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International Agricultural Trade
Research Consortium

Whither European Community Common
Agricultural Policy, MacSharried,
or Dunkeled in the GATT?

by

Vernon Oley Roningen*

Working Paper # 92-3

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April 1992

A Paper

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U.S. Department of Agriculture

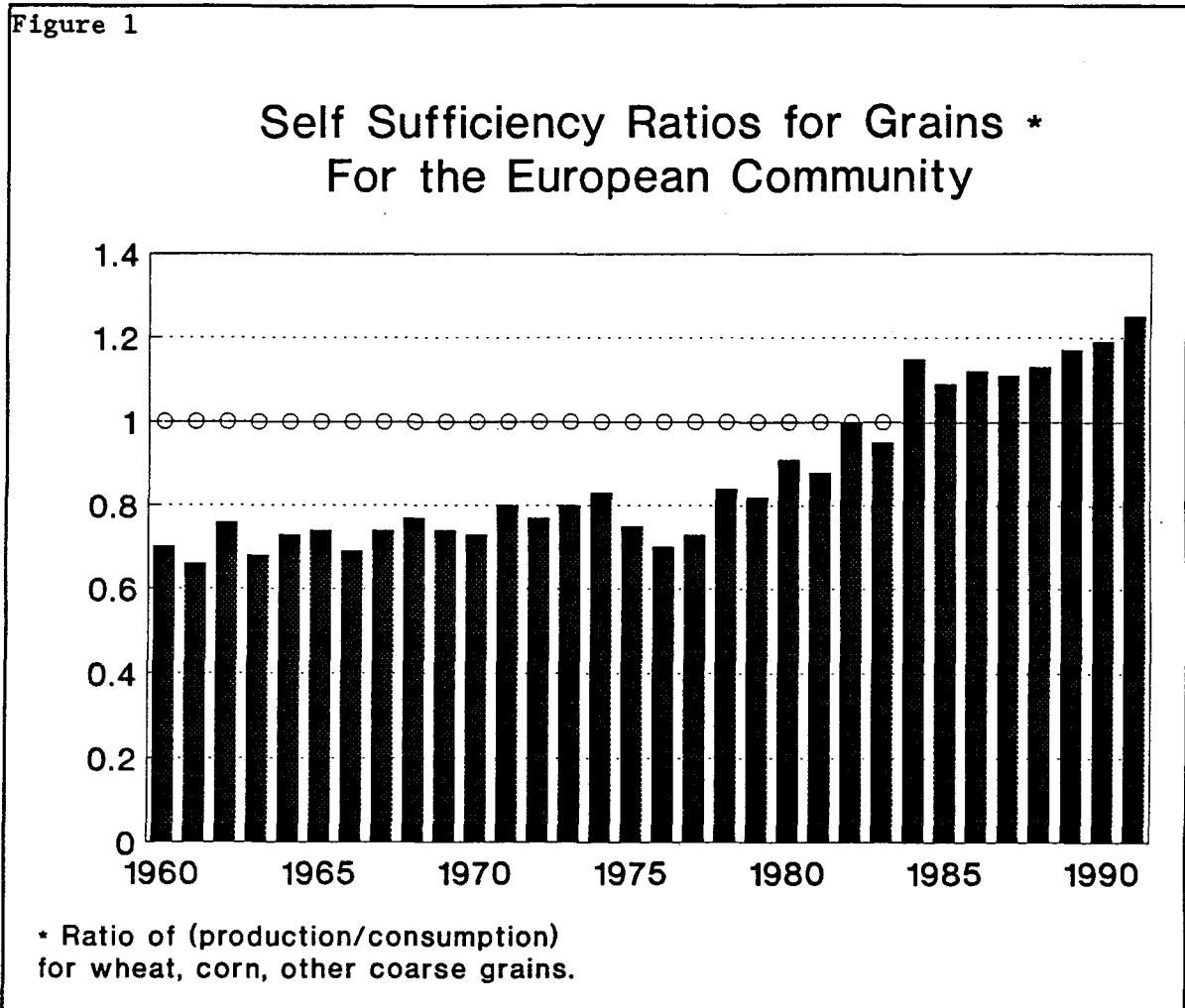
Abstract

The Uruguay Round of trade negotiations in the General Agreement on Tariffs and Trade (GATT) has been deadlocked over disagreement between the European Community (EC) and other GATT members about policy reform in agriculture. Last July, Mr. MacSharry, the EC Agriculture Commissioner, proposed an internal reform of the EC Common Agricultural Policy (CAP). Meanwhile, Mr. Dunkel of the GATT Secretariat has proposed a compromise GATT agreement that would reduce support to agriculture in the EC and other member countries. This paper summarizes these two proposals for agriculture and compares the effect of their implementation by the EC. The two proposals are then contrasted from an EC policy management viewpoint.

* The author is an economist with the Economic Research Service of the U.S. Department of Agriculture. The views in this paper are those of the author and do not represent positions of USDA or the U.S. government.

Background

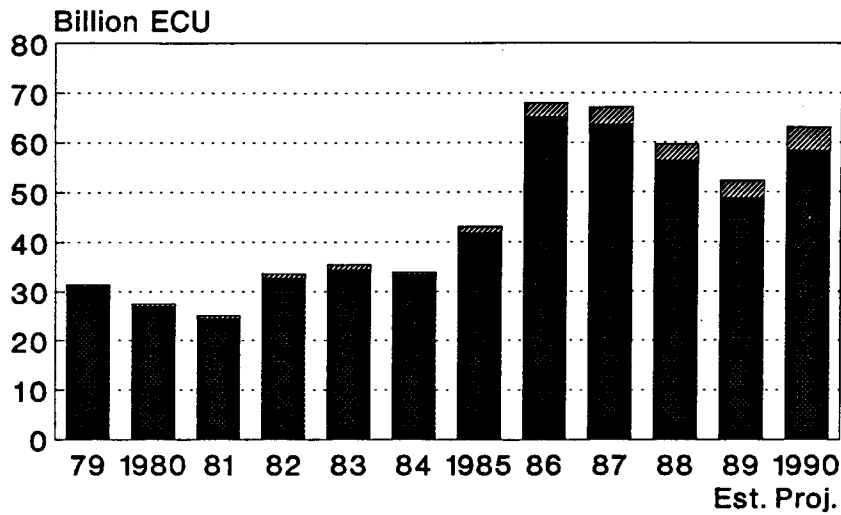
The United States and other traditional agricultural exporters have had a long-standing dispute with the European Community (EC) over the world-wide impact of its Common Agricultural Policy (CAP). Figure 1 (Self Sufficiency Ratios for Grains) illustrates the heart of the problem for traditional grain exporters like the United States, Canada, Australia, and Argentina. The EC, in response to its policy of high internal prices, has moved from a position of being a net importer in the 1960s and 70s to a leading grain exporter in world markets in the 1990s. A similar drive past self sufficiency has also taken place in the EC for meats and other agricultural products. The political response of the U.S. has been a combination of grain export subsidies to retain overseas markets and programs to curb grain production.



The EC has a system of administered internal prices, usually set far above world market prices. Variable import levies or export subsidies ("restitutions" in EC CAP jargon), support these high internal prices. As the EC has produced more and become a net exporter, budget costs have risen as support has shifted from consumer taxes (import levies) to export subsidies. Figure 2 compares market and direct support to agriculture in the U.S. and EC.

Figure 2

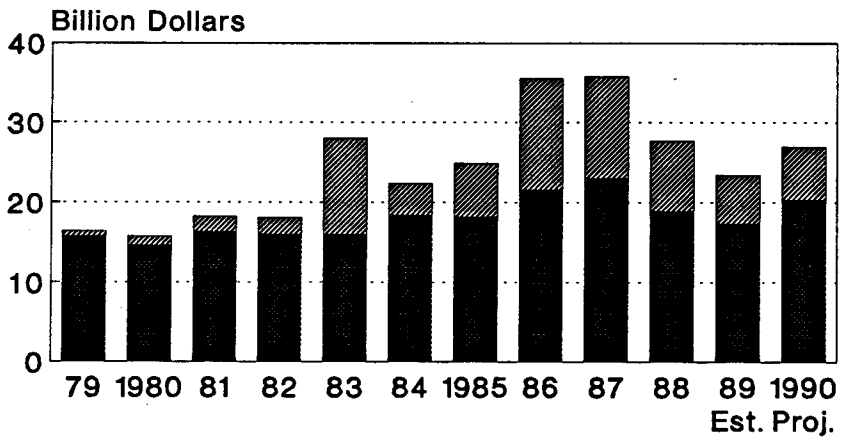
Market and Direct Support to Agriculture



European Community *

* 10 members, 1979-85,
12 members, 1986-90

Market support Direct payments



United States

Source: OECD Tables of Producer and Consumer Subsidy Equivalents

Figure 2 highlights the fact that EC support rose in absolute terms in the mid 1980s, partially due to EC enlargement. The figure also contrasts a major difference between agricultural support in the EC and the U.S. EC policies consist mostly of "market" support, i.e. policies such as import levies (tariffs) and export subsidies which keep internal prices for both the

consumer and producer well above world market levels. The U.S. in contrast, relies much more on direct payments to producers from the Federal budget. In addition U.S. grains policies generally accompany these direct payments with supply control schemes which, on average, keep consumer prices near world levels and minimize trade distortion effects.

An estimate of the cost of the EC CAP can be obtained by removing all support to EC agriculture in a global trade model. For this purpose, a SWOPSIM¹ (Static World Policy SIMulation) model calibrated to 1989 data was used.¹ The model is static, non-spatial, intermediate-run, multicommodity, multi-country, and partial equilibrium. The model includes 11 countries/regions (U.S., EC, Canada, Japan, Australia, New Zealand, and five aggregate regions) and 22 products/product groups (beef, pork, lamb, milk and milk products, wheat, corn, other coarse grains, rice, soybeans and products, other oilseeds and products, sugar, cotton, and tobacco). Key model assumptions include competitive markets and perfect substitutability between domestic and traded goods. Support information used to parameterize the model comes from OECD and USDA (see References).

The results of a total EC liberalization experiment are shown in Table 1. Current EC policies depress world agricultural prices. The experiment suggests that prices would be, on average, 9 percent higher if the EC CAP were totally removed.² In quantity terms, EC production is about 11 percent higher than it would be otherwise while US agricultural production is 3 percent lower. In 1989, EC support policies provided about 40 billion dollars of income to EC producers at the expense of 12 billion dollars income lost to U.S. producers. The EC net trade position in agriculture could decline (decreased exports, increased imports) by almost \$22 billion. The welfare costs of the EC policies amount to about 10 billion dollars. Clearly the impact of the EC Common Agricultural Policies on world markets is enormous.

Several countries submitted proposals to the Uruguay round of trade negotiations which would have required the EC to reduce its support. The U.S. took the high ground by proposing a complete liberalization of all agricultural support. Although no GATT (General Agreement on Tariffs and Trade) settlement has been reached yet for the Uruguay round, the EC was put under considerable pressure to reform the CAP. Several studies showed both the high levels of EC support to agriculture and the large amount of world agricultural trade that was distorted by EC policies.

¹ See Documentation of the Static World Policy Simulation (SWOPSIM) Modeling Framework by Roningen, Sullivan and Dixit, Economic Research Service Staff Report No. 9151, USDA, Washington, D.C., Sept. 1991. A full set of modeling experiments can be found in How Level is the Playing Field? An Economic Analysis of Agricultural Policy Reforms in Industrial Market Economies by Roningen and Dixit, Foreign Agricultural Economic Report No. 239, Economic Research Service, USDA, Washington, D.C., December 1989.

² These figures come from the "ALL MODEL PRODUCTS" row in Table 1. The model does not cover all EC production nor does it include all support documented by the OECD. Market and direct support is excluded but national policies which the OECD estimates to be about 6 percent of total support, are not included in the model calculations. These numbers can change from year to year because EC tariffs and subsidies vary with world market conditions in order to maintain stable internal target prices.

In addition, as budget costs of the CAP rose because of increased export support, internal pressure was building on the EC to reform its agricultural policy. This budget pressure will likely increase as other European countries in West and East Europe petition for membership in the EC.

Table 1--Estimate of the Impact of Removal of EC Agricultural Support in 1989

PRODUCT	World Price (%)	EC Supply (%)	US Supply (%)	EC Producer Income (B.US\$)	US Producer Income (B.US\$)	EC Net Trade (B.US\$)
Meat, Eggs	9	-16	6	-18	6	-13.6
Dairy Products	43	-9	4	-13	4	-4.6
Cereals	2	-5	1	-6	1	-1.1
Oilseeds	5	-13	.3	-2	.4	-1.7
Sugar	18	-5	6	-2	.3	-.5
ALL MODEL PRODUCTS	8	-11	3	-40	12	-21.6

The MacSharry Proposal for CAP Reform

EC Agriculture Commissioner MacSharry put forward a proposal for reform of the CAP in July 1991. The proposal, adopted by the Commission, is under consideration by the EC Council of Ministers. Although not part of the EC GATT offer, the proposal has been viewed by many as an accompaniment that could break the longstanding US-EC deadlock over agricultural support.

The proposal is significant for the EC in that it proposes a fundamental change in the level and manner of EC agricultural support.³ First, it would reduce internal price support. Internal (administered) prices for grains would be reduced about 37 percent. Meat and dairy internal prices would also be reduced. Second, direct producer payments would be introduced to compensate producers for the loss of support from high internal administered prices. For grains, these payments would be based on historical regional yields with the intention of "decoupling" the payments from current production decisions (preventing the payments from causing over-production by not linking them to current production yields). The third new item would be the introduction of land set-asides for larger farms (commercial producers). The greater reliance on direct payments and production controls, would move the EC

³ The MacSharry proposal does contain details of proposed price cuts for many products including grains, dairy products, and meats. However it only makes suggestions for other products. For example, for oilseeds, it proposes keeping the price ratio between grains and oilseeds consistent with the world market price ratio. Economists in Europe, Australia, and the U.S. who have analyzed the impact of the proposal have had to make assumptions about how the unclear parts of the proposal would be implemented.

Common Agricultural Policy in the direction of U.S. agricultural policy where direct payments and set-asides are the main policy instruments for grains.

Estimates of the impact of the MacSharry proposal are shown in Table 2. These results derive from a SWOPSIM model liberalization where changes suggested in the proposal are interpreted in terms of model structure and parameters. As expected, world agricultural prices would rise about 2 percent while EC production would fall an equal amount. EC producers would lose 4 billion in spite of compensation but the EC would experience an economic welfare gain of almost a billion dollars. The EC net trade position would deteriorate by almost \$5 billion. U.S. producers would likely benefit both in income and production volume terms. The most important caveat about these types of calculations are the assumptions that have to be made about the how much production is cut back by supply controls under the MacSharry proposal. In the end, the effect of such controls depends upon how they are implemented and monitored. This exercise assumed that 15 percent cutbacks for "commercial producers" in the MacSharry proposal result in roughly 10 percent cutbacks in production on an over all basis.

Table 2--Impact of an EC Implementation of the MacSharry CAP Reform Proposal

PRODUCT	World Prices (%)	EC Supply (%)	US Supply (%)	EC Producer Income (B.US\$)	US Producer Income (B.US\$)	EC Net Trade (B.US\$)
Meat, Eggs	2.4	-1.2	1.1	-4.5	1.2	-2.7
Dairy Products	3.4	-.6	.2	-.8	.2	-.2
Cereals	3.4	-5.7	1.2	.9	1.2	-2.4
Oilseeds	.4	-4.9	-.2	-.1	0	-.6
ALL MODEL PRODUCTS	2.3	-2	.7	-4	2.6	-4.9

The Dunkel Proposal in the GATT

Mr. Dunkel, the Chairman of the Trade Negotiating Committee in the GATT has submitted a proposal to complete the Uruguay round of trade negotiations. The Dunkel proposal is a compromise of the proposals submitted by several GATT members, including the U.S. For agriculture, it proposes several actions. First, all import barriers (quotas) would be tariffied and reduced 36 percent from the base period (1986-88). Second, budgetary expenditures on export subsidies must be reduced 36 percent and the volume of subsidized exports must be reduced 24 percent. Third, internal support must be reduced by 20 percent (e.g. deficiency payments to farmers for participating in programs). Finally, there are minimum access requirements which mean that remaining barriers to trade must be configured so that imports can reach a minimum of 5 percent of consumption. All of the support reductions are to be calculated from a 1986-88 base. This means, for example, that quotas are converted to tariffs in this period rather than at current levels. Reductions in support and other requirements such as those for minimum access are to be phased in from 1993 to

1999.

The period 1986-88 generally was one of higher protection for cereals and lower protection for meats in the EC than is the case currently. This means that the calculation of support to be reduced is a complicated process requiring detailed information on commodity programs over time. If support has risen since the base period, extra cuts would have to be made (in excess of those outlined above) while if support has declined, cuts could be less.

To evaluate the impact of the Dunkel proposal, OECD support data was used with the author's interpretation of the Dunkel proposal. These calculations are incomplete in that they do not necessarily enforce the 24 percent cut in quantities receiving export support that is required along with the 36 percent cuts in export support values. They also do not enforce the minimum access requirements spelled out in the Dunkel proposal.⁴ Information on cuts to be made plus changes in support from the base period is applied to a SWOPSIM model based upon 1989 data. The model removes the necessary support and estimates the impact of an EC implementation of cuts as envisaged in the Dunkel proposal. These impacts are shown in Table 3 for major product groups and all products in the model.⁵

Table 3--Impact of EC Implementation of the Dunkel Proposal in the GATT

PRODUCT	World Prices (%)	EC Supply (%)	US Supply (%)	EC Producer Income (B.US\$)	US Producer Income (B.US\$)	EC Net Trade (B.US\$)
Meat, Eggs	3.1	-6.4	2.4	-7.8	2.3	-4.8
Dairy Products	8.2	-2	.8	-2.5	.7	-.7
Cereals	-.4	1	0	-.2	.0	.5
Oilseeds	3	-7.9	.4	-1.2	.3	-1.4
ALL MODEL PRODUCTS	2.1	-3.6	1.1	-11.8	3.4	-6.4

The results are of expected sign and magnitudes. World prices would rise 2

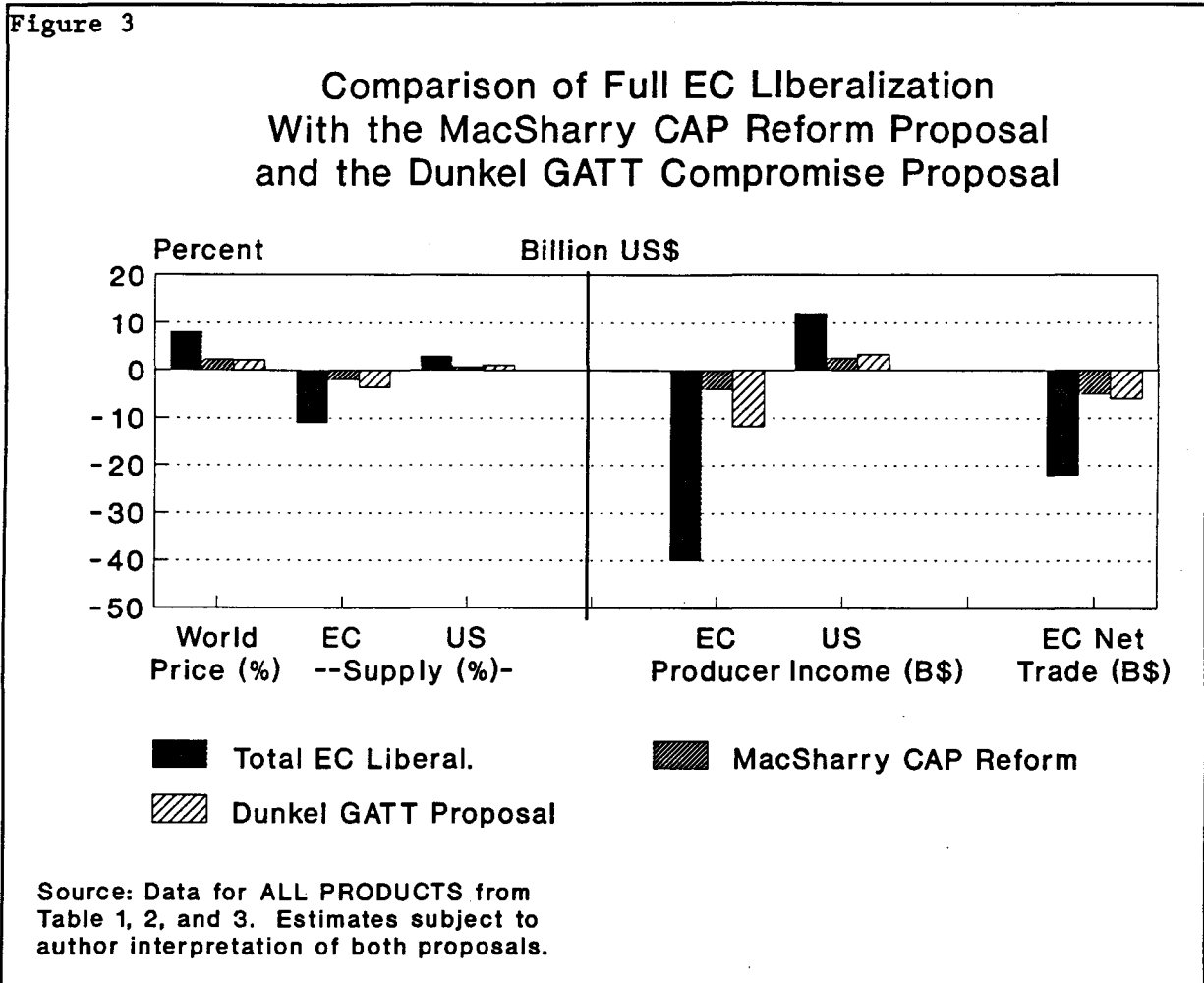
⁴ The model contains a set of commodity aggregates such as corn and other coarse grains which includes barley, rye, sorghum, and other grains. One would have to carry out calculations at the detailed commodity level to be precise about the impact of the Dunkel proposal. This paper emphasizes general magnitudes and directions of results which are consistent with the degree of aggregation in the model.

⁵ All of the estimates in this paper come from unilateral cuts in support by the EC. In a GATT agreement, other countries including the U.S. would also be required to cut agricultural support and the final impact of an agreement would have to include all of these effects. Previous experience with the SWOPSIM model suggests that the sum of unilateral support cuts by countries roughly equals the effects of a multilateral cut.

percent while EC supply declines over 3 percent. EC producer incomes would decline significantly (almost \$12 billion) because support was removed with no compensation as was the case with the MacSharry CAP reform proposal. EC gains \$4 billion of economic welfare; production and producer income in the U.S. rise in response to the partial EC liberalization. The EC net trade position in agriculture would deteriorate by about \$6 billion.

Comparison of EC Implementation of the MacSharry and Dunkel Proposals

Both the MacSharry CAP reform proposal and the Dunkel GATT proposal are partial liberalization of support provided to the EC by the Common Agricultural Policy. Figure 3 provides a graphical comparison of the impact of these proposals with a full EC liberalization experiment.



In terms of possible economic impacts, both proposals would result in a partial liberalization of the EC CAP. Depending upon the measure, one could say that either proposal would amount to a 10-30 percent liberalization for the EC. The effects transmitted to world markets and the U.S. through world prices and trade are similar for both proposals, but the impacts in the EC are different for producers. The MacSharry CAP reform proposal compensates producers for cuts in market support with direct payments coupled with supply

controls. Therefore producer income does not decline as much under the MacSharry proposal and EC welfare gains are less because of the budget costs of these direct payments.

Comparison of the Proposals From A Policy Management Viewpoint

Measurement of policy intervention makes trade negotiations possible. It is important to realize the bold and difficult step that has been taken in attempting to bring agriculture policy under GATT regulation. Agricultural policies have many components which have been considered "domestic" in nature. Policy instruments differ among products within countries and between countries and they are often very complex. Negotiations require a comparison of all agricultural policies and their impact in some common framework across products and countries. Work in the OECD and national governments measuring support in common ways such as "producer subsidy equivalents" (the amount of income received by a producer from all policies affecting a product) has been extremely helpful in making complex policies more transparent and comparable. One can easily argue that without this analytical step, agriculture would have never been included in the current GATT negotiations. Policy measurement also has implications for policy management, especially in an international context like the GATT.

The Dunkel GATT reform proposal emphasizes instruments and methods for reducing agricultural support consistent with the history of tariff monitoring and reduction in the GATT. The conversion of import quotas to tariffs makes support transparent and amenable to a managed reduction in the GATT context. Export subsidies are also quantifiable and reducible. But because subsidy values are subject to world price fluctuations, agricultural exporter concerns have been taken into account in the Dunkel proposal by insuring that volumes of subsidized exports are cut as well.

Non-GATT-traditional solutions to trade problems found in the Dunkel proposal are the minimum access requirements and the use of aggregate support measures for policies formerly considered "domestic" in nature which have been clearly shown to distort trade. Minimum access requirements are included as way of guaranteeing some entry into markets even though the protection that remains in place after any reductions may be high. Support that is not from trade tariffs or subsidies would be measured in an aggregate measure of support (AMS - the amount of income a producer receives from internal support policies) for each commodity--the AMS would then be reduced. Countries would have to submit plans outlining how all of these traditional GATT based and other support reductions would be accomplished.

Because agricultural policies are complex and because "domestic" or non-tariff non-trade policies are to be reduced under the Dunkel proposal, policy monitoring and compliance in the GATT would have to expand. The GATT Secretariat and member countries would have to keep track of internal support and the complex formulas for reduction set out in the country plans. Tariff reductions, export support expenditures and export volumes, minimum access rules, and internal support measures would all have to be measured on an ongoing basis to insure compliance. Policy makers in countries now would have to add the monitoring and maintenance of the Dunkel proposal objectives to the list of goals they must reach with their agricultural policies. Managing and monitoring the results of the Dunkel proposal, should it be implemented, will not be easy.

The EC CAP reform proposal is simpler for the EC to manage although it would require that two additional policy instruments be created and managed. The EC CAP reform proposal concentrates on removing some trade distortion caused by EC support policies in a way that minimizes losses to producers. The EC CAP reform proposal manages this via traditional EC policy instruments and by adding new ones in terms of direct producer payments and supply controls. The proposal is in line with the tradition of the EC to control agricultural production to some public end. The Dunkel GATT proposal is more oriented toward an opening up of EC markets to global market forces.

Whither European Community Common Agricultural Policy, MacSharried, or Dunkeled in the GATT?

The EC CAP reform proposal itself can be viewed as a public confession by the EC that its agricultural policies do distort trade and need to be changed if trade liberalization is to proceed. Budget pressures and the transparency of EC trade distortion that has been publicized by the work done in support of the GATT negotiations, have led the EC to contemplate CAP reform. The MacSharry EC CAP reform proposal is what many Europeans think might be politically possible in the EC--continued support of agriculture in a more complex, but less trade distorting manner.

The Dunkel GATT proposal represents an attempt to bring all countries agricultural policies under GATT control and reduction. Where policies could be converted to traditional GATT instruments, that would be done. Where that is not possible, GATT responsibilities would have to be expanded to include the monitoring of minimum access trade requirements, export subsidy values and the volume of exports subsidized, and the value producers receive from internal policies that impact trade. The route of the Dunkel proposal is also complex and the EC fears that inconsistencies in targets would make its management of a Dunkel reduction in agricultural support difficult.

Is there room for a compromise? Some imagination could result in a version of the Macsharry CAP reform proposal being made compatible with the Dunkel proposal in the GATT. This is one optimistic view of a successful conclusion of the Uruguay round in agriculture.

Are there simpler ways to accomplish the purposes of EC CAP reform and a GATT sponsored global reduction in agricultural support? Much effort has gone into the current MacSharry and Dunkel proposals. So even though the congruence of work by lawyers, economists, and politicians is not always clear and simple, it is thorough. If the EC continues to resist a GATT agreement, then negotiators might start looking for other proposals. Common sense tells us that as long as significant support for agriculture exists in the EC and elsewhere, there will be need for creative ways to manage agricultural policies and reduce their trade distortion effects.

Part of the answer depends upon the economic philosophy pursued. If open markets and no government intervention are the ultimate goals of negotiations, then complex rules and administration problems are worth the cost in achieving them. On the other hand if one believes that governments can intervene as they wish as long as they do not transmit trade effects to other countries, then a simpler way of directly monitoring, measuring, and controlling trade distortion might be helpful. Either philosophy requires the measurement of policies and their impacts; but administration of reform will be a challenge!

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