GATT Negotiations And Agricultural Policy Reform

by John A. Schnittker and A. P. VanStolk

➢ Unrealistic U.S. objectives and unnecessary EC rigidity on agriculture interrupted the Uruguay Round but never threatened it. Now the trade talks enter their realistic stage, in which barely perceptible, but politically difficult changes in existing EC, U.S., and Japanese systems build bridges to major farm policy reforms which could emerge in five to ten years. The logic of the year-to-year farm policy changes arises mainly from internal political and financial considerations. The pace of these changes depends on political evolution, although external political pressure is also important. The role of the Uruguay Round is to balance and to bind these domestically-driven reforms, making future farm policy spending sprees too expensive to consider.

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Negotiators from the United States and the European Community (EC) have found just enough common ground on agricultural policy reform to permit the Uruguay Round of trade negotiations to continue. At the December 1988 mid-term review in Montreal, negotiators set April 8, 1989 as the deadline to break the deadlock on farm issues. Now trade liberalization talks can proceed in fourteen other sectors as well as in agriculture.

There was every prospect that the United States and the EC would agree to some broad framework for agricultural progress, if not by April 8, then very soon after. In March, draft language came out of Geneva that almost any country could accept, once a few obvious points had been resolved. Ambassador Carla Hills took a soft line on the original U.S. hard line as soon as she was confirmed. It became clear that the Uruguay Round would not be allowed to languish or fail at the halfway mark because of impatience or intransigence on agriculture.

Both the United States and the EC began the Uruguay Round and went to the mid-term review with unrealistic positions on agriculture. The U.S. proposal *to end all trade distorting* farm subsidies in about 10 years was made, paradoxically, as U.S. farm subsidies peaked at $26 billion in 1986. The U. S. proposal had Congressional and farm group support because it was designed to dramatize the worldwide subsidy situation and to embarrass the EC. The proposal turned on a clever and ambiguous definition of the term "trade-distorting", which would permit the U.S. to simply alter the basis of its farm subsidies to meet the proposed test.

Once subsidy payments were decoupled from farming—turning them into "income support" rather than "production" payments—the United States and others could continue to subsidize farmers without sinning (distorting trade patterns). Such steps will do little to reduce trade distortions, and the proposal will not sell abroad or at home. More important, U.S. negotiators and Congress know that the United States and other countries are going to continue substantial assistance to agriculture indefinitely. U.S. farm supports continue to be "entitlements" in the budget: in any crop season, the Department of Agriculture must spend whatever it takes to offset low prices and to remove surpluses as specified by law, no matter the costs.

The EC had earlier proposed to continue year-to-year reductions in subsidies under its farm support system—the Common Agricultural Policy or CAP. At least until recently, it did not admit to a definite long-term objective of substantially reducing subsidies or mitigating their effects on world trade. Subsidy levels in the EC, as in the United States, also peaked several years ago when greater restraints were introduced in dairy products, sugar, and grain programs. The EC farm subsidy budget was "capped" at a high level

Headquarters of the GATT Secretariate in Geneva *Courtesy Gatt Secretariat*

in 1988, and the maximum spending levels will decline in real terms as time passes. Ratcheted reductions in oilseed price guarantees were also introduced, geared to production levels.

The difficulty with this approach is that farm price guarantees in the EC have been so high that marginal subsidy cuts could be made for many years without any material effect on production or EC consumption patterns. EC crop surpluses might actually increase, if technological gains offset the year-to-year price cuts. Surpluses would continue to be subsidized unless specific commitments are made to limit spending on export subsidies, or to limit export tonnage.

EC officials and the leaders of member governments generally understand that the CAP has about run its course, and that it must be changed fundamentally by the end of the 1990s. This is necessary not only to make a GATT agreement possible, but more importantly, to increase potential economic growth in the EC, which is now held back by the high cost agricultural system.

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CAP Origins

The origins of the CAP lie in the masterly political, if not economic, compromise worked out in the late 1950s and early 1960s by EC Commissioner Dr. Sicco Mansholt. Through the years this compromise has achieved almost a mystical character inextricably entwined with the very existence of the EC. At the beginning, the original six EC nations were importing about twenty million tons of cereals. Mansholt set EC grain prices equal to the highest prices of any member nation. These high prices were supported with intervention purchases and variable levies on imports. He combined this with a concession to animal feeders, granting virtually free access to oilseeds, oilmeals, grain products, and other grain substitutes.

In time, EC grain prices were raised further; grain production eventually exceeded consumption, and the EC became a net exporter. High internal grain prices allowed feed compounders to pay relatively high prices for substitutes. They imported a large part of world production of grain byproducts, manioc roots, sweet potato slices, feed peas and beans, beet and citrus pulps, and oilmeals into the EC. Today, EC animal feed consumption consists of 50 percent non-grains against about 20 percent in the United States. This structurally reduces demand for grain.

In order to change this unbalanced agricultural situation, the governments of the (now) twelve EC nations will have to face up to the need for change, overcoming the psychological barrier of amending and eventually overturning the magic Mansholt CAP. Each of these governments will not only have to overcome the resistance of the lobbies of agricultural producers, but grain cooperatives and banks as well. Each of these groups has found a relatively risk-free and profitable place in the current CAP and will resist change. An economically sound CAP would create more competition, upsetting vested interests. It is arguable that even some agribusiness in the United States has an interest in continuing the current CAP structure, which is the basis for the premium prices paid for byproducts of oilseed crushing and grain grinding, as well as for beet and citrus pulps.

It will be a Herculean task to reform the CAP structurally in the face of widespread resistance. Sustained pressure from outside the EC will be helpful, tying agricultural change to prospective gains in other forms of economic activity would help. But it is up to Europe to actually do it. Long-term objectives for EC agriculture must be formulated and a gradual phase in program must be agreed upon. No other country or region faces comparable agricultural reforms in the 1990s. (Continued page 24)

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What Can Be Done?

Now that the EC has signed on to the modest objectives of the Uruguay Round and the United States has dropped its extreme demands, it is time for all major parties to become practical about what can be accomplished in the current round of trade negotiations. Progress toward reduction of agricultural subsidies and their effects remains the *sine qua non* of progress in other sectors. This will be as true in 1990 as it was in 1988 at the time of the mid-term review. The task is no longer impossible, now that the hurdles have been lowered. Other sectors have a great stake in agricultural reform and should help define successive realistic approaches to future crises, so the Uruguay Round can be successfully concluded in 1990 or 1991.

Fortunately, practical and progressive options are available. Having backed off the proposal to end all trade distorting subsidies U.S. negotiators now need to adjust to the political fact that Congress will continue substantial farm subsidies indefinitely. The United States has also agreed to give "credit" in the negotiations for actions other governments have already taken as constructive in a long-term context. Public scorning of these actions as inadequate is no longer an option. U.S. markets for some food products will need to be pried open a few years from now. Finally, the United States needs to figure out how to cap its farm subsidy budget, and thereby progressively end the historic open-ended entitlements U.S. farmers have enjoyed for 50 years.

The EC needs to accept, in principle, that marginal reductions in its farm subsidy guarantees do not, by themselves represent an adequate basis for long-term negotiations. Such changes in the CAP are, however, the essential bridge to fundamental reform, since they are already under way and are headed in the right direction. These reforms need to be directed toward an agricultural system that is progressively less trade-distorting and that takes into account the big farm/little farm dichotomy that is rapidly developing in Europe. Marginal price cuts are squeezing out the small family producers the CAP is supposed to protect, while reducing only slightly the substantial profitability of large-scale farms.

Recent price reductions in EC agriculture do not offset the negative income effects for smaller, higher cost, agricultural producers. For the EC to carry price reductions much further, measures will have to be taken to alleviate these effects. This can take the form of direct income supports, of a differentiation in intervention levels whereby each producer would be eligible for a higher support price for a fixed limited quantity of production, or of payments per hectare for a limited number of hectares. These are essentially internal political problems to be solved over many years.

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Needed EC Concessions

The EC needs to make several concessions in the course of the current negotiations and throughout the 1990s:

- Define in broad general terms the kind of agriculture Europe intends to have in 10-15 years (by 2000 or 2005), and how that sector will fit into the world trading system. The short-term measures the EC has taken and proposes to take under the CAP need to be aimed toward some tangible objectives.
- Accelerate the implementation of some of the constructive decisions already taken: lower price guarantees; limit marketings where such schemes can work (as for milk); start substituting fixed levies for variable levies; bring grain and other feed prices, including protein meals, into economic balance by reducing grain price guarantees while adding a fixed duty to grain substitutes and oilseeds and products.
- Assure EC farmers that fluctuations in exchange rates will not capriciously dilute their returns from farming as the transition to new policies proceeds.
- Limit Europe's spending on export subsidies, or cap its farm exports quantitatively. This action is necessary in case lower price guarantees do not limit or reduce total farm output for three to four years. A pledge to build grain reserves as a matter of policy in cooperation especially with the United States and Canada, would be helpful in this regard.

U.S. Concessions, Too

The U.S. needs to make specific and difficult concessions as well:

- Accept the proposition that EC actions already under way represent positive if small steps toward reduced trade distortions. Also, the United States should be careful to remember that reduction, not elimination, of agricultural subsidies is the true objective of the Uruguay Round of negotiation.
- Come clean with the other trade negotiating parties on the fact that the Congress controls U.S. farm policy, and that it intends to continue the general framework of existing farm law at least until 1995. With the Congress finetuning the 1985 Act to perceived domestic farm problems and to the budget available comes first. What the rest of the world has done or will do to cut subsidies in the 1990s comes second. "Stay the Course"—not revolution—is the watchword of U.S. farm policy. —Keep U.S. negotiators credible by recognizing the momentum of current agricultural policy and recognize that U.S. budget pressures are pushing the U.S. to cut subsidies unilaterally. Officials are not credible when they imply that decoupling farm subsidies from production, a proposal with only a small U.S. constituency, would have substantial effects on the level of U.S. farm production or on world trade in farm products.
- U.S. soybean growers and the producers of corn by-products need to prepare themselves for a shock, when the EC begins to reconcile grain prices with protein prices. U.S. grain growers, on the other hand, will be in for a pleasant surprise, as increased demand for grains offsets reduced consumption of soybean meal and byproduct feeds in Europe, perhaps by the end of the century.

Once it is clear that the United States and the EC and perhaps Japan, intend to fine-tune present farm policy systems for a number of years, while designing more fundamental future changes, the basis for subsidy-reducing negotiations becomes clear. *The EC and the U.S. should do what they would have done anyway* *under domestic budgetary and political pressures — and a little more.* Perhaps by 1991 or 1992 all parties would promise to cut subsidies further into the mid-1990s. By 1995, countries could start to introduce fundamental policy changes such as an end to the EC's variable import levies, and higher dairy product import quotas and improved sugar access in the United States. These intentions could be "bound in GATT" by 1992, reducing the risk that new governments will again go on a farm subsidy spree, like we saw in the mid-1980s.

Some agreement between the United States, the EC, and Canada, whereby each would hold reserves of wheat in relation to its production, average wheat exports, or a combination of both, could help stabilize world wheat trade. Coarse grains might be added to the agreement. Any agreement must accept that the ability of southern hemisphere grain exporters to hold stocks is limited and that their production does not greatly affect world wheat price movements.

A wheat (or grain) reserve plan would have to include agreements on normal carryovers, the world price levels at which stocks would be built up and run down, and a host of technical details.

Such a wheat reserve plan could go a long way toward defusing controversies between the U.S. and EC in the important area of export subsidies, while providing guarantees to developing countries of regular wheat supplies at relatively stable prices.

The April agreement in Geneva tends to illustrate both the value and the limits of external pressure on complex political systems like the EC. Cairns Group countries (Australia, Canada, Brazil, Argentina, and others) can affect the nature and speed of change by putting pressure on the EC, the United States, and Japan, and by some marginal farm policy reforms of their own. But theirs will be a minor role, compared with the countries called upon to make the reforms and most of the concessions. Japan may well sit on the sidelines as the United States and Europe do battle. But Japan will continue to open its farm product markets inch by inch, under pressure from its trading partners, and in concert with its internal political and economics evolution.

The long, slow, mystical dance of agricultural rationalization and trade liberalization will continue largely at its own pace. Like an army, it cannot advance too far beyond its support systems. Like a giant snake, it must rest and digest from time to time. Like any human institution, it aspires to improvement if not perfection. By about 2000, after the evolutionary progress of the 1990s, the trade negotiating process can begin again. It will then be time to build for a century whose food and agriculture developments we can now barely imagine. C