price instability is reduced;

(4) producers in exporting countries may or may not gain depending on whether the new world price remains below previous internal support prices. In general producers in countries with low levels of internal support gain, e.g. the Cairns Group;

(5) producers in importing countries generally lose;

(6) consumers and taxpayers benefit in most developed countries;

(7) consumers in exporting countries with little difference between world and domestic prices (price transmission elasticities approaching 1), e.g., Australia and New Zealand and in most developing countries, lose;

(8) global welfare increases.

These results are generally consistent with theoretical expectations about liberalization by developed countries who subsidize producers and tax consumers and/or taxpayers.

Developing countries (LDCs) tend to do the opposite, namely subsidize urban consumers and often tax producers (Schiff and Valdés). Thus liberalization of food and agricultural policies in developing countries would generally have the opposite impact on world markets as compared to developed country liberalization (Islam and Valdés). Removal of consumer subsidies and producer taxes would increase domestic prices, expand production, and contract consumption. In food importing developing countries (most of them) excess demand would shift back to the left. The impact would be to decrease world price, contract the volume of trade, reduce world market price instability, benefit domestic producers, and hurt domestic consumers in poor countries.

The combination of the two scenarios, i.e. DCs and LDCs both liberalize, produces ambiguous results as might be expected: world prices may rise or fall for particular commodities; trade volume could rise or fall; impacts on producers in developed country exporters are more likely to be negative; and producers in LDCs gain while LDC consumers lose.

The specific results are not the main point. The important conclusion is that under any of the scenarios some groups always lose, e.g. import competitive producers in DCs, and other groups may gain and yet others may lose. None gain unequivocally under all scenarios. The bottom line is that agricultural trade liberalization is not a positive event for everybody.

Further the models are basically static and few include stochastic elements. Most deal simplistically, if at all, with several actual and potential major players such as the former Soviet Union, China and India (1/2 of the world's population). Projections, for example, of China's future international market role vary widely suggesting that under differing circumstances China could be a large importer or exporter of grains (Carter and Zhong).

Similarly what will happen in the former Soviet Union is highly uncertain. Currently the region is a large importer (mostly under export assistance) but there is, in the minds of many, great potential to become an exporter, again.

Therefore economic theory and empirical analysis does not answer with clarity or conviction two critical questions always asked by domestic agricultural producers:

(1) Will I be better off with liberalization?

(2) What are the future implications for world markets including prices and trade volume?

In the absence of convincing arguments, producers rationally opt to retain current safety nets. This result should not surprise us.

On the national scene, a politician must ask whether it is worth stirring up a hornets nest of anger among some domestic farmers for changes in a small and declining share of world trade. Recall that French farmers rioted, blocked roads with burning tires, and threatened additional forms of violence after the Blair House agreement was announced. Estimates of the benefits from liberalization are in national terms exceedingly small and uncertain. OECD says US total transfer to US agriculture in 1992 was less than $90 billion, a large absolute number, but only 1.5 percent of US GDP. Only an uncertain portion of this would be gained with partial liberalization.

V. Where Do Things Go from Here?

This lecture is not only long, but I fear may seem unduly pessimistic. But, the history of agricultural protectionism induces pessimism. The fact that levels of transfers to agricultural producers and taxes on consumers in most developed countries have risen steadily, while the economic importance of the sector continued to dwindle, sustains pessimism. The likelihood that the developed countries, including the US, will probably buy into a relatively innocuous agricultural agreement--a modified Blair House--declare victory, and end the GATT Round, portends continued pessimism.

How things have changed over the course of the Uruguay Round. In the early going the U.S. rallying cry was, "No agreement is better than a poor agreement." Now it seems to be, "Any agreement is better than no agreement."

So agriculture in all likelihood will remain a highly protected sector in rich countries. Its economic importance, already small, will be further diminished by these inward looking policies. But politicians seem unwilling to risk incurring the wrath of a vocal, well organized, and relatively wealthy minority when those who would benefit from liberalization wouldn't come running to the politicians defense. Politicians must see it as a negative sum game.

So in the end, whether an agricultural agreement comes out of GATT or not, it probably won't make a lot of difference to developed countries who subsidize their agriculture. That outcome could, I supppose, put it high on the agenda of the next Round of GATT negotiations, if and when they occur. In that event we will have another wave of books, articles, and conferences which, if nothing else, will create employment for future generations of agricultural trade economists. But it is also possible that bilateral and regional trading agreements (e.g. NAFTA) will increase in prominence to such an extent that future global negotiations in GATT on agriculture could be irrelevant (McCalla, 1992).

At the end of this analysis one feels somewhat empty. If the mess is so bad, and the case for reform so strong, why doesn't something happen? Could it be that the only ones who really care are trade economists and that we really don't count?

END NOTES

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1. George Ladd has reminded me that in the 1780s Thomas Jefferson was sent to Europe to negotiate treaties with the French regarding access to French markets for tobacco and other products. Dos Passos comments that "... opening the French market, hedged on every side by privilege, monopoly, and corrupt bureaucratic practices, to American products was an endless slow grind" (p. 263). Things seem to have changed little in over the last 200 years.

2. Argentina, Australia, Brazil, Canada, Chile, Colombia, Hungary, Indonesia, Malaysia, Philippines, New Zealand, Thailand, and Uruguay.

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