



EC TRADE AND COMMERCIAL POLICY IN THE 2000s: CONSTRAINTS AND DYNAMIC FORCES

Chapters 4 and 5 aim to give a sense of what the EC's attitude could be in the multilateral trade negotiations of the coming decade. They examine what has been done—or not—by the EC to fulfill its Uruguay Round commitments, and try to spot the dynamic forces that could change the course of EC protection. Chapter 4 deals with trade policy and focuses on agriculture and manufacturing. Chapter 5 deals with commercial policy, which covers topics of increasing importance for the coming round, such as services, trade and labor issues, public procurement, and competition.

Chapter 6 describes the EC's addiction to discriminatory policy based on preferential trade agreements, and tries to assess the possibility of a slow shift away from this stance and toward a more multilateral approach. It also looks at the use of the various dispute settlement mechanisms available to the EC, particularly the WTO dispute settlement procedure.

The Dynamics of EC Trade Policy

If EC trade policy is now largely communitarized, its impact will never be. Common EC trade barriers have different effects on member-state economies with different production patterns. Each EC member-state has a different mix of sectors, the relative prices in which are modified by EC trade policy, all other things being constant. These differences are magnified in the medium (politically key) term by the fact that member-states are diversely exposed to world trade: extra-EC trade represents more than 40 percent of total trade only for Germany and Britain—meaning that trade shocks will not occur simultaneously with the same strength in all member-states. Member-state goals and strategies in trade policy thus will continue to differ—perhaps more than ever, because similar effects on member-state economies can no longer be achieved by a differentiated use of trade instruments.

As for the foreseeable future, the Community will have no supreme arbitrator (as the United States has with its president) and no institution able to generate deals on a routine, nonconsensual basis (as the US Congress does with majority voting). Therefore, the differentiated effects of EC trade barriers on member-state economies will continue to make EC trade policy dependent on ad hoc deals struck by coalitions among members. This situation will erode de facto the difference—based on the Treaty of Rome—between the Community’s exclusive competence in trade policy and the joint competence of the Community and its member-states in commercial policy (see box 1.1 and chapter 5).

Modern trade policy deals with more than border barriers (tariffs or quantitative restrictions). Its coverage extends to nonborder barriers, such as technical regulations (TRs, that is, mandatory norms and voluntary

standards), which, intentionally or not, can have a severe direct or indirect impact on trade flows. Since its origin, the Community has acknowledged this wide scope of trade policy, and the Treaty of Rome includes provisions for coping with it—although such preoccupations materialized only in the 1970s when the Common Market focusing on internal tariffs on goods was achieved.

In the early 1980s, a small group of major industrialists—the European Roundtable of Industrialists (ERT), led by the Volvo chief executive, Pehr Gyllenhammar—began to promote the concept of the Single (or Internal) Market. The ERT first set a vast agenda to eliminate intra-EC nonborder barriers, such as technical standards, customs and border facilities (trade facilitation), and inadequate physical infrastructure, ultimately reaching topics pertaining to commercial policy (see chapter 5) (Cowles 1995; Richardson 2000).¹ Later, the ERT plan—benefiting from the legal precedents established by the EC Court of Justice during the previous decade—was relaunched by another influential ERT member (the Philips chief executive, Wisse Dekker) in January 1985. This renewed plan gave birth, within a few weeks, to the Single Market Program (SMP, also often called the 1992 Program). The SMP, which was developed by the Commission and the Council between 1985 and 1993, has had (and still has) an important impact on nonborder barriers imposed on intra-EC trade in goods, and large effects on EC trade policy vis-à-vis the rest of the world, as is underlined below.

The dynamics of EC trade policy for the next decade will be dominated by three questions. First, to what extent has the EC fulfilled its Uruguay Round commitments on trade in goods? Second, to what extent have EC member-states been preparing for the coming WTO round with appropriate domestic reforms? (Chapters 2 and 3 underline how much the coming round will require serious preparation, because it will deal with the EC's most entrenched protectionist sectors.) Third, have recent years witnessed evolution in the position of some member-states on trade policy issues, making possible coalitions among them that would be more favorable to liberalization during the next round? The chapter outlines contrasting answers to these questions.

1. The key role of Gyllenhammar (who was also a member of the Leutwiler Group set up in the GATT to cope with the—often forgotten—disastrous attempt to launch a new round of talks in 1982) should remind us that European integration is much less EC-centered than often stated. It has been argued (e.g., see Baldwin 1995) that increased integration in the EC has negatively affected non-EC countries, thereby prompting their application for EC membership. This view presents the EC as the *source* of change. The ERT role shows that some EFTA leaders have been *instrumental* in EC integration. It suggests that investment diversion from the EFTA to the EC may have been more a reaction to the *future* integration of the *whole* of Western Europe than to the actual level of integration already reached by the EC at that time (a point consistent with the poor state of the Single Market Program at that time and the fact that empirical studies suggest 1988–89 as the first years for investment diversion (Baldwin, Forslid, and Haagland 1995; Sapir 1997).

On the one hand, the chapter shows that the EC has done little homework in its highly protected sectors, leading even to doubts about its capacity to fulfill some of its Uruguay Round agricultural commitments after 2000–01, or to stop an endless drift in antidumping measures for some industrial sectors. In addition, the late 1990s witnessed the increasing use of underlying fears in Europe about the environment or food safety as a source of high or even prohibitive trade barriers—including *within* the EC—in food products (e.g., meat or dairy products) *and* in industrial goods (e.g., asbestos, soft polyvinyl chloride).

On the other hand, the chapter suggests changing attitudes among member-states on trade policy. Certain states that so far have traditionally been staunch supporters of protection could shift to a much freer trade attitude at any time in the future, whereas others that have traditionally supported a free trade approach may have been captured by EC protection enough to have lost their energy for promoting EC openness. Because these changing attitudes in various member-states are so complex, and to some extent may go in opposite directions, it is hard to predict their ultimate influence on the course of EC trade policy—in particular, whether they will push for deeper liberalization than during the past decade.

Box 4.1 and table 4.1 reveal the implicit preferences of the three major European institutions (the Commission, the Council, and the Parliament) on the seven topics of trade policy by examining the texts released by these institutions just before the Seattle WTO Ministerial. (In February 2001, the EC Council reduced the hope among EC trading partners of a more accommodating EC stance, raised by the Commission's statements in late 2000, by making clear that the Council text adopted before Seattle remains the basis for the EC approach for a new WTO round.) Box 4.1 suggests a rationale for organizing the chapter in five sections. The first and second sections below (on agriculture and industry, respectively) describe the homework done, or not done, by the EC after the Uruguay Round and in preparation of the coming round. The third section focuses on the potentially new source for severe trade barriers, namely, technical regulations (norms and standards), with a special attention to food safety and health concerns. The fourth section examines whether there are signs that attitudes on trade policy are evolving in certain member-states. A concluding section summarizes a few proposals that the EC ideally should table.

Agriculture: An Incredibly Slow Liberalization Process

The texts released for the Seattle WTO Ministerial by the three European institutions send a rather negative message on agriculture. They insist on the aspects of Article 20 of the Uruguay Agriculture Agreement that can

Box 4.1 The EC trade policy revealed at the 1999 Seattle WTO Ministerial

Table 4.1 presents the seven topics concerning trade policy covered by the texts released for the Seattle WTO Ministerial by the three European institutions (Council, Commission, and Parliament). In February 2001, the Council confirmed that its text remains the basis for the EC approach toward a new WTO round. Table 4.1 assumes that the length of the text devoted to a topic reveals the relative importance of this topic for the European institution in question. This length is measured by the number of words as a percentage of the total number of words for each text (excluding the introductory and concluding general remarks). Table 4.1 also gives the rank of each trade policy topic among the total of 14 topics covered in the three texts (the seven other topics pertain to commercial policy or refer to the trade and development relations between the EC and developing countries; see chapters 5 and 6).

These crude measures of the relative importance of the various topics dealt with by EC trade policy suggest three major lessons. First, the Commission and Council have relatively similar agendas, with the same preeminent issues. They differ on the less important topics, for reasons that may either reflect a joint strategy vis-à-vis the rest of the world or underlying conflicts between them. The Commission has put more emphasis on technical issues (technical barriers to trade and trade facilitation), on which it may want to expand its influence and which are particularly sensitive for developing countries. The Council, conversely, is more interested in trade defense instruments (on which it may want to show its grip), which are also a major concern of US trade policy. Second, the Parliament differs in its huge emphasis on trade and environment. Third, the topics related to technical barriers to trade and trade-related health and environment issues have globally received the largest amount of attention from the Parliament and Commission—but not from the Council.

For each of the seven topics covered, table 4.1 also aims to capture the economic “tone” of the Commission text by looking at the frequency with which 15 key terms (and their variations) have been used: five proliberalization terms (competition, liberalization, market access, mutual recognition, and reduction of barriers), five terms associated with more “neutral” views with respect to liberalization (barriers, disciplines, nondiscrimination, subsidies, and transparency), and five terms reflecting a reluctant approach to liberalization (progressive, harmonization, regulation, safeguard, and reciprocity). The general impression that can be drawn from this exercise is that all the topics are rather loaded with neutral or reluctant terms—except industrial tariffs.

For the sake of minimizing quotes, this chapter refers to the Commission text, limiting references to the two other sources only to cases of noticeable differences among the three texts.

be easily used for protectionist purposes, in particular by focusing on the effects of implementing the reduction commitments made under the agreement, and by taking into account the “nontrade” concerns and special treatment for developing countries. Moreover, they do not mention the basic fact that Article 20 is entitled “Continuation of the Reform Process,” and starts by recognizing [...] the long-term objective of substantial progressive reductions in support and protection.”

Three aspects of the texts merit noting. First, the EC texts offer no perspective about further EC tariff or export subsidy reductions or tariff-quota increases (despite the fact that, in 2000, 186 key EC cereal, meat, and

Table 4.1 Trade policy topics in EC preparatory texts for 1999 Seattle WTO Ministerial

Topic and ranking criteria	Commission			Council			Parliament		
	Share	Rank	Rank	Share	Rank	Rank	Share	Rank	Rank
Topic importance by source^a:									
Text length devoted to topic									
Agriculture	9.2		4	14.4		2	12.3		3
Industrial tariffs	8.8		6	9.1		4	7.4		6
Trade and environment	8.9		5	8.3		5	12.3		2
Trade defense instruments	2.2		14	4.9		9	4.1		11
Trade facilitation	6.9		7	3.9		12	0.7		14
Technical barriers to trade	5.7		10	2.8		13	1.8		12
Trade and consumer health	3.0		12	1.8		14	6.8		8
Reminder:									
Commercial policy issues ^b	42.6			42.9			47.4		
Trade and development ^c	12.6		2	13.3		3	7.0		6
“Tone” by topic^d:									
Term frequencies									
Agriculture			Industrial tariffs			Health and environment			Trade instruments
33.3		60.0	0.0	0.0		42.9		0.0	20.0
44.4		0.0	37.5	42.9		42.9		55.6	40.0
22.2		40.0	62.5	14.3		14.3		44.4	40.0
9		3	8	7		7		9	5

EC = European Community

WTO = World Trade Organization

a. Decreasing order in the Council text.

b. For details, see table 5.1.

c. For details, see chapter 6.

d. Proliferation terms: competition, liberalization, market access, mutual recognition, (barrier) reduction. Neutral terms: barriers, disciplines, nondiscrimination, subsidy, transparency. Reluctant terms: harmonization, progressivity, reciprocity, regulation, safeguard.

Source: See box 4.1.

dairy products were expected to still be subject to EC duties higher than 80 percent; Bureau and Bureau 1999). Moreover, the texts take for granted the current definition of acceptable and unacceptable subsidies (in particular, the “blue” box) and all the existing special safeguard provisions included in the Uruguay Agriculture Agreement.

Second, the texts state that the coming negotiations should lead to the renewal of the “peace clause” (a provision that de facto excludes farm subsidies from the WTO dispute settlement regime) and should deal with the elimination of specific barriers, such as state-trading companies, export credit schemes, food aid, and loan deficiency payments—all barriers used more by EC trading partners than by the EC (at least for the time being), although the EC intervention agencies running the Common Agricultural Policy and the EC intervention price mechanism have many common features with state-trading firms and the US marketing loan regime, respectively.

Third, the texts insist on the recognition, in the future, of “non trade concerns” as legitimate restrictions in farm trade. Some of these nontrade concerns are relatively new, and may be quite acceptable for all WTO members, such as the consequences of the fact that past and existing farm policies have caused severe environmental deterioration—particularly in Europe. But other concerns, such as the “multifunctional” role of agriculture, are vague, to say the least, whereas a last group of concerns, such as food security, is quite traditional, and heavily loaded with a protectionist content (it is generally a synonym for self-sufficiency).² The texts provide no clues about the EC’s choices from among all these interpretations.

This initial EC approach could be seen as tough negotiating tactics, consisting, at the beginning of the talks, of offering no concessions and demanding maximal concessions from its partners. It could also reflect specific circumstances of the late 1990s: the Asian and Russian crises making European farmers (particularly large cereal growers or pig exporters) more reluctant about trade liberalization than a few years ago; the coming EC enlargement to include Central European countries with good potential for farm products (see chapter 6); the wrong but widespread and well-entrenched perception among European leaders that EC agriculture has no comparative advantages under market conditions (see below).

The latest news from the ongoing negotiations on agriculture in Geneva (launched in the context of the Built-in Agenda of the Uruguay Round) suggests that indeed there may have been a tactical element in the initial EC toughness. In November 2000, the EC approved a negotiating proposal including reduction of tariffs, export subsidies, and domestic support.

2. From an economic perspective, multifunctionality should be conditional on the existence of robust evidence showing that farmers make more of a nonmarketed contribution to social welfare than other producers (Anderson, Erwidodo, and Ingco 1999), and it could largely rely on instruments other than subsidies that could be much better monitored than state aid (Mahé and Ortalo-Magné 2001).

Though the proposal shows EC's willingness to negotiate, its offers are still very limited: an overall average reduction of tariffs, with a minimum reduction per tariff line (contrary to the traditional EC approach toward manufacturing tariffs); only "further reductions" (not elimination) of export subsidies; and the maintenance of the existing domestic support (subsidy) regime. Moreover, the proposal keeps many of the EC points tabled in Seattle, particularly on "nontrade concerns" (the question being whether this expression represents a real improvement over the previous expression of multifunctionality) and on trade barriers imposed on farm imports by EC trading partners. It remains that the EC proposal has been perceived by EC trading partners as open enough that they decided in March 2001 to start the second phase of agriculture talks in the WTO.

However, the constant reference of the three EC Seattle texts to the decisions of the 1999 Berlin European Council on agriculture suggests another reason for the very defensive position of the texts. It reflects, *above all*, the very limited *domestic* reforms achieved by the EC since the Uruguay Round. (The same could be said for fisheries, another source of conflict between the EC and its trading partners, for reasons explained in box 4.2.) As a result, the rest of the section focuses on the Common Agricultural Policy and, in particular, on its evolution since 1992. After a brief presentation of the CAP initial framework, the section underlines the fundamental gap between the 1992 CAP Reform and the Uruguay Agriculture Agreement—a gap that has cast serious doubts on the EC's ability to fulfill some of its Uruguay Round farm commitments in the coming years. In March 1999, the European Council held in Berlin (hereafter, the Berlin Council) made far too modest decisions; it reduced (not eliminated) the risks of EC failure in implementing its Uruguay Round farm commitments, but left the Community in a defensive position in the WTO negotiations, as mirrored by the Seattle texts.

The Initial CAP: A Brief Review

The Treaty of Rome devotes Articles 32 (ex 38) to 38 (ex 46) to the design of the CAP, which was then seen as necessary for creating a common market in agriculture.³ Article 33 (ex 39) lists the key CAP goals: (1) to increase

3. These 10 initial articles represent one-tenth of the 69 pages of the Treaty of Rome devoted to economic governance—a proportion roughly in line with the GDP share of EC agriculture in the late 1950s. After the late 1960s, the Community's resources (time, budget, and regulations) devoted to farm issues became increasingly out of line with the size of the farm sector: more than 50 percent of the EC budget during most of the past 30 years (and still 45 percent in the late 1990s), more than one-fourth of the EC directives adopted between 1958 and 1998 (including those devoted to standards for farm products). Three articles (ex 44, ex 45, and ex 47) of the initial version of the Treaty of Rome have disappeared in the Amsterdam TEC version, because they were dealing with the mechanisms for establishing the CAP and the implementation procedures during the period of transition.

Box 4.2 The Common Fisheries Policy: Another Loch Ness monster?

Article 32 (ex 38) of the Treaty of Rome defines fisheries as agricultural products—hence, no wonder that the Common Fisheries Policy (CFP) has many common legal points with the CAP: a common market organization for fish adopted in 1981, the same year as for sugar; minimum prices for domestically caught fish; and, above all, a vast set of subsidies of all kinds (from financing stocks to modernizing the fleet).

However, there are two key differences between the CAP and the CFP: if no adequate measure is taken, fish is an exhaustible resource. Until the mid-1970s, seas were “commons,” without clear property rights (in sharp contrast to farmland). Fish were then doomed to disappear sooner or later, because every fisherman had an incentive to catch as much fish as he could, and to rely on other fishermen to avoid fish exhaustion. In 1977, following the UN Conference on the Law of the Sea, the EC coastal member-states expanded their sovereignty to “exclusive economic zones” (EEZs), defined as 200 nautical miles from their North Sea and Atlantic coasts (instead of a few miles, as before). These EEZs have empowered EC member-states to define and enforce annual “total allowable catches” (TACs, i.e., the maximum quantity of fish to be caught to ensure the sustainability of the fish resource) for roughly 120 different species. TACs have generated (and still do) severe conflicts about the scientific basis justifying them, as witnessed in December 2000, when the Commission proposed drastic cuts in catches of cod and hake for the years to come.

TACs determine the quantity of fish to be caught, and hence to be traded, for a given consumption pattern. Obstacles to getting TACs can thus inhibit trade in the fishery sector as strictly as could trade barriers on fish per se. This feature explains why tariffs and trade instruments on the product (fish) have a limited role in the fishery sector—in contrast to the CAP. In fact, since the 1962 Dillon Round, EC fish products have been subject to bound (completely since 1995) and moderate (9.6 percent in 2000 on average, with a substantial tariff escalation) tariffs, with substantial tariff preferences for developing countries (Shirotori 1997).

By contrast, constraints on TACs abound in almost all the countries implementing them (including the EC). Only nationals can get them, domestic firms having received TACs cannot hire the services of foreign vessels or harbors, foreign fishermen are not allowed to invest in the domestic fishery sector, and so on. Such restrictions prevail even within the EC. EC TACs may be initially defined on biological (sustainability) grounds, but their ultimate level and breakdown between member-states rely on arcane considerations with little biological rationale: traditional fishing rights and activities, the political balance between regions, restrictions on EC fishing capacities due to the creation of EEZs by non-EC countries, etc. Member-state TACs are then split between vessels according to various schemes, from professional unions (Britain) to administration (France). In sum, EC TACs boil down to fishing quotas granted on a vessel basis through an allocation system severely limiting extra- and intra-EC competition.

If EC TACs address the sustainability issue of the fish resource, they have thus a key limit from an economic point of view: They do not permit screening the most efficient EC fishermen—in determining the fish allowed to be caught—from the least efficient ones. They thus waste resources, from vessels to harbors and fishery logistics. This intrinsic flaw has been greatly amplified by the very generous subsidies granted by the CFP to EC fishermen who are unable to assess correctly market evolution because they are protected by minimum prices. In 1997, the average rate of subsidization in EC fisheries was 15 percent—ranging from 5 percent (Belgium) to 90 percent

(box continues next page)

Box 4.2 (continued)

(Finland), relative to 4 percent (Iceland) and 25 percent (Canada) in the rest of the OECD countries (OECD 2000e). Such subsidies are fundamentally inconsistent with the objective of sustainable fish resources because they create strong incentives for overfishing, particularly in member states with lax enforcement of TACs, which leads to periodic excess supply and financial crises in the EC fishery sector.

Because of these flaws, the EC TAC regime has fueled many trade conflicts. The EC has tried to ease TAC-generated constraints by getting access to EEZs held by non-EC countries for EC (often Portuguese or Spanish) vessels. This has often led to bitter situations, as is best illustrated by the conflicts with Morocco and Chile. Moreover, constrained by GATT-bound tariffs, the EC has increasingly used nontariff barriers to limit access to its fish markets in four ways: (1) Costly conditions on fishing techniques have been imposed, such as banning certain types of fishing nets (1998). (2) Complex rules define fish country of origin by the nationality of the vessel, crew, staff, and captain, and even members of company boards (in 1992, fish caught by a Mauritian firm were no longer considered EC fish because a Japanese citizen had become a member of the company's board, following the acquisition of the Mauritian firm by a Japanese company). (3) Recurrent antidumping and antisubsidy measures (consisting of minimum prices on foreign Atlantic salmon) have been routinely imposed for years. (4) Last but not least, there are a half-dozen WTO dispute settlement cases on fish products, with the EC involved in five.

Improving EC TACs requires two key measures. First, to promote the efficiency of the fishing sector, TACs should be transferable between vessels, as they are in Iceland (Gissurarson 2000) and, to a lesser extent, in the Netherlands. "Individual transferable quotas" (ITQs) could then be bought by more efficient fishermen from less efficient fishermen, leaving both operators (and the whole country) in a better situation. Second, trade liberalization should make ITQs transferable among the fishermen of the *whole world* (and not only from the country in question), that is, tradable between countries—with all their components of services and investment.

farm productivity, (2) to ensure a fair standard of living for the agricultural community, (3) to stabilize markets, (4) to assure the availability of supplies, and (5) to ensure that supplies reach consumers at reasonable prices. This list reveals the basic problem of the CAP: too biased in favor of producers. Even point 5, which is the only one mentioning consumers, refers to "reasonable"—not low—prices. Moreover, until the early 1990s, the CAP was essentially based on using *one* instrument (price support) to reach *all* these objectives, and that has been an important additional source of distortions and costs.

The CAP began to be implemented in July 1964, three months after the beginning of the Kennedy Round negotiations. During the following 30 years, all agricultural goods have been progressively subjected to 26 different common market organizations (CMOs), leaving less than 12 percent of EC total farm output *de facto* not regulated by CMOs (with potatoes as the only important product).⁴ Until the CAP Reform was adopted

4. Grant (1997) reports European farmers' pressures to get fully operational CMOs (with floor prices and quantity regulations), even for minute products, e.g., bergamot or honey.

in 1992, all the CMOs relied essentially on a set of multiple guaranteed prices determined on an annual (or half-yearly) basis by the Council of Ministers (appendix A gives details for the five farm products examined in chapter 3). Because these guaranteed prices were unrelated to world prices, they required two-sided protection—first on import, then on export. Since its origin, the CAP has imposed variable levies on imports, that is, adjusted specific tariffs that vary on a daily basis raising world prices to the level of EC domestic prices (which are guaranteed on an annual or half-yearly basis)—making imports prohibitive. A decade later, export subsidies have become routinely necessary to dump into world markets the growing EC excess supply generated by the too-high, rigidly guaranteed EC farm prices.

In an effort to limit the effects of such guaranteed prices, two other instruments—supply control and market-support payments—became increasingly important in the late 1970s. Supply control (stock management) was expected to suffice to cope with excess supply. But inflated stocks—generated by the cumulation over years of continuous excess supply—have imposed such a budgetary burden on the Community that it has been necessary to have increasing recourse to additional tools to control supply, such as quantitative limits on production (e.g., mandatory production quotas on milk, introduced in 1984) or on essential inputs (e.g., voluntary set-aside programs for cereals or planting rights in wine). Last, market-support payments were granted under the form of demand subsidies (for low-income consumers) or supply subsidies for private storage (which tend to increase food supply) and for the cessation of production or for early retirement of farmers (which tend to decrease food supply).

Table 4.2 provides some sense of the long-term evolution of EC farm protection and support with the progressive accumulation of CAP instruments, and a comparison with three other OECD countries. This section is also based on the old OECD methodology for estimating CSEs and PSEs; see chapter 2.) Although there are no CSE or PSE estimates for the years before 1979, available studies suggest that the average nominal rate of protection in Western Europe increased from 30 percent (in the early 1950s) to 40 percent (late 1950s) and 60 percent (late 1960s) (Gulbrandsen and Lindbeck 1973). These figures give a sense of the ever-increasing trend of EC protection in agriculture from the immediate aftermath of World War II to the mid-1990s—leading to the striking situation (see table 4.2, bottom rows) that the total domestic support (as defined by the OECD) granted to EC agriculture represents more than 90 percent of the farm gross value added after 1993.⁵

5. For international comparisons, only ratios in terms of farm value added or GDP are meaningful. It is hard to compare the average domestic support per farmer or per hectare between countries because it is largely determined by differences in average farm size and labor intensity. The ratio of total domestic support to GDP allows us to take into account the fact that a portion of this support may be captured by the nonfarm sector.

Table 4.2 Consumer and producer subsidy equivalents and total farm support, 1979–99^a (percent)

Group or country	1979–86	1986–88	1989–90	1991–92	1993–95	1996–98	1999
Consumer subsidy equivalents (CSEs) (percent)							
European Community	30	44	36	42	32	29	37
Japan	42	57	49	51	51	50	52
United States	11	13	10	10	9	7	6
Australia	7	9	8	9	6	6	6
Producer subsidy equivalents (PSEs) (percent)							
European Community	37	49	43	50	46	47	55
Japan	63	73	68	70	75	71	68
United States	21	30	22	21	18	22	29
Australia	11	10	10	11	10	9	9
CSE-based tariffs (ad valorem tariff equivalents of the CSEs, percent)							
European Community	45	80	57	74	47	42	58
Japan	76	134	97	103	103	100	116
United States	13	15	11	12	10	8	6
Australia	7	10	9	10	7	6	6
EC total domestic support							
As percent of farm value-added	72.9	89.8	77.7	97.0	92.2	86.6	90.7
As percent of GDP	2.4	2.6	2.1	2.3	1.9	1.5	1.5
In euro per full-time farmer	6,204	10,975	11,983	16,383	15,450	16,413	17,211
In euro per hectare	894	1,394	1,382	1,769	1,578	1,504	1,571
In euro per EC inhabitant	233	311	304	364	318	303	316
EC consumer subsidy equivalent							
As percent of farm value-added	34.0	47.1	34.7	40.6	31.9	24.6	28.3

a. Based on the old method (see text).

Sources: OECD, *Economic Accounts for Agriculture*, Agricultural policies in OECD countries, various years; author's computations.

This initial version of the CAP has generated two major distortions in EC agriculture. First, because the CAP has relied on instruments providing support proportional to production or input volumes, it has essentially benefited large farms. In the early 1990s, the top 25 percent of EC farms, representing 72 percent of EC farm output, received 68 percent of EC price-support subsidies (OECD 1999b). Second, as shown by economic analysis, guaranteed price increases have had two opposite effects. On the one hand, they have increased farmers' income, but only on a transitory basis, because in the long run, farmers' incomes have followed the skill-adjusted average income prevailing in the rest of the EC economies. On the other hand, guaranteed price increases have progressively accumulated, in the form of rents attached to the fixed factors necessary for farm production—in particular, to land prices. In other words, if farmers as *producers* have enjoyed only transitory income increases from the CAP, farmers as *landowners* (and owners of other key fixed inputs, e.g., the rights to produce milk under the quota regime) have benefited from rents increasing in the long run.

The perverse impact of the CAP instruments explains the apparent paradox of recurrent and violent demonstrations by farmers who have been, and still are, receiving massive CAP transfers. The farmers who demonstrate are most often small farmers. They earn modest incomes from their farm activities and benefit from CAP rents only on limited assets (small landholdings or cattle). Although they receive limited benefits from the CAP, they are very dependent on it (they often have to do other business to survive). In addition, they feel threatened by the trend to larger farms, substitution of capital for labor, and accelerating rural depopulation—all developments that the CAP instruments are exacerbating because of their built-in biases in favor of large farms.

By contrast, large farms earn higher incomes because of their larger size and increased intensity in skilled labor, and they benefit from CAP rents on their large assets. In these circumstances, it is crucial for these large farmers to keep alive the popular myth in Europe of “one” agriculture based on small farms, to maintain a strong coalition with small farmers so that they do not become too politically isolated, and can keep pressure on elections in rural constituencies. As a result, large farmers strongly support the “one trade union” approach, and behind the scenes, they contribute substantially to the demonstrations of the small farmers.

1992 CAP Reform and the Uruguay Round: A Crucial Gap

The 1992 CAP Reform (also called the MacSharry Reform, from the then EC agriculture commissioner, Ray MacSharry) was adopted in May 1992, after the rejection, by the Netherlands and Britain, of a bolder plan including the possibility of subsidies degressive on a farm basis, and after

Box 4.3 The 1992 Common Agricultural Policy Reform

The 1992 Reform covered arable crops (cereals, oilseeds, and protein seeds), beef, and milk, that is, almost one-fourth of EC farm production in 1992 (one-fifth in the late 1990s). Table 4.3 summarizes the evolution of key guaranteed prices and compensatory subsidies under the reform, with all prices and subsidies expressed in euros (because prices and subsidies were published until 1995 in “green euros,” they have been multiplied by a conversion factor of roughly 1.2 to get series consistent for the whole period). Table 4.3 deserves three comments, which for simplicity’s sake are only presented for arable crops (with figures rounded). First, the “intervention” price (the other types of guaranteed prices have been abolished) was reduced in three annual steps (1993, 1994, and 1995). The intervention price for 1995 was set for an indefinite period (it was changed by the 1999 Berlin Council for the years 2000–06).

Second, compensatory land-based subsidies (€54 per ton in 1995) have also been increased in three annual steps. These subsidies are defined by ton, but they are paid on a per-hectare basis. This required complex calculations to determine historic regional yields. Each member-state had to specify “cereal growing regions”; for each of these regions, it had to determine an average annual yield based on past (pre-1991) performance; then the yield (in tons per hectare) was multiplied by the subsidy (in euros per ton) to determine the payment by eligible hectare. The whole system was specified by type of crop, productivity level, irrigation method, and so on. Not surprisingly, such a complicated system, in combination with weak monitoring, has allowed massive overcompensation for price cuts.

Third, mandatory set-aside obligations have been imposed on large (but not on small) farmers who have also been compensated with subsidies (€57 per ton in 1995), with a similar regime of reference yield to get the payment per hectare set aside.

Table 4.3 shows that the reform of the beef sector was based on the same format of decreased guaranteed prices combined with compensatory factor-based subsidies (called “premiums”), with some limits imposed on the number of possible claims (cattle head) eligible for subsidies.

The 1992 Reform also introduced environmental measures, but marginally and ambiguously. Depending on the precise circumstances of implementation, these measures have played the role of pure subsidies (in the absence of effective monitoring, as for pork in Brittany), or they have been implicit market-support payments to a “new farm” product—“nature,” announcing the theme of “multifunctionality” in agriculture.

the withdrawal of an alternative scheme, supported by Germany, based on the generalization of the milk production quota regime to major farm products. The reform introduced two key changes (see box 4.3 and table 4.3): (1) reduction of guaranteed prices for arable crops, beef, and milk; and (2) full compensation of the income losses caused by lower guaranteed prices through “compensatory payments,” consisting of “factor-based” subsidies defined on a per-hectare or cattle-head basis.

This package of measures reveals a crucial gap between the CAP Reform and the Uruguay Agriculture Agreement. The farm trade liberalization launched by the Uruguay Round aims to generate substantial decreases of production costs, and changes in the varieties of farm goods produced. By contrast, the 1992 Reform introduced no strong incentives to *reduce* EC costs. What follows provides evidence confirming the as-

**Table 4.3 1992 CAP Reform and 1999 Berlin Council:
Select guaranteed prices and compensatory subsidies**

Commodity, price, and subsidy	1992 CAP Reform								
	1992	1993	1994	1995	1996	1997	1998	1999	
Cereals, oilseeds, and protein seeds									
Intervention price ^a	Euros/ton	184.7	137.7	127.1	119.2	119.2	119.2	119.2	119.2
Market price ^b	Euros/ton	167.2	163.6	151.8	150.8	150.0	136.8	125.4	n.a.
Set-aside rate (mandatory)	Percent	n.a.	15.0	15.0	12.0	10.0	5.0	5.0	10.0
EC compensatory subsidies ("payments")									
Cereals	Euros/ton	n.a.	29.8	41.7	54.3	54.3	54.3	54.3	54.3
Oilseeds ^c	Euros/cereal-ton	n.a.	83.7	88.4	89.5	89.5	83.9	87.6	94.2
Protein seeds	Euros/ton	n.a.	77.5	77.5	78.5	78.5	78.5	78.5	78.5
Set-aside	Euros/ton	n.a.	53.6	67.9	68.8	68.8	68.8	68.8	68.8
Meat (bovine)									
Intervention price	Euros/ton	4,088	3,833	3,632	3,475	3,475	3,475	3,475	3,475
EC compensatory subsidies ("premiums")									
Bulls (first age)	Euros/head	48	72	89	109	109	135	135	135
Steers (first age)	Euros/head	48	72	89	109	109	109	109	109
Suckler cows	Euros/head	60	83	113	145	145	145	145	145
Slaughter (adults)	Euros/head	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Additional member-state aid									
Suckler cows	Euros/head	42	30	30	30	30	30	30	30
Milk									
Increase in milk quotas ^d	Percent	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Intervention prices ^e									
Butter	Euros/ton	3,490	3,342	3,240	3,282	3,282	3,282	3,282	3,282
Skimmed milk powder	Euros/ton	2,055	2,029	2,029	2,055	2,055	2,055	2,055	2,055
Sugar beet									
Minimum price (A sugar) ^f	Euros/ton	46.7	46.1	46.1	46.7	46.7	46.7	46.7	46.7
CAP budget^g									
"Fund guarantee" ^h	Millions of euros	31,068	34,748	32,970	34,503	39,108	40,423	38,748	40,440
"Rural development"	Millions of euros	2,895	3,386	3,335	3,609	3,935	4,132	4,367	5,565
Average CAP budget									
Per full-time farmer ⁱ	Euros/farmer	4,757	5,269	5,265	5,224	6,070	6,502	6,391	6,617
Per hectare	Euros/hectare	505	537	524	507	567	589	n.a.	n.a.

CAP = Common Agricultural Policy.

EAGGF = European Agricultural Guidance and Guarantee Fund.

n.a. = not available

VAT = value-added tax

a. Based on 155 green euros/ton in 1992.

b. Producer prices (excluding VAT).

c. From 1992 to 1996, converted from a euro/hectare basis (conversion factor of 4.6).

d. A third increase of 0.5 percent is scheduled for 2007.

e. A third decrease of 5 percent is scheduled for 2007, with a compensatory subsidy of 17.24 euros/ton.

assessment already made in 1995 (Johnson 1995) that the 1992 Reform represented a significant change in the *structure* of farm support in Europe, but not a change in the *level* of support, a situation meaning troubles ahead for the EC. The absence of incentives for cost cutting flows from the principle of full compensation of price cuts included in the 1992 Reform—following a tradition dating from the very first years of the CAP (in the mid-1960s, German farmers were fully compensated for German price decreases following the CAP's introduction in Germany).

In fact, the implementation of the 1992 Reform witnessed a massive *over*-compensation of cereal price decreases caused by two factors. First,

Berlin Council: Decisions for 2000, proposals for 2000–06							Change (percent)		
							1995/ 1992 ^a	2006/ 1996	2006/ 1992 ^a
2000	2001	2002	2003	2004	2005	2006			
110.3	101.3	101.3	101.3	101.3	101.3	101.3	-35.5	-15.0	-45.2
n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-9.8	n.a.	n.a.
10.0	10.0	10.0	10.0	10.0	10.0	10.0	-20.0	0.0	-33.3
58.7	63.0	63.0	63.0	63.0	63.0	63.0	82.4	15.9	111.4
81.7	72.4	63.0	63.0	63.0	63.0	63.0	6.9	-29.6	-24.7
72.5	72.5	72.5	72.5	72.5	72.5	72.5	1.3	-7.6	-6.4
58.7	63.0	63.0	63.0	63.0	63.0	63.0	28.3	-8.5	17.5
3,240	3,010	2,780	2,780	2,780	2,780	2,780	-15.0	-20.0	-32.0
160	185	210	210	210	210	210	128.0	93.2	340.5
122	136	150	150	150	150	150	128.0	38.0	214.6
163	182	200	200	200	200	200	143.1	38.0	235.6
27	53	80	80	80	80	80	n.a.	n.a.	n.a.
50	50	50	50	50	50	50	-27.6	65.6	19.9
0.0	0.0	0.0	0.0	0.0	0.5	0.5	0.0	n.a.	n.a.
3,282	3,282	3,282	3,282	3,282	3,118	2,954	-6.0	-10.0	-15.4
2,055	2,055	2,055	2,055	2,055	1,952	1,850	0.0	-10.0	-10.0
46.7	46.7	46.7	46.7	46.7	46.7	46.7	0.0	0.0	0.0
40,526	39,605	39,570	39,430	38,410	37,570	37,290	11.6	-5.0	20.0
2,618	4,495	4,330	4,340	4,350	4,360	4,370	16.6	20.1	50.9
6,183	6,599	6,907	7,027	7,005	7,009	7,106	9.8	17.1	36.0
n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	0.4	n.a.	n.a.

f. EC price (Italy, Ireland, Portugal, Finland, Spain, and Britain have slightly higher prices).

g. Member-state subsidies are not taken into account.

h. EAGGF effective expenses until 1998, forecasts afterwards.

i. Assuming a 2 percent annual rate of decrease of the number of full-time farmers (from 1998 to 2006).

Note: From 1992 to 1994, prices and payments are expressed in commercial euros, based on a conversion factor of 1.2 euro per green euro.

Sources: *The Agricultural Situation in the EU*, various years. European Commission: *The CAP Reform: A Policy for the Future*, 1999.

producer prices (paid at the farm gate, excluding the value-added tax) declined by much less than intervention prices (e.g., common wheat market prices declined by 10 percent, relative to 35 percent for intervention prices, as shown by table 4.3), so that the compensatory subsidies that were largely based on the decline of *intervention* prices were excessive. Second, the detailed provisions of the 1992 Reform allowed “generous” calculations of compensations, which seriously contributed to minimizing the impact of the 1992 Reform and preserving the initial CAP (see box 4.3 and, for details, Chambres d’Agriculture 1994b or Swinbank 1997). This overcompensation has been estimated at 11 percent of the granted com-

pensatory subsidies (*excluding* set-aside subsidies) for 1993–94, 30 percent for 1994–95, 42 percent for 1995–96, and 21 percent in 1996—a total of €8.5 billion for the four years (European Commission 1997b). More important, the CAP Reform has penalized low-cost farm production in the long run, in several ways: efficient farmers and those with good land (whose yields are higher than average) have been penalized by the fact that compensatory subsidies are based on an average yield, stricter set-aside obligations for large farms have limited low cost production made possible by these farms, and so on.

Skyrocketing compensatory subsidies could not last forever. They reactivated another EC tradition dating from the waiver granted in 1984 to Britain for its contribution to the CAP budget. In the late 1990s, member-states became increasingly obsessed by their individual budgetary “rate of return” (*taux de retour*; i.e., how much money a member-state can get back from its contribution to the EC budget). This concern led to the 1999 Berlin Council decision to “stabilize” the EC farm budget for 2000–06. But such a stabilization can only impose a “soft” constraint: it corresponds in fact to an increase in the subsidy rate *by farmer*, because the number of EC farmers is continuously decreasing (see box 4.5 below). As a result, it is unlikely to induce remaining EC farmers to cut their production costs, and to change their product mix.

Full compensation and budgetary stabilization have allowed the EC to escape the difficult decision about which farmers should be entitled to receive subsidies. From the perspective of the Uruguay Agriculture Agreement, the *raison d’être* of subsidies is to be *transitory* compensation for those farmers who have been induced to make wrong decisions in the past because of the CAP, and of the farm policies of other countries. Ideally, such subsidies should thus be granted only to *incumbent* farmers; they should not be available to entrant farmers, who should make market-based decisions, and they should not be based on production factors, in order to be “de-coupled” as much as possible from farm production. Ideally, the level of subsidies should mirror the length of time during which the farmers in question have been induced to make wrong decisions—meaning that subsidies should have some determined endpoint.

Not only did the compensatory subsidies introduced by the CAP Reform have none of these desirable features, but they have amplified (and still do) the negative effects of the initial CAP regime. They also tend to be capitalized in land and other input values—increasing once more the value of land for arable crops, relative to land for pastures, forests, or other environmentally friendly uses (Mahé and Roe 1996). And they are also biased in favor of large farms—favoring the heirs of incumbent farmers to the detriment of entrant “farm entrepreneurs” coming from the rest of the economy, and hence generating long-term losses in entrepreneurial capacity in the EC farm sector (Mahé and Ortalo-Magné 2001). Ironically, this basic issue of who should be entitled to get compensation has resurfaced

in the context of the EC's enlargement to Central European countries—to the great confusion of the EC, which has provided inconsistent solutions and arguments (see chapter 6).

Two mutually reinforcing reasons have contributed to further limiting the impact of the Uruguay Round on the CAP Reform. First, most European governments looked at the Uruguay deal in terms of what they could gain from US reforms—not of what they could gain from the EC's own reforms. This approach greatly underestimated the potential EC benefits from the round, as illustrated by the following estimates: in 1990, the cost of US farm policy for EC farmers was roughly \$800 per farm, whereas the cost of the CAP for EC consumers was roughly \$11,100 per farm—that is, an underestimating factor of almost 14 (the cost of the CAP for US farmers was roughly \$3,400 per farm) (Tyers and Anderson 1992).

Second, defining the reference period for tariffing existing border barriers is a key element of the Uruguay Agriculture Agreement (for a general description of the agreement, see Josling 1998 or Swinbank 1999). As shown by table 4.2, the main reference period used (1986–88) corresponds to peak farm protection in the EC. Hence, the EC Uruguay Round commitments for tariff reductions rely on the highest possible initial base—making effective liberalization minimal, and full compensation the most expensive possible. Indeed, in 1992–94, EC member-states were still largely underestimating CAP overall costs, and thus the subsidies necessary to implement the full-compensation principle. Table 4.2 mirrors this point, showing the widening gap between EC PSEs and CSEs after 1993—this divergence reflecting the increasingly intensive use of compensatory subsidies by the EC.

Implementing EC Uruguay Round Commitments: Trouble Ahead

The very limits of the CAP Reform raise a question: could the EC face difficulty in meeting its Uruguay Round commitments (which are briefly described in appendix A for the five farm products covered in chapter 3) on export subsidies, market access, and aggregate measures of support (these topics are ranked by decreasing order of expected trouble in the future)?

Export Subsidies

Difficulties have been faster to emerge and are most severe in the domain of export subsidies—a worrisome situation from the world perspective, for two reasons. The EC accounts for roughly 90 percent of export subsidies notified to the WTO, and the bulk of EC export subsidies is devoted to the major farm products of interest for almost all WTO members (grains, beef, dairy products, and sugar). Between 1995 and 1998 (the years for which EC official notification of export subsidies is available),

the EC exceeded its Uruguay Round commitments for beef (1996), olive oil (1996), other milk products (1996–97), rice (1996–97), poultry (1997), sugar (1997–98), coarse grains (1998), pork (1998), and eggs (1998) (OECD 2000d). This evolution was expected to continue and spread over more products for 1999 and 2000 (Tangermann 1999; OECD 2000d).⁶

As underlined in chapter 3 (table 3.5), export subsidy rates and tariff rates should be similar for the same product (they both reflect the same wedge between domestic and world prices), and indeed they generally are. This means that increasingly low EC tariffs will increasingly constrain the level of export subsidies that the EC can grant. In the absence of serious adjustment (due to the full-compensation principle), this evolution will lead to increasing EC domestic stocks *and* to declining world shares of EC farm exports. This dark perspective was behind the attempt to make further CAP reforms in 1999 (see below).

Market Access: Barriers to Imports

The 1992 CAP Reform has connected world and intervention prices, import duties, and compensatory subsidies in such a way that the EC could not have faced any noticeable difficulty in meeting its market-access Uruguay Round commitments in the late 1990s. But this political tour de force was achieved at a huge cost: the absence of noticeable economic incentives for change in the agricultural sector, an illustration of the French saying “*plus ça change, plus c’est la même chose*” (the more it changes, the more it is the same). Comparing the post-Uruguay Round, postreform year 1995 to the pre-Uruguay Round, prereform years 1991–93 for common wheat offers the best illustration of this remark (for simplicity, figures have been rounded, and the complications related to wheat quality ignored).

First, the EC commitments on bound tariffs have been de facto irrelevant since 1995, as is best illustrated by what happened in 1995–96. On the basis of the 1995 world average wheat price of €93 per ton forecast by the Commission in 1994, the 1995 bound specific tariff (€140 per ton) would have generated a level of protection of 150 percent for 1995—a level judged unacceptable by the major EC trading partners during the Uruguay Round negotiations. As this situation has persisted in the following years,

6. Because the EC did not exhaust its allowed export subsidies in 1995 (because of very high world prices), it has invoked a “forward” mechanism (the possibility of compensating for excess export subsidies during a year with export subsidies unused in past years, as is possible in other agreements, such as in the Multi-Fiber Agreement). That could be an expediency, but could not be a solution for the recurrent problems faced since 1996. It should be added that an approach in terms of effective (rather than nominal) rates of export subsidies would be useful to get a more complete assessment of the EC situation (export subsidies have been granted to the EC food industry as compensation for high protection of basic farm products).

despite the scheduled progressive reduction of EC bound tariffs (see below), the EC has had to use the alternative definition (included in the Uruguay Agriculture Agreement) to determine its external tariff, namely to cap the tariff to be paid at 55 percent of the wheat *intervention* price. Since 1995, this formula has been de facto the operational definition of the EC tariff on wheat.

Second, the tariff-cap formula has maintained a substantial level of protection, even when world prices have been unusually high. For instance, in 1995, the duty-paid price was €185 per ton (1.55 times the 1995 intervention price of roughly €119 per ton), that is, a rate of protection of almost 100 percent when based on the Commission forecast of €93 per ton for the 1995 world price, and still a rate of protection of almost 30 percent when based on the unusually high world price of roughly €150 per ton prevailing in the 1995–97 world markets. (It is important to note that, by definition, any decrease in world prices generates an *increase* of the tariff-cap-based rate of protection).

Third, the full-compensation principle has ensured that no significant change could occur in basic domestic support to farmers. For instance, the sum of the EC 1995 intervention wheat price (€119 per ton) and the associated compensatory subsidy (€54 per ton) comes close to the prereform floor price of roughly €195 per ton.

Following all these measures, access to EC markets seems already tightly locked. However, the Uruguay Agriculture Agreement allows for “special agricultural safeguard” measures in case of unexpected difficulty with import prices or volumes. In the EC case, the potential application of these safeguards covers 539 tariff lines—almost one-third of the total number of lines for farm products in the EC tariff schedule. Effective price-based safeguards (“snap-back tariffs”) have been imposed on 12 (1995), 14 (1996 and 1997), and 12 (1998) items (mostly sugar, poultry, and molasses); volume-based safeguards have been imposed on 47 (1996), 46 (1997), and 27 (1998) items (mostly fruit and vegetables) (OECD 2000d).

The Uruguay Round negotiators were so aware of the limits imposed on market access liberalization that they took care to introduce tariff quotas: 3 percent of domestic consumption could be imported at tariffs lower than bound tariffs, and this share should be progressively increased to 5 percent over 6 years. However, despite the fact that the EC “in-quota” tariffs were roughly one-third of the bound tariffs, the average “fill” rate steadily declined from 76 percent (1995) to 72 percent (1996) to 71 percent (1997) to 66 percent (1998) to 68 percent (1999) (OECD 2000d). This evolution mirrors the protectionist impact of the EC quota-management system, which relies on licenses on demand—a mechanism opaque enough to reduce the awareness of cheaper world prices among EC consumers.

All these relations between world prices, domestic prices, and the various instruments of protection were bound to evolve progressively under the pressure of two forces independent of the post-1995 EC farm policy:

(1) the evolution of world prices, and (2) the committed decreases of EC bound tariffs (by 36 percent, i.e., from €140 per ton in 1995 to €95 per ton in 2000 in the wheat case). In such a framework, the only instrument left at the disposal of the EC decision makers was the intervention price—leaving two alternatives for post-1995 situations.

One alternative would be for world prices to *increase* more than the scheduled decrease of EC bound tariffs. In this case, the tariff-cap formula remains the only effective constraint, bound tariffs are redundant, and farmers enjoy overcompensation—high world prices coupled with subsidies rigidly based on too high intervention prices. This alternative prevailed in 1995–96, with unusually high world prices—even leading the EC to impose export *taxes* (on wheat and barley) for a few months, in an effort to reduce EC prices relative to world prices.

The other alternative would be for world prices to *decrease* enough to make the progressively *reduced* bound tariffs the effective trade barrier (the tariff-cap formula becoming then redundant). For instance, a hypothetical world price of €90 per ton in 2000, combined with the committed 2000 bound tariff of €95 per ton, would have given a duty-paid import price of €185 per ton (corresponding to a tariff equivalent of 106 percent, i.e., *more* than the average tariff equivalent for the years 1994–98). Since 1997, this second alternative has prevailed, and the world prices for 2000 leave some—but now small—redundancy of EC bound tariffs, except for low-quality wheat and barley (Tangermann 1999). In other words, the 6 years since the end of the Uruguay Round have witnessed the elimination of the initially huge and “redundant” tariff protection incorporated into the EC Uruguay Round commitments on market access. This redundancy is now limited, and any new tariff reduction may trigger some *effective* liberalization.

These observations on wheat can be expanded to the other major farm products (Tangermann 1999). In all cases, EC commitments on market access have been so minimal that the EC will remain a difficult partner in the coming WTO negotiations—in particular for all products whose intervention prices have been left untouched by the 1992 Reform, or have not been subject to further reductions since 1995 (by the Berlin Council; see below), such as sugar.

Aggregate Measures of Support

Prospects in the domain of aggregate measures of support are better than those for export subsidies and tariffs. For 1995 and 1996, the EC aggregate measures of support (AMS) levels represented 64 and 67 percent, respectively, of EC commitments in this domain (€73.5 billion in 1995, to be progressively reduced to €61.2 billion by 2000) (OECD 2000d).

However, this positive note deserves a serious caveat: it relies on the assumption of the stability of the existing definition of domestic support, an assumption that will almost certainly be challenged by all EC trading

partners in the coming negotiations in two respects. First, the current AMS coverage of dairy products refers only to milk used in butter and skimmed milk powder; as a result, it ignores €6 billion out of €19 billion in subsidies paid to the EC dairy sector. Second, the AMS is just a portion of the total domestic support for the farm sector. Total support also includes the blue and green boxes of subsidies (plus a *de minimis* component and a special and differentiated component, which are small and can be ignored in what follows). In particular, the EC favorable situation in AMS mirrors the current definition of the blue box, which includes the €16 billion compensatory subsidies paid to arable crops.

Changing these definitions will generate severe difficulties for the EC. The most serious challenge concerns the blue box—the EC being the only WTO member (with Norway) to intensively use this implicit escape clause to the Uruguay Agriculture Agreement. The blue box represents 23 percent of the EC's total domestic support granted from 1995 to 1998 (34 percent for Norway), in sharp contrast with 4 percent for the United States, and 0 percent for Japan or South Korea, the EC's traditional allies in agricultural matters (OECD 2000d). If the blue box subsidies had been included in the AMS definition in 1995–96, the EC would have already been dangerously close to its AMS commitments (by 10 to 5 percent).

The EC compensatory subsidies currently included in the blue box deserve two additional remarks. On the one hand, they could be seen as a powerful instrument for further reforms in the long run. Even French taxpayers are beginning to find expensive the total domestic support to agriculture, amounting to more than €17,000 per farmer in 1999 (with a peak of €18,000 in 1998), whereas the French minimum *wage* is €10,000 per year.⁷ This emerging reluctance will be boosted when it will be more widely known that the average total income of agricultural households is higher than the average income of other households in the rich EC member-states—by 5 to 10 percent in Belgium, to more than 50 percent in France, to more than 100 percent in the Netherlands, the only important exceptions being Germany and Italy, where farm income is 10 to 20 per-

7. This figure is based on OECD "total domestic support," which serves as a basis for estimating the share of domestic support in farm value added in table 4.2 (the figure of roughly €6,500 per farmer in table 4.3 takes into account only the transfers financed by the CAP budget). Similar figures are available at the member-state level (e.g., in 1997, total transfers to French farmers amounted to €18 billion [a figure that includes the often ignored support for fruit and olive oil, but also reflects the fact that the price support for cereals was smaller than usual because of high world prices] represented 75 percent of the French value added in farming, or twice the level of net farm income [Bureau and Bureau 1999]). The impact of such information is best illustrated by the opposite fate of two Parliamentary reports. In 1993, the Devedjian Report (which was the first one to courageously underline the CAP costs) was pilloried by almost all French politicians. In 1998, the Marre Report stressed this point again, and the unfairness of the subsidy regime (in 1997, 938 French farms received subsidies larger than €115,000 each, whereas 200,000 farmers received less than €7,500 each; it was well received).

cent short of the nonfarm income (OECD 1999b). Indeed, this increased transparency had already changed the tone and content of the debate about the CAP in France and several other member-states before the 1999 Berlin Council—leading these countries to focus more on questions of the intrinsic soundness of the CAP regarding global resource allocation, income distribution among farmers, and environmental damage by farm activities, and to look for ways to reduce subsidies.

On the other hand, the fact that massive farm subsidies are considered acceptable as long as they respect budgetary stabilization is unhealthy. It endangers the Treaty of Rome: excluding farm goods from the state-aid rules of the treaty is anachronistic—and inconsistent at a time when all manufactured goods *and* services are increasingly subjected to such disciplines. Far from being an instrument of change, such massive subsidies have inhibited (and still do) the adjustment efforts that the EC farm sector should make before the new round of negotiations, to become more competitive by world standards. They will inevitably generate more inefficiencies (even in those EC farm segments considered efficient today) and ultimately fuel demand for more protection. In this subsidy domain, as for the rest of farm policy, the EC should aim to benefit from New Zealand's and Sweden's experiences of bold moves (described in box 4.4), with their positive effects on efficiency, product diversification, and consumer gains.

1999 Berlin Council: Another Missed Opportunity

In March 1999, the Berlin Council adopted several decisions (see box 4.5 and table 4.3), which have been presented as a “new” CAP reform for the years 2000–08. In fact, the Council was close to collapse on farm issues, and has been unable to go very far. In particular, reductions in intervention prices range from small to nil, leading to three consequences: (1) Intervention prices in sectors left untouched by the 1992 Reform and the Berlin Council, such as dairy products (until 2005) and sugar, will be increasingly unsustainable; (2) further EC tariff reductions will be difficult without further reductions of intervention prices; and (3) the EC will find it increasingly hard to fulfill its existing commitments on export subsidies. In sum, the Berlin Council has left the EC in a defensive position in the coming negotiations—in many ways, not in a much better position than before the 1992 Blair House negotiations (for a modestly more optimistic view, see Tangermann 1999).

In sum, the outcome of the Berlin Council is too modest to substantially change the major trends of EC production and consumption, and hence of domestic stocks and trade (for information, stock cereals in mid-1998 were back to their 1990 level). In particular, it would still be hard for the EC to fulfill its commitments (with adverse secondary effects on the EC mix of farm products), if and when the euro becomes stronger or world farm

Box 4.4 Swedish farm policy reform: A blueprint for future CAP reform?

New Zealand is the most frequently mentioned illustration of farm policy reform in an OECD country because it has the longest experience with "life in agriculture after subsidies" (Chambres d'Agriculture 1993; Federated Farmers of New Zealand 1999; Johnson 2000). The Swedish experience of the early 1990s is less well known, but it is very interesting in the EC context, because of the many similarities between Sweden and the rich EC member states (Britain, France, Germany) that block the farm reform process in the EC: Sweden has a farm share of less than 2 percent of GDP and employment, an acreage per head equal to the EC average, CSEs and PSEs 50 to 150 percent higher (during the 1980s, before its accession to the EC) than the corresponding figures for the EC (and with a similar evolution during the 1980s), and so on. In sum, Sweden shows that the so-called specificities of the EC farm sector do not resist scrutiny (for a careful analysis of this point and a detailed presentation of Swedish reform, see Molander 1994).

The Swedish farm policy reform, which was launched in 1989, was founded on four basic principles: (1) the dismantlement of domestic regulations (price guidance and milk quotas similar to those of the CAP), (2) the elimination of export subsidies, (3) the use of variable-import levies as the main instrument for protecting Swedish farmers (pending the tariffication process under negotiation in the Uruguay Round), and (4) budget-financed support to take care of the environmental, social, and regional aspects of farm production.

The proposed policy devoted special care to transitional measures: (1) The dismantlement was set at the beginning of the process (July 1991). (2) A transitional floor price on grain (set so that the average marginal farmer should be neutral between continued production and leaving the sector) was guaranteed for three years. (3) The price decrease was compensated for by stepwise-reduced, de-coupled income support providing 75, 50, and 25 percent of the income reduction for the average grain producer. (4) This support was to follow the producer, *not* the land. (5) A pension system was offered to milk producers. (6) A safety net was provided for farmers who had entered the sector after 1980, to avoid situations of large debts as a direct result of the U-turn of farm policy.

In June 1990, these proposals were adopted by the Swedish Parliament, with certain modifications (the transition period was prolonged to five years, a program of subsidies for new farmers was introduced, export subsidies for beef were granted through fiscal 1992–93, etc.), which were not too damaging for reform (except perhaps the fact that income support should follow the land, not the producer). Even watered down, the Swedish reform shows striking differences with the 1992 CAP Reform (and the 1999 Berlin Council; see below). It imposes large decreases of guaranteed prices (40 percent for grain in four years, 50 percent for ovine meat in 2 years, etc.) in a few years; it covers all the major products (it includes milk); and it relies on transitory income support, with the strongest possible decoupling between farming activity and income and wealth stability.

The Swedish farm reform did not last long. In late 1990, Sweden announced its intention to join the EC; in spring 1993, the Swedish Parliament decided to reintroduce export subsidies to begin complying with the *acquis communautaire*. In 1995, the EC CAP was fully introduced in Sweden without any transitional period. The results of such a short-lived reform are, of course, limited (see the New Zealand case for full results). However, the reform (the elimination of export subsidies during a few years probably being the single most important measure) reached a few results: (1) The elimination of milk quotas (implemented since 1989) brought no market disturbances. (2) In meat, the adjustment was faster than expected. (3) The number of farms has decreased in accordance with the historical trend (3 percent). (4) Investment and pesticide use have significantly decreased. (5) Consumer prices for food products have risen more slowly. In sum, consumers and environment have begun to get the expected benefits, without serious adjustment costs for farmers.

Box 4.5 The modest decisions of the 1999 Berlin Council

The Berlin Council aimed to prolong the 1992 Reform for 2000–08 by introducing additional cuts in intervention prices, additional (factor-based) compensatory subsidies for cereals and beef, and by introducing the first measures for dairy products (but not before 2005 for this last group of products). One should note that, whereas prices and values before 2000 (reported in table 4.3) are observed in current prices, expected prices and values after 2000 are “constant,” because they are expressed in 2000 terms. Table 4.3 describes the major measures, which require three additional remarks. First, concerning sectoral subsidies, the risk of overcompensation is reduced. Additional EC compensatory subsidies (also defined on a ton, head, or hectare basis) compensate only partly (from 50 percent in cereals up to 80 percent in milk) for the revenues that could be lost if market and intervention prices follow the same course (an important condition not fulfilled during the 1990s).

Second, the CAP budget has been stabilized in absolute monetary amounts. This stabilization, which was presented by the Council communiqué as the greatest achievement of the Berlin Council, deserves two caveats. First it rather means, in fact, an average *increase* of roughly 2 percent in the subsidy rate per farmer, because the number of European farmers declines at an average rate of 2 percent per year (an evolution that will continue during the coming decade because almost 40 percent of EC farm workers are aged 55 or more). The second caveat is that it ignores member-state farm budgets, and their possible drift; in 1999, member-states budgeted €12 billion for farmers (€2.5 billion for France, €2 billion for Germany and Italy, €1.4 billion for Finland, and €1.2 billion for Britain) (WTO, *Trade Policy Review: The European Union*, 2000).

Third, all the regulations implementing the Berlin measures include options for “review,” which may signal possible reversibility in member-state commitments. They also specify that exports and imports of farm products require licenses, and they explicitly allow for export subsidies.

In addition to these “sectoral” subsidies allocated to specific farm products, the Berlin Council has adopted a “horizontal regulation,” by which member-states (and only they) can “modulate” direct subsidies. These subsidies can be reduced by 20 percent at most, on the basis of size-related criteria, such as labor intensity of farms, farm “wealth,” global amount of aid received by farms, or “agri-environmental” objectives. But they are reallocated to “rural development,” to which the Berlin Council has given a higher degree of visibility—but without clarifying it. Rural development remains a vague concept, which goes from preretirement schemes to aid to young farmers to animal welfare to reforestation—hence, it can be used to increase farm output and productivity, as well as to lower them.

The Berlin Council has introduced many regulatory simplifications in the CAP. There is now only one type of regulated prices (the intervention price which covers wider ranges of products), certain existing regulations have been simplified (e.g., 1 wine regulation has replaced the 23 existing regulations), and so on.¹ All these simplifications have been adopted to facilitate the EC position during the new WTO negotiations. But such simplifications are counterbalanced by two forces: (1) there are a high number of criteria based on production processes or uses to determine subsidies (farm size, irrigation level, stocking density, cattle extensification, product quality level, environmental conditions, and so on); and (2) to the extent that they are expressed in specific terms (euros per unit) and not in ad valorem terms, compensatory subsidies can be a source of important distortions (as seems to be the case between wheat and coarse grains).

¹ This effort of simplification is far from complete: many product-specific measures remain, from minimum prices for potatoes for producing starch, to additional compensatory payments for durum wheat, to different subsidies for various types of animals.

prices lower (OECD 2000c). In this case, the EC might try to alleviate its obligations by granting “generous” food aid or export credits at “preferential” rates of interest—all practices that have been lavishly used in the past for manufacturing goods, and that the history of the OECD Consensus on export credits for industrial goods shows as very difficult to discipline.

This perspective is disappointing, all the more because the Berlin Council was preceded by a debate that was much more lively than usual. The Commission proposals, presented in March 1998 in a document called Agenda 2000, were much more promising than the Berlin decisions. Agenda 2000 included an additional immediate 20 percent cut of the guaranteed price of cereals, a 30 percent price cut for beef over three years, and a 15 percent cut for guaranteed dairy prices over four years—but Agenda 2000 also left untouched two key farm products, sugar and olive oil. Discussions addressed the (formerly taboo) question of whether the Community should reform its farm policy before the coming round or wait for the end, in 2003, of the “peace clause” with the United States.

More important, the whole debate revealed increasingly stronger forces in favor of further reforms for *domestic* reasons—the need to reallocate scarce funds to other purposes than agriculture, the necessity of preparing for the accession of Central European countries (some of them having substantial capacities in agriculture in the long run), and last but not least consumers’ interests in getting cheaper products (e.g., see European Commission 1997b). In particular, the debate began to clarify the merits of “renationalizing” EC farm subsidies (cofinancing, in EC parlance) in comparison with “modulating” (reducing) them.

A renationalization raises two major problems. First, it would be consistent with EC state-aid rules (see chapter 5) only if the subsidies would not distort intra-EC trade, or if EC member-states would adopt pure income-support schemes. (Farm policy then would come close to social transfers, for which member-states have exclusive competence; see chapter 5.) None of these conditions has been met—and if the second condition were fulfilled, most pending WTO issues would also be solved. Second and more important, it is unlikely that renationalizing EC farm subsidies would lead to the elimination of the CAP. More likely, Germany would save its budgetary transfers to the rest of the EC but it would continue to support its own farmers, whereas the current beneficiaries of intra-EC farm transfers would compensate for vanishing German funds by increasing their own funds. The final outcome would be “15 CAPs” (except for one or two EC member-states, such as Sweden, willing to reestablish their previously more open farm policy), leading to the collapse of the EC common markets in farm products (already de facto anaesthetized by the current CAP) and to more difficulties in opening EC member-state farm markets. Moreover, because renationalization is mostly driven by budgetary concerns, it raises insurmountable problems for the EC enlargement to major Central European countries, such as

Poland and Romania—which are budgetarily poor, but have potential comparative advantages in agriculture (see chapter 6).

The alternative formula—modulating farm subsidies—should ideally combine a degressivity over time of the global amount of EC *subsidies* and a nationalization of the subsidy-cutting formula. There should be an EC common decision to reduce farm subsidies by a certain percentage over a certain period, but each member-state should be left free to use its preferred formula for reaching the common target. Such freedom is required for a simple political reason. If France prefers a formula based on degressivity by farm size, and Britain an across-the-board formula, it is because France has a much larger proportion of small farmers—who could provide the necessary political support for such an approach—than Britain. The combination of an EC-wide freeze on farm aid (a soft version of modulation) and a national subsidy-cutting formula has been the only really positive outcome of the Berlin Council—although EC member-states are implementing it in homeopathic doses, and in a reversible way (as shown by the fact that Germany has not yet abandoned its idea of renationalizing farm aid and cofinancing, as recently illustrated by the Schröder Document; see chapter 7). This timid move may reflect a shift of certain member-states traditionally favoring farm protection toward structural change, hence ongoing deep changes in the EC economies, as is discussed in the section on ongoing changes in the EC economies, below.

Manufacturing: Old Peaks of Protection, New Instruments

On the topic of manufacturing, the texts released for Seattle by the three European institutions are very close, and deal with three issues. First, the EC is looking for “substantial tariff reductions and the elimination of tariff peaks” by introducing a tariff-band approach (based on three bands of low, medium, and high tariffs) and the determination of tariffs at the 6-digit level of the tariff classification; it also proposes an upfront commitment from all industrial countries to implement, no later than the end of the round, duty-free access for essentially all products from less developed countries. However, the EC’s zeal for a tariff elimination is tempered by the fact that such changes could be smaller or slower for “sensitive” products, hence reducing the “value” of EC tariff preferences (in particular, for its GSP and Lomé trading partners; see chapter 6).

Second, the Seattle texts are much more modest on “contingent” protection (antidumping, antisubsidy, and safeguards)—the Commission text being the only one opening clearly the prospect of further negotiations on antidumping, because the EC “will have both offensive and defensive interests,” a recognition of the worries raised by the worldwide spread of this instrument of protection during recent years. The three texts express

support for the WTO dispute settlement mechanism, although the Parliament text mentions “a controversy between trade interests and nontrade concerns.” Last, trade facilitation issues (licensing, customs valuation, etc.) are examined at length in the Commission text, with an effort to take into account the converging interests of developing countries and small firms in industrial countries.

This approach—much more positive than in agriculture—reflects the fact that, in sharp contrast to agriculture, there is no doubt about the EC’s ability to fulfill its Uruguay Round commitments on *tariff* cuts in the manufacturing sector. This observation leaves open two questions. To what extent has the EC fulfilled its WTO commitments to eliminate NTBs, in particular those contributing to the substantial pockets of protection still existing in EC manufacturing (textiles and clothing, steel, food products, and cars; see chapters 2 and 3)? And what are the consequences of the EC’s addiction to antidumping?

Elimination of NTBs: Still Incomplete

Table 2.1 suggests a noticeable decline of EC NTBs between 1990 and 1999. On 31 December 1999, the EC and member-state VERs on Japanese cars were eliminated—fulfilling the EC commitment under the Uruguay Safeguard Agreement. As a result, the EC NTBs officially remaining in force as of January 2000 were the surveillance measures on steel products from Eastern Europe and Asia, and, of course, the VERs on textiles and clothing (the elimination of quotas after 1995 under the Uruguay Agreement on Textiles and Clothing is largely a window-dressing operation; see appendix A, cases 13 and 14).

There are three reasons to believe that this short list may overstate the decline of the EC NTBs—even those defined as “core-NTBs,” that is, quantitative restrictions and price constraints. First, the above list relies on EC notifications to the WTO. However, EC trading partners have mentioned additional EC NTBs in the same context. For instance, in 1995, Japan notified import monitoring or licenses on VCRs, forklift trucks, ball bearings, and cotton fabrics, among others (*WTO Trade Policy Report on Japan, 1995*, 81–82). One could argue that this cross-notification may exaggerate EC trade barriers; if the EC partners were right, they should have submitted such cases to the WTO dispute settlement procedure (they would have won them). However, the EC partners may hesitate to do so because their own firms may prefer to keep such NTBs (to keep rents, or escape higher barriers, e.g., antidumping measures; see below). Hence, the question of the exhaustiveness of the EC list of notifications should, at least, remain open.

Second, it is difficult to monitor all the EC safeguard measures effectively. Between 1997 and 1999, the EC removed six safeguard measures: on coal imported in Germany and Spain (but a few months later, a high antidump-

ing specific duty was imposed on coke imports from China); on potatoes delivered to the Spanish Canary Islands; on Japanese cars imported in the whole EC (see appendix A, case 12); on minimum prices on dried grapes and preserved cherries in the whole of EC (WTO, *Trade Policy Review: The European Union*, 2000). However, the EC has a complex set of “import surveillance” schemes, with substantial “chilling” effects, as best illustrated by footwear (Winters 1993b, 1994; Single Market Review 1997c). Moreover, discrete and opaque safeguard measures can be taken in the context of the many EC preferential agreements (e.g., the Europe Agreements with the Central European countries or the Customs Union Treaty with Turkey; see chapter 6), all the more because these agreements provide a wider definition of what can trigger a safeguard than the Uruguay Safeguard Agreement—opening the door more widely to tailor-made bilateral protection, especially because the EC benefits from a strong negotiating position in a bilateral context.

Third, certain international agreements (which are probably inconsistent with WTO rules, but so far not challenged under the WTO dispute settlement procedure) to which the EC is a signatory can limit competition and be substitutes for NTBs. For instance, this may be the case with the 1994 Memorandum of Understanding on aluminum launching joint world “efforts” to cut aluminum output; or with the OECD agreement on shipbuilding and ship repairing—which imposes “fair” competition in the sector by permitting heavy sanctions against noncomplying shipbuilders and related shipping companies, and which could easily be used in a non-competitive, protectionist way (see below).

Taking into account noncore NTBs would substantially lengthen the list. Some noncore NTBs are covered by WTO disciplines, such as norms or standards (see below) and subsidies (see chapter 5). Indeed, the late 1990s offered several examples of subsidies being substituted for declining border core NTBs. For instance, the French government announced subsidies for the car sector under a massive layoff scheme aiming to substitute young for old workers (a ban on these subsidies by the EC Commission is likely, although its enforcement will almost certainly take a long time). The British government has granted preference to domestic coal (relative to gas) for producing electricity. And the privatization process in the eastern states of Germany has been a source of important subsidies and other NTBs in many industrial sectors (from oil refineries to high-technology production).

Other NTBs are ambiguously covered by WTO disciplines and commitments. “Preferential” rules of origin (justifiable under GATT Article XXIV) may constitute an important source of such additional tailor-made protection (Krueger 1999; Panagariya 1999a), because they are much more stringent than nonpreferential rules of origin, which generally rely on the “change-of-heading” approach. The EC is the nexus of a complex regime of several initially different sets of preferential rules of origin covering the

European Economic Area; Switzerland; the Central European countries; the Mediterranean countries; the African, Caribbean, and Pacific (ACP) countries; and most of the GSP countries.

The efforts to establish a “pan-European” regime of rules of origin covering all these countries (Driessen and Graafsma 1999) are far from having eliminated all the existing distortions, and they have created new ones, as suggested by the following indicative list. (1) Many of the above EC trading partners are small economies, suggesting that inputs imported from outside countries may often constitute a large part of domestic value added, enabling producers in partner countries with the lowest tariffs on inputs to more easily undercut producers in other partner countries. (2) Excluding certain export sectors (clothing) that are key for EC partners from the scope of pan-European rules is equivalent to increasing protection in these sectors. (3) New provisions (e.g., the “no-drawback” clause) in pan-European rules reinforce the central role of the EC economy, to the detriment of the partner economies. (4) In cases of antidumping, the EC may develop specific rules of origin for certain products (such as photocopiers).⁸

The Irresistible Rise of Antidumping Actions

As of January 2000, there were 10 regulations or decisions establishing the EC’s specific trade policy instruments. Five deal with antidumping procedures in goods and maritime transport, two with antisubsidy procedures, one with “trade barriers” (often nicknamed EC Section 301), one with the injurious pricing of ships (partly echoing the OECD Agreement), and one with the common rules on imports (see appendix B).

There are several reasons to focus on antidumping in goods. Few cases have been subject to the other regulations, with the limited exceptions of the antisubsidy instrument and the Trade Barriers Regulation.⁹ By contrast, the declining role of the EC NTBs has clearly been accompanied by

8. So far, the WTO negotiations on the harmonization of nonpreferential rules of origin have not been very productive: After four years of negotiations, solutions have been found for only one-third of the tariff chapters, with pending severe problems in many sectors with high levels of overall protection, e.g., agribusiness, steel products, textiles and clothing, and electronics (Nell 1999).

9. The application of the EC regulation on ship pricing has been suspended, pending ratification by the United States of the OECD Agreement. In April 2000, the EC signed with South Korea (the world’s largest shipmaker) “Agreed Minutes Relating to the World Shipbuilding Market” in order to promote “fair” competition and “to work together to stabilize the market, and thereby help raise the level of ship prices to ones that are commercially sustainable,” a statement that could reflect an effort to generate large-scale price collusion, http://europa.eu.int/comm/trade/whats_new/korea.htm, 11 April 2000. However, this agreement may not be enough for the EC, which is threatening to go to a WTO panel on Korean subsidies to the shipbuilding industry, despite the fact that the EC has massively subsidized its own shipbuilding industry.

Table 4.4 The pro-collusion impact of EC antidumping measures, 1980–89

EC market share held by complaining and defending firms (level of concentration)	Breakdown of all cases (in percent of all cases)	Percent of cases with an estimated level of injury ^a			
		Higher than 5 percent		Higher than 10 percent	
		Conser-vative ^b	Plausi-ble ^c	Conser-vative ^b	Plausi-ble ^c
Less than 100 percent (all cases)	100.0	55.7	31.1	41.0	16.4
Less than 95 percent	68.9	36.1	21.3	26.2	13.1
Less than 90 percent	55.7	29.5	14.8	19.7	8.2
Less than 85 percent	44.3	19.7	11.5	16.4	4.9

EC = European Community.

a. Measured as revenue losses by domestic firms (percent of total revenue).

b. Estimates based on a conservative set of elasticities.

c. Estimates based on a more plausible set of elasticities.

Source: Messerlin (1996a).

the irresistible rise of EC antidumping actions, which allow for quantity and price measures (under GATT Article VI derogatory provisions) so that they can be used as allegedly “GATT-consistent” substitutes for traditional core NTBs. In 1999, the EC initiated 67 new cases—an absolute record in EC antidumping activity for the past 20 years (see appendix B). Eleven industrial products (out of the 14 goods examined in chapter 3) are protected by antidumping measures in the form of specific tariffs, price, or quantity undertakings; appendix B provides more systematic evidence of the use of antidumping measures to both “consolidate” existing VERs and introduce new VERs.

This observation underlines the strongly anticompetitive and pro-collusion bias of antidumping procedures. In many cases, antidumping measures have not only protected EC firms, but they have also encouraged collusive behavior or abuse of market power between EC and foreign firms. Table 4.4 suggests that the risks of collusion following antidumping measures are very high because a vast majority of antidumping cases occur in markets held by a few firms. For instance, complainants and defendants that have a joint market share less than 95 percent of EC consumption represent only 68.9 percent of all the EC antidumping cases investigated between 1980 and 1989; lowering the market share threshold to 85 percent would decrease this number to 44.3 percent of all the cases (Messerlin 1996a).

Table 4.4 presents an even more worrisome picture when the level of injury for EC firms due to alleged foreign dumping is taken into account. For instance, complaining EC firms have lost more than 5 percent of their revenues in about 55.7 percent of all cases examined (probably in not more than 31.1 percent if one adopts a less conservative and more plausible set of elasticities for estimating revenue losses). But if one looks at the cases where

EC complainants and foreign defendants hold less than 85 percent of the EC market, EC firms have lost more than 5 percent of their revenues in only 19.7 percent of the cases in question (and more probably in only 11.5 percent of the cases, under the more plausible set of elasticities). In other words, revenue losses are mostly concentrated in cases where EC complainants and foreign defendants hold more than 85 percent of the EC market—that is, in cases where such limited revenue losses occurring in such concentrated markets may just mirror a healthy shift from large monopolistic rents to a more competitive situation, and where antidumping measures are likely to generate, maintain, or amplify anticompetitive practices.

Technical Regulations: Toward a “New” Protectionism?

The texts released for the Seattle WTO Ministerial by the European institutions deal with several topics related to technical regulations: technical barriers to trade (TBTs) per se, and the much wider set of trade, environment, and health (consumer protection) issues. Their general tone and suggestions are similar: (1) On TBTs, the texts underline the need for regulatory cooperation and for strengthening the promotion of international standards, including enforcement and market surveillance. (2) On trade, environment, and health, the texts make frequent reference to “sustainable development,” but without defining it, mention “positive synergies” between trade liberalization and environmental protection, and the desire for greater legal clarity on the relations between WTO rules and Multilateral Environmental Agreements, on the question of processes and production methods (e.g., are eco-labeling schemes WTO-compatible?), and on the definition and scope of the “precautionary principle,” particularly in the context of trade and food safety.

Technical regulations (TRs), as noted above, consist of mandatory “norms” and voluntary “standards,” which, in the WTO framework, are dealt with by the Agreements on Technical Barriers to Trade and on Sanitary and Phytosanitary (SPS) Measures.¹⁰ TRs are introduced for a wide range of reasons, and they can be applicable to products, producers (licensing requirements), or consumers (bans on certain products). The issues they raise can be split into two main categories: designing TRs and enforcing them. *Designing* TRs involves a wide range of actions; if voluntary standards can rely only on private decisions (although they may sometimes need some form of public support), mandatory norms require public intervention. *Enforcing* TRs include (1) conformity-assessment pro-

10. The TBT focuses on the nondiscrimination principles in the TR domain, whereas the SPS Agreement insists on the use of scientific methods and risk assessment in the process of domestic regulation making.

cedures (assessing the product's conformity with the relevant TRs of products or production processes requires testing, certifying, marking, etc.), which occur before goods go on sale, and (2) market surveillance procedures once goods are on sale. Conformity-assessment procedures can be ensured by public agencies or private firms (including the producers or distributors of the good in question), whereas market surveillance is generally done by public authorities (general police or specific agencies).

Because they have grown rapidly and steadily since the 1970s, and because they can raise the costs of nondomestic producers more than domestic firms, TRs have been increasingly perceived as a threat to trade (the costs of TBTs have been estimated to be 2 to 10 percent (with peaks of 30 percent) of firms' production costs [OECD 2000f]). This perception has been particularly strong within the EC about intra-EC trade—making internal EC TR policy the core of the Single Market Program in goods. In fact, the past 40 years of EC integration have witnessed more attention to product standards than to labor standards—an essential point for assessing the EC role in the debate on trade and labor standards in the WTO (see chapter 5).

The dynamics of EC trade policy in TR matters raise three major questions: what has been the external impact (on the level of EC protection on foreign goods) of the EC efforts undertaken to solve internal TR problems (intra-EC elimination of TR-related trade barriers) during recent decades? Is the current EC approach favoring the use of mutual-recognition agreements (MRAs) in the WTO likely to last long? Because food safety concerns play an increasingly critical role in the EC, what could be their future impact on EC policy in the WTO?

From the Old to the New Approach: Such a Success?

Since its origin, the EC has been obsessed with the protectionist risks that TRs could represent for the European Common Market, and the Treaty of Rome contains powerful (both direct and indirect) provisions covering TR matters (see box 4.6). But it has been under the Single Market Program that most efforts have been made. As a result, as of May 2000, roughly one-third of the 1,509 directives constituting the whole EC *acquis communautaire* dealt exclusively with TR issues, whereas a substantial part of the directives on agriculture and environment (representing almost 40 percent of the whole *acquis*) dealt also with TR-related provisions.¹¹

11. There is an interesting parallel to be made on these issues between the EC Single Market Program and the Swiss 1995 Act on Internal Market (with its safeguard clause of "public health"; Guilloid 2000) and the 1994 Canadian Agreement on Internal Trade between Canada and its Provinces (Weiler 2000).

Box 4.6 The *Cassis de Dijon* ruling and EC TR policy

Technical regulation (TR) issues in the EC are ruled by four provisions of the Treaty of Rome: (1) Article 28 (ex 30) prohibits quantitative restrictions on imports between member-states and “all measures having equivalent effect.” (2) Article 30 (ex 36) is a safeguard allowing for exceptions to Article 28 (ex 30) when “justified on grounds of public morality, policy or security.” (3) Article 94 (ex 100) allows the Council to issue directives on TRs if required by the functioning of the Single Market. (4) Article 95:5 (ex 100a) allows member-states to introduce national norms after the adoption of EC measures, conditional on the existence of “new scientific” evidence and on the Commission’s approval (the Commission’s disapproval can be challenged in the Court of Justice, and overturned, as in the 1994 case of a German ban on PCPs).

The balance between all these articles depends crucially on the definition of “measures having equivalent effect.” In its 1979 *Cassis de Dijon* landmark ruling (and its forerunner, the 1974 *Dassonville* ruling), the Court of Justice stated that Germany could prohibit imports of a French beverage (*Cassis de Dijon*) only if it could invoke “mandatory requirements” such as public health, protection of the environment, and fairness of commercial transactions. In other words, the Court introduced a very wide definition of Article 28 (ex 30), so that member-state TRs can be perceived to be almost systematically equivalent to trade restrictions—and hence legitimizing EC TR policy. Within a year, the Commission provided its own interpretation of this ruling (never contested since then): a product lawfully “produced” or “marketed” in one member-state shall be admitted to other member-states for sale, except in cases of mandatory requirements.

Not only did the *Cassis de Dijon* ruling legitimize the creation of an EC TR policy, but it also changed the EC approach to designing TRs by introducing the concept of “mutual recognition.” Before the ruling, the so-called Old Approach prevailed: it relied on “harmonization,” that is, on substituting newly defined EC TRs for existing member-state TRs—a long and difficult process. Since the *Cassis de Dijon* ruling, a New Approach has been developed, based on two components to be mixed in variable proportions on a case-by-case basis: core common rules are to be harmonized and adopted by all member-states, and the rest of the rules are left to member-state freedom of choice and are subject to mutual recognition by member-states. In fact, the Old Approach is still alive for updating previous Old Approach directives (mostly in the automobile, food, and cosmetics sectors, as is illustrated by the recent updating of the 1973 Chocolate Directive on the relative content of cocoa and other inputs for producing chocolate), whereas the New Approach was preceded by attempts to define limited harmonization (minimal, optional, partial, piecemeal, etc.) or by forerunners (e.g., the 1973 Low Voltage Directive).

The *Cassis de Dijon* ruling has a last feature that is particularly important for EC trade policy. The ruling makes no distinction between goods “produced” and “marketed” in a member-state. This silence has been interpreted as meaning that non-EC goods allowed for sale in a member-state and goods produced in that state should be treated similarly in the rest of the EC, that is, EC mutual recognition is *not* limited to products *made* in the EC. Surprisingly, this silence has never been challenged in the Court of Justice itself (only in member-state courts, e.g., the Baden-Württemberg Oberlandesgericht in 1988, which, so far, have always confirmed the nondiscrimination interpretation).

Until the late 1990s, EC TR policy focused almost entirely on the *design* of TRs, largely neglecting the critical importance of *enforcement* mechanisms. Since the mid-1990s, the preparatory work required for the accession of Central European countries to the EC has revealed the importance of such mechanisms—and the many deficiencies in the exact role and operational conditions of European agencies running conformity assessment procedures (Messerlin 1998c).

Before examining its potential impact on trade, the TR policy deserves a clarification. The New Approach is not the often-celebrated panacea, for three reasons. First, contrary to what is frequently believed, it does not consist only of rapidly negotiated, concise, wide-ranging EC directives. Such directives provide only terms of reference (the “essential requirements,” in EC parlance) for the complex task of defining *in detail* the EC core standards. This work is generally done by the European Standardization Bodies (ESBs, such as CENELEC, CEN, or ETSI), which are mandated by the Commission, and often under the close monitoring of dominant EC firms. This process can be a source of misunderstanding and frustration, for instance, because the essential requirements of the directive are too vague (e.g., the Machine Safety and Construction Products directives, for which the Commission was obliged to draft interpretative documents of its own essential requirements). It is also a time-consuming process; in 1998, only 914 (of a total 2,905 mandates granted to the ESBs) were ratified, leaving 1,081 pending approvals and 910 still in preparation. Moreover, these delays tend to be concentrated in new technology sectors and complex products, that is, precisely in activities where *not* delivering TRs in time is particularly costly. Meanwhile, national conformity marks, which tend to fragment EC markets, are burgeoning (European Commission 1999c), as is best illustrated by the fact that, between 1995 and 1999, the EC itself notified 167 TRs to the WTO, whereas the EC member-states notified 977 TRs on their own.

Second, the directives have to be “transposed” (that is, incorporated in EC parlance) into member-state laws—another time-consuming process and source of misinterpretations. The many shortcomings in the adequate application of the mutual-recognition principle by EC member-states often make it still necessary to include mutual-recognition clauses in national legislation, as emphasized by the 1998 *Foie Gras* ruling of the Court.

Third, there are infringements on transposed directives. There were 228 cases during the period 1996–98, often on products well known for their high level of protection (food, spirits and beer, cars, etc.). Only 105 of these cases were resolved through procedures lasting on average 15 months (European Commission 1999f).

There are no strong indications that all these difficulties would vanish in the near future—despite relatively stringent obligations about information and notification imposed on EC member-states by Directive 98/34. In 1998–99, EC member-states with a high rate of creating national technical regulations (Austria, Germany, and the Netherlands) showed little sign of decreasing activity, whereas two other member-states (Belgium and Denmark) were increasingly active (European Commission 2000a). At this stage, it may be useful to mention that lack of progress in the TR domain may be a key source of the little progress observed in the Single Market for goods (see the controversy between economists, as is illustrated by the discussion of Allen, Gasiorek, and Smith 1998).

Why so many difficulties? The success of a New Approach directive depends on its balance between harmonization and mutual recognition, that is, between ex ante trust and ex post regulatory costs (designing and enforcing common TRs) (Messerlin 1998b). Harmonization reflects the absence of ex ante trust between trading partners, and imposes ex post regulatory costs; mutual recognition reflects the existence of ex ante trust, and imposes no ex post regulatory costs, in addition to those already existing. The *Cassis de Dijon* ruling can be interpreted as a “mandatory” increase of the level of trust between member-states—ideally aiming to establish situations as close as possible to “unconditional” mutual recognition (meaning the complete absence of the harmonization component). In reality, the New Approach directives have been (and still are) based on mutual recognition that is conditional on a harmonization component large enough to impose substantial ex post regulatory costs.

This analysis suggests that the New Approach directives may represent an unstable equilibrium. Member-states may be tempted to go to more harmonization as soon as new problems emerge, or alternatively they may be attracted by unconditional recognition with countries that they really trust and that may happen to be non-EC member-states. This can have important consequences for EC trade and trade policy. In the first instance, the New Approach would be creeping toward the Old Approach, with key consequences for extra-EC trade (see below). In the second case, it might distort extra- and intra-EC trade in a very subtle way.¹²

Internal TR Policy and Its Impact on Protection

Any EC TR Directive could have two effects on EC trade. First, it can be a source of trade diversion, to the extent that it is a successful instrument of *intra-EC* trade liberalization. In this respect, the definition of “measures having equivalent effect” is key. Many rulings of the Court have provided (and still do) such a wide definition that they have not only led to the prohibition of clearly protectionist-minded TRs (the obligation to produce certificates, to make a declaration of origin, etc.), but they have also allowed the banning of measures (such as private selling arrangements) having no protectionist intent (but limiting complainants’ commercial freedom, even without involving products from other member-states).

The 1993 *Keck and Mithouard* ruling of the Court limited some of these excesses (Eeckhout 2000). Other counterreactions to the wide definition of “measures having equivalent effect” have emerged. In particular, the wider the definition of such measures is, the higher the demand for Arti-

12. Complications may be numerous because, if an EC member-state does not trust another member-state, it may not trust trading partners in their totality (e.g., it may trust certain US states and not others).

cle 30 (ex 36) and for Article 95:5 (ex 100a) by member-states can be, that is, the stronger member-state efforts to trigger the “precautionary principle” can be (see below). Despite these rebalancing forces, the EC case law may have amplified trade diversion related to intra-EC liberalization.

Second, any EC TR directive can reduce *extra-EC* trade to the extent that, in addition to some respectable economic purposes, it includes protectionist elements that create additional extra-EC trade barriers. In this respect, the Old Approach directives are likely to be more harmful than the New Approach directives. For a variety of reasons—ranging from minimizing adjustment costs in the largest (dominant) EC industry to sheer power struggles between member-state industries—New Approach directives tend to reflect the TRs existing in the dominant member-state industry of the product in question (and to be conceptually similar to “endogenous” tariffs in the context of a customs union; Olarreaga and Soloaga 1998). In sum, the risks of protectionist impact of EC TR policy in a given sector may be bigger in the case of a successful Old Approach. What follows provides some evidence on these hypotheses.

Table 4.5 (the two first columns) provides crude estimates of the sectoral value added covered by efforts of harmonization (the Old Approach) or by reliance on mutual recognition (the New Approach).¹³ A large proportion of EC value added in manufacturing has been covered by the EC TR policy: 33 percent by the Old Approach and 42 percent by the New Approach directives, with each approach dominating different sectors. The third column provides an “index of failure” of EC efforts to eliminate TR-related trade barriers within the EC, as perceived by the EC business community.¹⁴ As suggested by the above remarks on the complexity of the Old and New Approaches, EC TR policy leaves an impression of rather mixed results, with an average failure index (value-added-weighted) of roughly 1.7, that is, between index 1 (meaning measures implemented,

13. For simplicity, table 4.5 aggregates under “harmonization” all the sectors under the Old Approach (roughly 29 percent of EC value added) and a mix of harmonization and mutual recognition (4 percent). It aggregates under “mutual recognition” all the sectors under the New Approach (roughly 18 percent) and a mix of mutual-recognition procedures (Single Market Review 1998, vol. 1, appendix E). All these data are available only in the EC NACE classification, which matches poorly the ISIC classification—hence the absence of some ISIC sectors and the necessity to merge them in one last sector. The high level of aggregation and the poor correspondence between the various classifications used makes it impossible to look at the correlation between intra-industry trade and effective TR liberalization (Baldwin 2000) and at the possibility of TRs accompanied by higher import values (Neven and Röller 2000).

14. This failure index is based on extensive interviews with the staffs of EC firms (Single Market Review 1998). It ranges from 0 (no significant TR issue, so no solution needed) to 5 (serious TR-related problems exist, with no solution adopted). However, indices 4 and 5 have been observed in very rare instances, meaning that the range of the failure index is between 0 and 3. This absence of indices 4 and 5 may reflect an underestimating bias of the interviews to the extent that it does not fit well the EC business surveys, which repeatedly rank high TRs among the most important intra-EC trade barriers.

Table 4.5 EC technical regulation directives and EC imports, by sector, 1995

ISIC classification	Manufacturing sector	Coverage of EC technical regulations ^a				EC import structure, by ISIC sector									
		Harmonization	Mutual recognition	Total	Index of "failure" ^b	Rate of global protection (percent)	Intra-EC imports			Extra-EC imports from				Emerging ^c	ACP:
							World	United States	Japan	CECs					
200	Mining	96		96	1.2	3.4	0.4	2.4	2.5	0.0	1.8	0.6	5.1		
311-312	Agribusiness	100		100	2.0	30.4	5.8	3.8	2.1	0.1	6.6	3.5	8.4		
313	Beverages and sugar	63	37	100	2.0	22.5	3.2	1.1	0.9	0.1	0.6	0.6	9.5		
321	Textiles	59	59	77	0.9	23.1	3.6	4.2	1.2	0.9	10.3	8.2	3.9		
322	Clothing	77	77	77	1.5	31.4	2.3	5.6	0.6	0.2	16.6	10.2	1.9		
323	Leather goods			0		4.7	0.4	1.0	0.2	0.0	0.9	1.0	1.4		
331	Wood and wood products		100	100	1.3	4.8	1.9	2.2	1.4	0.0	6.9	3.8	4.7		
341	Paper and paper products	63		63	1.4	7.8	4.7	2.5	3.7	0.5	1.8	0.8	0.0		
351-352	Chemicals	22	76	98	2.6	7.9	14.7	9.2	14.1	9.1	6.7	3.4	3.0		
353	Petroleum refineries	100		100	1.0	4.3	1.5	1.6	0.7	0.0	2.5	0.2	0.3		
354	Petroleum and coal products		100	100	2.9	9.0	0.8	8.5	0.0	0.1	0.6	0.0	34.8		
355	Rubber and rubber products	54	0	54	2.4	7.8	3.7	2.1	2.3	2.7	2.4	3.3	0.1		
361	Pottery, china, etc.		79	79	1.6	8.4	0.3	0.6	0.3	0.0	0.8	0.0	4.2		
369	Nonmetallic products	11	55	66	2.0	4.8	1.9	1.0	0.7	0.9	3.8	0.7	0.0		
371	Iron and steel		24	24	2.8	15.8	6.9	7.1	3.7	0.8	9.9	0.6	7.7		
381	Metal products		43	43	0.8	6.5	3.1	2.2	1.7	1.3	5.2	2.9	0.1		
382	Machinery		93	93	1.9	4.5	14.0	16.5	29.0	32.4	5.8	23.5	0.6		
383	Electrical and electronic goods	18	82	100	1.8	8.0	10.0	13.5	18.2	25.5	8.1	25.1	0.5		
384	Transport equipment	74	19	93	1.0	9.2	15.6	8.3	11.4	22.4	6.8	4.8	5.7		
	Other manufacturing goods		62	62	2.1	5.9	5.3	6.7	5.5	3.1	2.0	6.7	8.0		

(table continues next page)

Table 4.5 EC technical regulation directives and EC imports, by sector, 1995 (continued)

Sectors	Coverage of EC technical regulations ^a				EC import structure, by ISIC sector							
	Harmonization	Mutual recognition	Index of "failure"	Rate of global protection (percent)	Total	World	Extra-EC imports from			Emerging ^c	ACP	
							United States	Japan	CECs			
All sectors ^d	33	42	1.7	9.5	75	100.0	100.0	100.0	100.0	100.0	100.0	100.0
TR-covered sectors with:												
An index of failure > 1.5			2.1	12.5	47	63.6	68.6	69.0	48.6	68.8	68.4	68.4
An index of failure > 2.0			2.3	15.5	28	30.0	22.8	13.2	21.7	13.9	62.5	62.5
Harmonization > 50 percent value-added	29		1.5	13.1		17.2	17.7	18.5	18.7	10.5	23.8	23.8
Harmonization > 50 percent value-added and failure index > 1.5	11		2.1	22.8		5.6	3.9	1.6	8.2	5.7	14.4	14.4
MRA > 50 percent value-added		33	1.9	8.2		56.0	59.1	61.1	47.3	66.1	54.9	54.9
MRA > 50 percent value-added and failure index > 1.5		28	2.0	7.8		51.4	57.1	60.6	34.4	57.4	47.8	47.8

ACPs = African, Caribbean, and Pacific countries.

CECs = Central European countries.

EC = European Community.

ISIC = International Standard Industrial Classification.

MRA = mutual recognition agreement

TRs = technical regulations

a. In percentage value-added.

b. For definition, see text.

c. Emerging-market economies; for definition, see text.

d. Value-added weighted averages for index of failure and rate of global protection; sum for the other columns.

Sources: *Single Market Review* (1997, appendix E); table 2.1; WTO, *Trade Policy Review: The European Community*, 1997, 139; Messerlin (1998).

but with some barriers remaining) and index 2 (meaning measures adopted, but with implementation or transitional problems still to be overcome). More important, the index of perceived failure is almost similar for the sectors of the New (1.8) and Old (1.6) Approaches—a perception that may announce the existence of permanent pressures within the EC for shifting from mutual recognition to harmonization.

Table 4.5 provides three interesting results. First, sectors with an index of failure higher than 2 (that is, with substantial or severe remaining problems of TR implementation or conception) represent a substantial amount of EC production and trade: 28 percent of value added, 32 percent of intra-EC trade, and 30 percent of EC imports from the world. In these sectors, trade diversion caused by the EC TR policy per se is likely to be small—but serious TR-related obstacles remain, *both* between EC member-states and between EC and non-EC countries. Intra-EC examples with ramifications at the world level have recently illustrated this first result. Finland (a producer of cadmium-free phosphate) asserts that cadmium in phosphate is damaging to health—opposing Italy and Spain, which import cheaper phosphates with a high cadmium content from Morocco. Canada is a large exporter of asbestos to the EC, whereas Greece, Portugal, and Spain are large producers, and the rest of the EC is raising questions about the effects of asbestos on human health. Other examples limited to the EC include PCPs (see box 4.6), phtalates, nisin (see below), and so on. In sum, after 30 years of intense efforts, member-states have kept a substantial number of national TRs—giving a strong signal of limited expectations about stricter international norms at the world level.

Second, sectors dominated by the harmonization approach (those with more than 50 percent of their value added under this approach) represent 29 percent of EC value added, 26 percent of intra-EC trade, but 17 percent of EC imports from the rest of world—and only 11 percent of EC imports from the emerging-market economies (Hong Kong, South Korea, Indonesia, Malaysia, Singapore, Taiwan, and Thailand). This difference in coverage is consistent with the potential protectionist impact of the EC harmonization of TRs. However, this impact may be magnified by (or partly due to) the relatively high rate of overall protection (13.1 percent) of these sectors. Sectors with the highest failure indices (higher than 1.5) show even stronger restrictions on trade flows, with a clear discriminatory impact on EC imports from the United States and Japan. This result may mirror strong member-state TRs (this factor itself could explain the failure of the EC policy) or the higher rate of overall protection in these sectors.

Third, sectors dominated by the mutual-recognition approach (those with more than 50 percent of their value added under the New Approach) represent a slightly higher proportion of EC value added than those under harmonization. More important, the antitrade bias observed for the Old Approach is not observed in their case. However, table 4.5 suggests another interesting result (although based on such small changes that ex-

treme caution is required): Although sectors with failure indices higher than 1.5 have a lower rate of overall protection, their trade declines roughly in the same proportion for intra-EC and extra-EC trade, *but* more than proportionally for the Central European countries, the emerging-market economies, and the ACP states—all three evolutions possibly mirroring the discriminatory impact of TRs on exporters from countries in transition or developing economies.¹⁵

MRAs and EC Trade Policy

During the past decade, the EC has advocated the use of MRAs in many regional or bilateral forums: (1) with Central European countries until 1996 (since 1996, the EC has obliged the CECs to adopt the EC TR directives as an integral part of the *acquis communautaire*); (2) with the United States and Canada in the Transatlantic Business Dialogue (see chapter 6); and (3) with the Asian countries that are familiar with TR issues within the Asia Pacific Economic Cooperation (APEC) framework (e.g., see US National Center for APEC 1999). As a result, the MRAs between the EC and major industrial countries (Australia, Canada, Japan, New Zealand, Switzerland, Israel, and the United States) cover a wide range of 20 sectors (from medical devices to pressure vessels, electrical equipment, and lawnmowers), and the Commission has the mandate to negotiate MRAs with a few more economies (Hong Kong, South Korea, and Singapore) (WTO, *Trade Policy Review: The European Community*, 1997, 139).

The MRAs signed between the EC and its non-CEC partners deal only with *conformity-assessment* procedures. They allow foreign manufacturers to have their exports to the EC tested and assessed for EC TRs by recognized agencies (bodies in EC parlance) in their *own* country, and vice versa, for EC exporters (e.g., Article 4 of the 1997 US-EC MRA specifies that the MRA shall not be construed to entail mutual acceptance of standards or technical regulations).

The compatibility of these bilateral MRAs with the WTO regime is an open question. On the one hand, Article 2.7 of the TBT Agreement gives the opportunity to WTO members to conclude such regional MRAs. On the other hand, questions could be raised about the consistency of the existing regional MRAs with GATT Article I on the most-favored-nation principle—stating that any advantage granted to one trading partner must be granted to all other WTO members automatically and unconditionally. In fact, the MRAs signed by the EC do not fulfill the two condi-

15. Brenton, Sheehy, and Vancauteran (2000) confirm the differing impact of the EC TR policy on the various CECs. They show that the CECs that are most advanced in their negotiations of accession are those particularly concerned by TRs; e.g., the estimated comparative advantages of the Czech Republic and Poland are concentrated in sectors subject to the New Approach.

tions that would be consistent with GATT Article I: they are not applied in an origin-neutral manner, and they do not allow WTO members other than the signatories to join unconditionally (once the essential requirements accepted by the initial signatories have been fulfilled by the candidates).

Will EC support for the MRA approach in the WTO context continue to be as strong in the next decade as it was in the recent past? The question is not superfluous: *both* the Commission and Council texts released for the Seattle WTO Ministerial do not use even once the terms “mutual recognition” or “mutual-recognition agreement.” The answer depends largely on two factors, intertwined to a large extent: the difficulties of implementing MRAs, and the problems raised by the accession of Central European countries.

Despite their limited objective of cost savings in conformity-assessment procedures, the MRAs signed by the EC with non-EC countries can be difficult to implement, as is best illustrated by the EC-US MRA on “veterinary equivalency” on red meat, dairy, fish, hides and skins. In the mid-1990s, following the adoption of food safety directives, the EC aimed to harmonize its import rules (still then under member-state competence) *but* without giving up the principle of “regional protection”—according to which, if an EC “region” (i.e., a member-state) is concerned by a disease, *only* exports originating from this region should be subject to the suitable food safety procedures by EC trading partners (hence, the rest of the EC member-states could continue to freely export their products).

Meanwhile, the United States wanted to refer to its own food safety *testing* rules for meat products (rather than to the EC rules), in accordance with the “equivalence principle” stated by Article 4 of the WTO SPS Agreement (the United States has quite different sanitary tests than the EC, but it is convinced that they achieve the same level of protection as the EC tests). Negotiations were completed in 1997, but the MRA was signed only in July 1999, after the addition of detailed technical provisions—with the EC raising doubts about the quality of US tests on chicken, and the United States about the EC’s ability to control *E. coli* and salmonella. In late 2000, the very slow enforcement of the MRA was a renewed source of United States-EC disputes (see the last section below).

Concerning TR issues related to Central European countries, there are widespread fears in the EC that these countries will not be able to implement properly the existing EC TR regime that they must adopt in its entirety before joining the EC (the asymmetries that TRs can generate between the EC and the CECs are examined in chapter 6). But in the late 1990s, Commission investigations led to an even more surprising—and worrisome—result: conformity-assessment agencies in the *current* 15 EC member-states are working under very different standards of confidentiality, ethical constraints, quality, and so on.

Because conformity-assessment procedures can be handled by a wide range of means—from trust in private behavior (manufacturers have a

strong interest in taking care of their reputation because it is an essential part of their capital) to reliance on ad hoc public agencies, there is a wide range of solutions to such problems. At one extreme, one could tighten the grip of EC and member-state authorities by imposing more harmonization on conformity-assessment procedures. At the other end of the spectrum, one could favor the emergence of a healthy competition regime between existing (and possibly new) conformity-assessment agencies. For instance, a conformity-assessment agency located in one member-state could decide to provide the “best” services (for testing, certifying, and marking, or for any subset of these activities) for a limited range of goods (those for which it believes it has the best expertise, i.e., “comparative advantages”). If the conformity-assessment agency in question has correctly evaluated its abilities, it should be able to attract manufacturers from the whole EC (not only those of its member-state of origin, as today) *and* even from outside the EC.¹⁶

As of today, there are conflicting signals on the choices made by the EC authorities (EC member-states and Commission) between these two alternatives. The benefits of competing conformity-assessment agencies are recognized, but there are also strong requests for more harmonization. The choice between these two options will be important for the future EC trade policy. Choosing more harmonization would have a negative impact in terms of implicit protection of EC products (see above). It would also make it more difficult for EC agencies to provide technical aid in these matters, and more generally in trade facilitation—that is, to fulfill an important task underlined in the Seattle texts.

Impacts of Food Safety Concerns on the Dynamics of EC Trade Policy

Issues related to food safety (or consumer health) are crucial for the EC MRA approach and for the level of EC protection. In Europe, they tend to be more important than issues related to the environment, in contrast to the US situation. In the past few years, food safety concerns have been used as a justification for import bans *within* the EC. In particular, the use of the “precautionary principle,” which has attracted a lot of attention both in the WTO and in the intra-EC context, has reached a peak with the “mad cow” disease and the complete disruption of *intra-EC* beef trade (see box 4.7).¹⁷ This principle has two major features. It requires action if

16. En passant, this alternative is much more consistent (in sharp contrast with the increasing grip option) with the popular view in the EC, according to which the New Approach and MRAs are a way to promote competition between EC regulators (and their capacity to deliver optimal rules).

17. The TEC mentions the precautionary principle only for environmental matters. According to the February 2000 Commission Communication devoted to this topic, measures based

Box 4.7 Mad cow disease and the Common Agricultural Policy

Mad cow disease (bovine spongiform encephalopathy, or BSE) was first identified in Britain in November 1986. It was identified in Ireland in 1989, in Portugal in 1990, in France in 1991, and since then, progressively, in the rest of the EC member-states (as shown below, time lags may have been due, at least partly, to inappropriate detection methods in Continental Europe). Ten years later, in March 1996, the British health minister evoked the possibility of a relationship between mad cow disease and a new variant of an already existing human illness, the Creutzfeldt-Jakob disease, creating the first severe mad cow crisis (as of April 2001, this possible relation had not yet been totally confirmed). In 2000, several cases of mad cow disease detected in France at the last minute or even too late (after the slaughterhouse) have triggered the second (even more severe) mad cow crisis in Continental Europe.

The major causes of BSE—animal proteins or certain pesticides (the first explanation being by far the most widely accepted)—awaken strong echoes in the CAP. Animal proteins have been developed in Europe as a substitute for soybeans and protein seeds made very expensive by the CAP. In order to decrease the production cost of animal proteins, EC firms have reduced the pressure and heat of the production process, a key factor in the emergence of BSE.

An examination of the sanitary measures adopted by the EC Continental member-states (European Commission 1998b; INRA 2000) shows that mad cow disease has been mostly used as a protectionist device against British beef. Available sanitary measures are of four types: prohibiting both (1) animal proteins and (2) BSE-sensitive beef parts (brains, eyes, tonsils, spinal cords, and offal) for bovine consumption, and banning both (3) beef and (4) BSE-sensitive beef parts for human consumption.

For each of these four types of sanitary measures, the scenario during the past decade has been very similar. Britain takes a sanitary measure roughly two years before Continental EC member-states; meanwhile, these latter countries rapidly ban the British imports. For instance, Britain banned animal proteins for bovine consumption in 1988; France did it in 1990, but only partially (hence paving the way for many errors and fraud in France during the 1990s) and after having banned imports of British proteins in 1989 (although the production techniques for these proteins are largely similar on the Continent). Time lags can be much longer. For instance, Britain banned almost all BSE-sensitive beef parts for human consumption in 1994, whereas in France such a decision required a series of measures from 1996 to 2000. As of today, Britain has taken a key measure that no other EC member-state has adopted: the elimination of almost one-third (4 million head) of its bovine cattle in order to eliminate vintage-related risks.

Lags in domestic safety measures have often been justified by the large difference in the number of declared BSE cases: 175,000 in Britain between 1987 and mid-2000; 499, 452, and 151 in Ireland, Portugal, and France, respectively; a handful of cases in the rest of Europe. However, there are increasingly serious doubts about the quality of detection procedures in Continental Europe, for a variety of reasons (veterinary services depending on the Agriculture Ministry, as in France; mere carelessness; etc.). First estimates of underreporting amount to 4,700 to 9,000 cows in France (Donnelly 2000).

The key point is that the most drastic trade measure taken by the EC Continental member-states has been largely inappropriate—but highly profitable from a political point of view. The trade ban on British “muscle-based” beef (i.e., the meat exclusively consisting of muscles) could not have a serious impact on health safety because

(box continues next page)

Box 4.7 (continued)

BSE risks are much lower in muscle-based meat than in the previously specified beef parts. The only impact of this ban has been the elimination of British competition from Continental depressed beef markets. In fact, by eliminating much better-monitored British beef from Continental markets, trade bans have increased health risks for Continental European consumers, whereas trade bans on British BSE-sensitive beef parts have been inefficient in protecting Continental European consumers from the risks of *domestic* products containing BSE-sensitive beef parts.

The strong resistance of Continental European farmers to the systematic and complete elimination of herds including one sick animal, to the systematic detection of the disease, and to stringent and clear safety measures for BSE-sensitive beef parts and on their uses, leaves one question: what will be the reaction of European consumers when they realize how much their health has been endangered by *domestic* farm lobbies using foreign products as a scapegoat for *domestically* produced *malbouffe* (bad food)? The strong reaction of French consumers to the 2000 beef crisis, and the failed attempt by French wine grape growers to use the precautionary principle to eliminate competing EC wines, may be the first signs of a serious erosion of trust between European consumers and farmers. If confirmed and stable, this trend might lead to dramatic changes in the EC approach to farm liberalization.

there is a risk, as long as there is no scientific *certainty* that the risk will *not* exist in the *long* run. And it is very rarely assessed in a context that economists would qualify as “general equilibrium” (in other words, not acting generates other risks): for instance, risks raised by genetically modified corn seed are generally assessed in the context of the corn sector *alone*—leaving aside possible positive effects of the new seed on deforestation (a more productive or resistant corn seed could allow less deforestation while yielding the same crop).

The fact that the precautionary principle has huge popular appeal makes it very attractive to both politicians and vested interests. It offers politicians opportunities to take ostentatious actions (in particular, in trade matters) apparently in the general interest, while it offers to vested interests the possibility of capturing politicians and public opinion under the cover of scientific evidence.

on the precautionary principle should be, inter alia, proportional to the chosen level of protection, nondiscriminatory, consistent with similar measures, based on the examination of the potential benefits and costs, subject to review, and capable of assigning responsibility for producing the scientific evidence. However, the Commission has difficulties in clearly defining certain terms (what exactly does “a proportionality test based on the chosen level of protection, and not on the potential risk” mean?; how can “similar” measures be defined?) and in assessing the operational content of others (what does a cost-benefit analysis mean in situations where, by definition, the probabilities of the risks are unknown?).

In the EC, the beef hormone case illustrates this conjunction of interests. In 1989, after eight years of intra-EC conflicts, about-faces, and delays, the EC started to prohibit the use of six hormones for cattle-growth-promoting purposes, and consequently to ban imports of beef bred with such hormones. The ban led to bilateral discussions between the EC and the major beef-exporting partners, then to a GATT dispute case, and finally to a WTO dispute settlement case lodged by Australia, Canada, New Zealand, and the United States. In early 1998, the WTO panel ruled that the EC ban violated the EC's WTO obligations. In February, the Appellate Body upheld this conclusion, on the basis that the EC ban was not based on a sufficiently specific risk assessment to show the existence of residues constituting a risk to consumers. In March, the EC announced its desire to carry out a complementary risk assessment. Fifteen months later, at the end of the period usually allowed for implementing WTO rulings, the EC had not complied with the WTO ruling and was still trying to get scientific support, without much success. In June 1999, Canada and the United States asked for WTO authorization to implement retaliatory tariffs on imports from the EC. In July 1999, the WTO authorized Canada and the United States to impose retaliatory tariffs on imports from the EC of US\$116.8 million and C\$11.3 million per year.

It has always been clear that the EC prohibition of beef hormones has little to do with food safety. Alleged relations to stilbene-related problems having occurred in the 1980s are remote, and very few experts, including those in Europe, believe that there are serious cancer risks for human health related to beef hormones (indeed, one of the two experts appointed by the EC for the WTO panel concluded that there was no danger). As a matter of fact, the EC authorizes three hormones in beef breeding for therapeutic use. Moreover, there are constant rumors reporting permanent, significant illegal use of beef hormones in the EC—such illegal use being a much more serious source of health concern for humans, because it is probably accompanied by the nonobservance of the correct procedures for using the hormones.

Clearly, the main reason for the 1989 ban was the EC's shrinking beef markets. (The EC consumption of beef meat has declined at an annual rate of 1.3 percent since the early 1980s.) Because hormones allow substantial increases in beef production, they could only create massive stocks in an EC unable to reform the CAP. The real role of the EC ban on beef hormones can thus be seen as equivalent to the mandatory set-aside in cereals: it restricts EC farm production by limiting inputs. The major difference is that it also eliminates foreign competition.

In addition to its general appeal for politicians—and vested interests—in the world, the precautionary principle has an especially strong appeal for European politicians. It is the least costly, most powerful open-ended escape clause to the wide definition of “measures having equivalent ef-

fects” of Article 28 (ex 30) of the TEC. In the 1981 *Eyssen* case, the Court of Justice de facto gave such a key role to the precautionary principle by not imposing on EC member-states (invoking the safeguard clause of Article 30 [ex 36]) strong requirements concerning the conclusive proofs to be shown about a possibly harmful product.¹⁸ As a result, the precautionary principle has become the closest available instrument to a safeguard provision in *intra-EC* trade.

The unquestionable political appeal of the precautionary principle raises a key question: could such a principle become an important source of protectionist measures in the long run, or is it self-destructive if used from this perspective?

Any protectionist use of the precautionary principle will be subjected to two counterforces, as illustrated by box 4.7 on the intra-EC mad cow disease. First, the disease could spread in any countries implementing the import ban, turning the heat of the precautionary principle against domestic producers. Second, it may not take long for consumers to realize the profound inconsistency between banning imports of goods that could represent an unknown risk in the future, and not banning imports of products that represent a certain and immediate risk, such as tobacco (reported to kill 60,000 people annually in France), canned or prepared food products (subject to listeria or salmonella), or simply cars.

Such counterforces should make *nonmyopic* governments and vested interests (i.e., those that have some sense of their long-term interests) careful to contain the protectionist use of the precautionary principle in order to avoid devastating boomerang effects. However, the nonmyopic condition is not necessarily met by politicians in democratic regimes, who are subjected to repeated and close elections and hence are biased toward short-term actions and may be insensitive to long-term consequences. Its strength thus depends, to a large extent—quite unreassuringly—on the vested interests that may be more concerned about the long-term impact of their actions. (During the 1990s, the relatively cautious handling of the mad cow issue by the French *Chambres d’Agriculture* may illustrate such a long-term awareness.)

That being said, the precautionary principle raises a crucial question for the EC, as well as all WTO members—and hence for the WTO itself: is the

18. The *Eyssen* case deals with the Dutch government’s ban on the use of a preservative (nisin) in processed cheese (sold in the home market). The ban was criticized by cheese producers from other member-states as an unfair trade barrier, because Dutch companies could use nisin for cheese to export (some member-states [France and Britain] permit unlimited use of nisin). However, the Court held that the ban was justified because the acceptable daily intake had not been established, because such an intake depended on the entire dietary habits of an individual, and because such habits varied from one member-state to another (Oliver 1996, 208).

key role given to “scientific evidence” robust enough to solve food safety problems? The answer may well be no.¹⁹

The notion of scientific evidence on which EC rules (e.g., Article 95:5 [ex 100a]) and WTO rules (e.g., Article SPS 5) are based better fits slow-moving 18th-century science than fast-moving, quite unpredictable 21st-century science. Strong technical progress puts a lot of pressure on the trade regime. On the one hand, it increases the number of trade conflicts because it boosts competition by generating new products or production processes that circumvent existing trade barriers. On the other hand, it makes solutions to these conflicts less easy to reach because strong technical progress is engineered by systematic “scientific doubt” and permanent challenges to established scientific evidence much more than by consensus about a fine line between “excessive” and “reasonable” precautions which is implicitly behind the notion of scientific evidence.

As a result, rapid technical progress makes scientific evidence unlikely to constitute a robust enough basis for facing food safety issues, and the precautionary principle is likely to be hijacked by vested interests—inducing politicians using the absence of unanimity among scientists as a license to take “easy” actions (i.e., to restrict imports and do little about domestic production, as is best shown by the mad cow case). In such a context, it is not astonishing that scientific evidence has become an increasing source of conflict, among scientists and between scientists and politicians.

A good example of conflict among scientists is the statement in 1999 of the French Food Safety Agency (Agence française de sécurité sanitaire des aliments, or AFSSA), according to which British beef still represented a specific risk, a concern that the EC Scientific Steering Committee (SSC) “unanimously does not share” (SSC press release, 29 October 1999). Conflicts between scientists and politicians have also followed the continuous reluctance of Continental member-state governments to take adequate domestic measures, raising increasing doubts about the committee’s role. For instance, in June 2000, the French government refused to impose a ban on offal used to make large sausages (andouillettes, cervelas, etc.), despite strong requests from AFSSA. The same inertia can be observed in Germany (despite a high consumption of sausages and patés) or in Spain (despite the fact that, at the time, Portuguese cattle were already considered largely contaminated).

Genetically modified organisms (GMOs) constitute another contentious topic (in particular, between the EC and United States) that illustrates the

19. The reasons given for justifying this negative answer are valid even when scientific committees are independent from political masters. This basic condition is not always met in many EC member-states (as is best illustrated by the radioactive “Chernobyl Cloud,” which, according to the French scientific committee of that time, was respectfully bypassing France while covering all the rest of Western Europe). Such a heritage makes the issues even more difficult—and labeling an even more appealing solution.

above points (Perdikis 2000; WTO, *Trade Policy Review: The European Union*, 2000). GMOs are a compendium of all the possible problems. They have the same undesirable impact as beef hormones in an unreformed CAP (they increase substantially productivity and output) and they have similarities with the mad cow case (their risks are complex to assess; Kerr 1999). In addition, they raise their own specific sources of conflict. First, there is little doubt that they will involve increasingly large markets (in particular, among developing countries) in which EC and US GMO producers will probably be major competitors. In this context, banning EC markets to US firms on precautionary grounds (making these markets a potential sanctuary for EC firms) could only be a measure aiming to help lagging EC firms to catch up, whereas being the first to move could be seen as giving an advantage to US firms.

Second, GMOs can substantially modify the vertical relationships between farmers and GMO producers. By selling sterile seeds, GMO producers could force farmers to buy these seeds every year, and then use their resulting market power to the point of vertically quasi-integrating farmers (but in this context, not selling sterile seeds could be an attractive policy for competitors in order to get more clients). Third, the international legal background available for dealing with the GMO issues is very messy. In particular, the Preamble of the Montréal Biosafety Protocol signed in 2000 allows socio-economic factors to be considered in the approval process for imports, although these factors have nothing to do with environmental or health issues, and are clearly at odds with trade issues (Phillips and Kerr 2000). Fourth, as was already stated, the precautionary principle puts the GMO issue in a very narrow perspective: it tends to hide the fact that banning GMOs may magnify other environmental issues (such as deforestation in developing countries, which would need more land to feed their population without GMOs than with productivity-enhancing GMOs).

In the context of rapid technical progress, the best approach, therefore, seems to rely on *individually* assessed risks, on the basis of the best available scientific *information* provided by public *and* private sources. This implies that a country-based approach to food safety issues is likely to be nonoptimal. There is nothing such as an “average French” or “average British” consumer. There are simply more or less risk-averse and risk-loving consumers in France and Britain, who should decide for themselves between alternative products with different risk intensities.²⁰ Public authorities have the responsibility to inform consumers about the existing scientific evidence (with all the honest doubts and opposed views) available in the importing *and* exporting countries. But individual consumers should keep the final choice.

20. All other things being constant, consumers with a stable risk aversion over time would smoke less when they are 20 years old (because of the compounding risk over the years) than when they are 70 years old (at this age, tobacco-related health risks become limited relative to other health risks).

Such an approach makes *labeling* a pivotal instrument, as indeed it is in the case of tobacco, and its risks of cancer. The EC could offer an interesting international field of experimentation to see how to reduce or eliminate the protectionist potential of labeling. This potential can be substantial: for instance, it has been estimated that the logo mentioning the French origin of beef has allowed French farmers to increase their sale prices by 4 to 8 percent (Chambres d'Agriculture 2000). But such a protectionist potential would be much reduced if the label (1) is voluntary, (2) relies on product-based criteria, not on the mere indication of the origin country, (3) does not impose a "yes-no" situation (e.g., the lower the segregation threshold between GMO and non-GMO crops, the higher the costs of GMO crops), and (4) is subject to cross-monitoring of adopted TRs between trading partners (e.g., would British experts be allowed to monitor German mad cow detection programs, and vice versa?).

These basic conditions suggest that the labeling rules for beef that were implemented starting in September 2000 in the EC have a protectionist potential. They are compulsory; the cross-monitoring will be limited to rare EC missions; and much more important, the information they convey will be concentrated on the country of origin at the various production stages (a particularly worrisome feature because the EC is constantly asking for rules of origin in MRAs. The country of origin is an irrelevant issue for TRs; either the product meets the TRs, or it does not, independently from its geographical origin of production. All these observations are valid for assessing the current debate on the "traceability" system to be introduced for genetically modified food commodities and related products—an ongoing debate within the EC (in relation to the enforcement of Directive 90/220) and within the WTO forum (in relation to the Codex Alimentarius).

The protectionist potential of labeling often makes non-EC firms reluctant to recognize the value of this instrument. Such firms should not forget two aspects. First, voluntary labeling could also be a powerful instrument of market access. For instance, a label underlining that beef has been raised on Argentinian or Uruguayan vast lands can constitute a key marketing advantage over EC beef intensively raised in stables. Second, EC and non-EC food producers alike have to cope with the fact that consumers in rich countries are implicitly making food increasingly close to pharmaceuticals; this consumer behavior forces food firms to adopt marketing strategies increasingly similar to those used routinely by drug producers.

Ongoing Deep Changes in the EC Economies?

The EC indirectly affects world trade by changing the ways in which its member-states interact and respond to shocks in the world economy. In this context, three questions deserve attention. Were the farm and manufacturing sectors of member-states diversely affected by the changes in

the common EC trade policy on agriculture and industry made during the 1990s? If yes, what could be the consequences of this evolution on intra-EC coalitions and on EC trade policy during the coming WTO negotiations? And what changes may have been revealed by the EC's approach to the Seattle WTO Ministerial?

EC Member-states: Changing of the Guard in Agriculture?

Despite the modest outcome of the 1999 Berlin Council, are EC member-state positions on farm trade policy evolving? This possibility is suggested by the timid choice of the Berlin Council in favor of direct subsidy "modulation." In particular, has the ongoing trade liberalization of EC agriculture—though minimal as it is—had a significantly different impact on member-states—possibly inducing states to change sides and create new coalitions on farm issues?

In the early 1990s, despite differences in the support granted to various farm products, the overall high level of protection implied a relatively similar level of aggregate support for the farm sector in all member-states, independent of the production mix. Despite all its limitations, the Uruguay Agriculture Agreement has modified this situation; it has tended to lower protection on grains more than on animals—and hence to have a differential impact on member-states with varying mixes of animal and vegetable production.

Table 4.6 attempts to capture this differential impact, although, in what follows, one should keep in mind that CSEs reflect world price changes as well as EC policy changes. For 11 key products in 1990 (wheat, corn, rice, sugar, oilseeds, milk, beef, pork, sheep, eggs, and poultry), the CSE-based tariffs estimated for the whole EC have been weighted by the corresponding output in each member-state. For all but the Mediterranean member-states, these 11 products represent more than 50 percent of total farm output. The resulting production-weighted average CSE-based tariffs by member-state have been calculated for the pre-Uruguay Round agreement period (1990–92) and for the post-agreement period (1996–99).

The table suggests a lesson that sheds some light on the Uruguay Round negotiations per se and is useful for understanding possible member-state approaches in the coming WTO negotiations on agriculture. (Because their specific farm products are not covered, the Mediterranean member-states—Greece, Italy, Portugal, and Spain—are left aside in the following discussion.²¹) The average decrease of the EC-wide CSE-based tariff hides

21. The case of the Mediterranean EC member-states (dominated by cotton, fruit and vegetables, olive oil, tobacco, and wine) is difficult to assess. On the one hand, because theirs were not among the major products covered by the CAP during the Uruguay Round negotiations, they tend to be relatively open to progressive liberalization (a point illustrated by table 4.6; Sarris 1992), with certain observers expecting a small impact of the Uruguay

Table 4.6 The differentiated impact of EC trade policy on EC member-states: Agriculture

	CSE-based tariffs ^a (EC-12 = index 100)		Farm output coverage ^b	Euros per job ^c	EC average farm budget (EAGGF, 1995–97)	
	1990–92	1996–99			Percent of value added	Percent of farm income
Belgium	94.3	95.2	67.3	12,273	36.9	81.8
Britain	104.7	100.2	77.3	6,759	20.1	41.6
Denmark	86.5	80.2	82.5	11,673	23.2	85.2
France	102.6	98.3	66.4	8,390	26.1	48.1
Germany	101.2	110.0	75.4	4,848	17.8	49.4
Greece	107.9	96.2	37.9	3,492	46.6	34.2
Ireland	127.9	135.2	90.8	12,552	85.1	113.7
Italy	97.6	91.6	41.6	3,174	30.4	45.5
Netherlands	98.0	111.1	56.0	7,168	9.6	46.6
Portugal	96.1	83.0	51.9	1,319	22.8	41.8
Spain	88.8	76.7	48.2	4,175	33.2	33.6
EC-12	100.0	100.0	62.2	5,139	31.3	47.7
Austria		104.3	72.7	2,692	34.4	42.9
Finland		130.1	74.1	2,730	35.9	34.0
Sweden		115.9	79.5	3,878	34.3	21.3
EC-15		100.0	62.2	4,971	31.1	47.4

CSE = consumer subsidy equivalent.

EAGGF = European Agricultural Guidance and Guarantee Fund.

EC = European Community.

a. At constant 1990 and 1995 (respectively) production pattern.

b. See text.

c. Per person employed in farming.

Sources: European Commission, *Report on Agriculture*, various years, and various documents; *European Economy* (1994); OECD, *Monitoring Agricultural Policies*, various years; OECD (1995); Eurostat.

very different changes among individual member-states. After the Uruguay Round, two member-states increased (Germany and Ireland) and one maintained (Britain) their protection relative to the EC average. Even more interesting, two member-states changed sides: France shifted from more-than-average to less-than-average protection, whereas the Netherlands shifted from less-than-average to more-than-average protection (similar computations based on PSEs by member-states confirm the observations based on the CSEs, with minor nuances). The CSE-based results may explain (assuming perfect information) why, in the traditionally mercantilist multilateral negotiations, France was the most vocal opponent of the Blair House agreement in the EC: it was giving the most important trade concessions (because of its farm production structure).

These results offer an interesting—and to a large extent unexpected—picture of intra-EC forces for the coming round. The EC emerges as composed of a stable set of more-than-averagely protected countries (Germany, Ireland, and Britain), a stable set of less-than-averagely protected countries (Belgium and Denmark), and two countries possibly changing sides (the Netherlands becoming more, and France less, protected than the EC average), again leaving aside the Mediterranean member-states.²²

The results also confirm the pivotal position of France, and the fact that it could shift toward freer trade positions at any time—as soon as its substantial comparative advantages in agriculture finally become the driving force of its farm trade strategy, and as less weak French governments take the side of French farm export interests (Messerlin 1996b).²³ Increasingly, numerous groups of French farmers are realizing that their comparative advantages have been (and still are) constrained (rather than developed)

Round agreement on Mediterranean products (Tracy 1997). On the other hand, it should be underlined that the EC has overshot its export subsidy commitments for olive oil (OECD 2000d), that CAP subsidies for olive oil almost doubled between 1995 and 1998, becoming almost equivalent to those for dairy products (€2.2 vs. €2.6 billion), and that safeguards have been introduced on imported fruit and vegetables. These changes were mirrored by the fact that, during the Berlin Council, Spain was one of the most inflexible member-states.

22. This paragraph and the following two are limited to the 12 EC member-states at the time of the Uruguay Round. The three member-states that joined the EC in 1995 have a very different background in farm policy. Austria and Finland were at least as protectionist as the EC-12, whereas in sharp contrast, in 1989, Sweden launched a major reform of its farm policy (see box 4.4). It is interesting to note that under the qualified majority rule, Germany (with 10 votes) needs only 16 more votes to create a minority-blocking situation in the EC 15.

23. During the past 40 years, the German position (freer trade in manufacturing and protection in agriculture) has reflected economic logic bound by political constraints. The French acceptance of the same stance defies economic and political logic: why has France accepted freer trade in manufacturing, where its comparative advantages were few, and why has it refused freer trade in agriculture, where its initial comparative advantages were many? Such a miscalculation may reflect more a profound ignorance of the way markets function than the strength of farm lobbies (for an in-depth analysis of French farmers' voting, see Adams 1999). It may also reflect an incredibly weak government.

by the CAP, and that—far from being eliminated from the world markets by freer trade—they could improve their market penetration in non-EC (and EC) markets under a more liberal world trade regime.

Of course, trade policy strategies are not determined by existing relative protection alone. Whether a member-state is more (or less) protected than the EC average does not mean that it will necessarily advocate for protectionist (or freer trade) policy at the EC level. Nevertheless, the presumption that a less-than-averagely protected member-state will be inclined to adopt a more open policy cannot be rejected—particularly if it fits the country's comparative advantages, and a general perception of the major forces present, as are briefly described in the introductions to appendix A, cases 15 to 18.

To take into account the fact that member-states will not define their farm strategy in the coming WTO negotiations on the exclusive (or even maybe dominant) basis of changes in the relative level of protection, table 4.7 presents four other indicators that could play a decisive role in designing the future farm strategy of individual member-states. These indicators are based on the following working hypotheses: a member-state will be more inclined to liberalize further if it has (1) a small share of employment in agriculture, (2) a large share of large farms, (3) a large average farm size, and if it is (4) a net provider of European farm funds.²⁴ To summarize the information by ranking for each criterion every member-state with respect to the EC average (a plus if the state performs better than the EC average, a minus if the contrary): two member-states (Denmark and France) perform best; they are followed by Britain and Germany, and then by the rest of the member-states.

Growing Differences in Manufacturing?

As in agriculture, the EC common structure of tariffs, NTBs, and antidumping measures for manufactured goods has a differentiated impact on member-state economies that rely on varying mixes of industries. Can this differentiated impact generate new coalitions among member-states in favor of further liberalization?

24. Table 4.7 provides "total economic transfers" (capturing all CAP-generated transfers, from price supports through milk quotas to financial rebates granted to certain member-states, e.g., Britain) and the corresponding "rates of return" (pure budgetary transfers) for 1997 (Alix 1998). Discrepancies between total economic transfers and rates of return depend, in particular, on the member-state's involvement in intra-EC trade (which is channeling transfers), on the types of subsidies implemented (price supports favor exporters; direct aid favors producers, independent of their export performance), etc. Simulations based on Agenda 2000 suggest that, relative to the 1997 situation, Spain would be the member-state gaining the most from Agenda 2000, and Britain the member-state losing the most (Alix 1998).

Table 4.7 Select economic aspects underlying political forces in agriculture, by EC member-state

	Farm labor ^a (percent of total labor force)			Farm size structure (farms with > 50ha)		Average land per farm (hectares per farm)		Total economic transfers, 1997		Rate of return, 1997 (millions of euros)
	1979	1990	1998	1979	1987	1979	1987	1997	1997	
	Millions of euros	Percent of farm output	Millions of euros	Percent of farm output						
Belgium	3.0	2.7	2.2	3.8	5.8	11.3	14.8	20.6	-285.0	-542.5
Britain	2.6	2.2	1.7	31.3	33.3	63.2	64.4	69.3	344.6	-258.1
Denmark	8.6	5.5	3.7	9.5	17.2	27.8	32.2	42.6	810.5	385.8
France	8.8	5.8	4.4	13.5	18.1	29.7	23.3	41.7	2,093.9	1,727.4
Germany	6.0	3.3	2.8	3.7	6.1	14.2	14.3	32.1	-5,692.9	-5,118.9
Greece	30.3	21.6	17.7	n.a.	0.5	0.4	n.a.	4.3	1,786.6	1,861.6
Ireland	19.2	13.8	10.9*	7.4	9.0	14.1	23.7	29.4	1,609.3	1,448.6
Italy	14.2	8.5	6.4	1.7	1.9	1.8	6.2	6.4	-1,207.0	85.9
Netherlands	4.6	4.5	3.5	2.8	4.4	7.1	13.1	18.6	-457.3	-655.6
Portugal	26.6	17.5	13.7	n.a.	1.9	2.3	n.a.	9.2	-76.7	-2.0
Spain	18.8	10.7	7.9	n.a.	6.0	8.2	n.a.	21.2	1,554.1	1,585.4
EC-12	8.1	6.2		6.8	6.8	15.3	13.3	16.3	-76.3	-213.7
Austria			6.5			4.1		23.7	-68.5	-34.5
Finland			7.1			8.8		34.7	-334.8	-11.4
Sweden			3.1			21.3		18.4		
EC-15			4.7*			8.6				

EC = European Community.

ha = hectare

n.a. = available

a. Figures followed by * refer to the previous year (latest available).

Sources: European Commission, *Report on Agriculture*, various years; *European Economy* (1994, 90); OECD, *Monitoring Agricultural Policies*, various years; Alix (1998).

Table 4.8 provides evidence about the magnitude of this differential impact by weighting the EC sectoral tariffs and rates of overall protection by value added or by employment for each member-state (using the 1990 [for 1990] and 1995 [for 1999] data on value added and employment patterns from OECD 1997a). It gives three results similar to those found for agriculture. (1) The gap between the most and least protected member-states is again substantial, with the highest average tariff for a state being 1.5 to 1.9 times higher than the lowest average tariff for a state. (2) This gap increases noticeably (to roughly 1.7 to 2) when NTBs and antidumping measures are taken into account. (3) The gap noticeably widened between 1990 and 1997.

These observations again suggest a useful taxonomy of less-than-averagely protected member-states versus more-than-averagely protected ones. In 1990, the first set of member-states included France, Germany, and Britain (this club would have also included Finland and Sweden, meaning that these two new member-states were “reprotected” when they joined the EC). All the other countries could be seen as relatively protected.

That the less-than-averagely protected member-states include France seems at odds with that country’s strongly protectionist vocal stance during most of the early 1990s. In fact, France is the member-state closest to the EC average, particularly for labor-weighted indices of overall protection. This “central” position fits well both France’s role as a deal-striker within the EC, and France’s final rally to the Uruguay Round outcome, despite its inability to get substantial additional concessions from its non-EC trading partners.

Between 1990 and 1999, there were significant changes between the two sets of member-states. In 1999, the less-than-averagely protected member-states included Denmark, Finland, and Sweden—but the French position had deteriorated (it remained relatively open in value added, but not labor). Two more-than-averagely protected member-states (Italy and Spain) moved closer to the EC average. These changes fit well with recent internal EC debates (e.g., antidumping measures on cotton bleach proposed by the Commission and strongly supported by France have been rejected by the Council; see appendix A, cases 13 and 14). They suggest that France may have lost its central position, after the reinforcement of the “pro-freer trade” group of member-states by the three last accessions (in particular, Sweden), and after the softening of the more-than-averagely protected group.

Concluding Remarks

Current EC trade policy and its corresponding domestic policies will not be able to fully cope with the challenges raised by a new round of negoti-

Table 4.8 The differentiated impact of EC trade policy for manufacturing on member-states (percent)

Country	1990						1999					
	MFN tariffs			Overall protection			MFN tariffs			Overall protection		
	Labor weighted	Value-added weighted		Labor weighted	Value-added weighted		Labor weighted	Value-added weighted		Labor weighted	Value-added weighted	
Austria	7.6	9.5		11.7	12.7		5.5	6.8		8.0	8.6	
Belgium	8.2	8.3		13.1	12.9		6.4	6.9		9.8	9.5	
Denmark	8.0	8.3		11.9	12.4		5.3	6.3		7.2	8.2	
Finland	7.5	7.6		11.1	10.5		5.1	4.8		7.0	6.4	
France	7.6	7.8		11.8	11.2		5.9	6.0		8.9	8.2	
Germany	7.2	8.3		10.6	11.2		5.1	5.9		7.6	7.9	
Greece	10.8	10.6		17.8	16.7		8.7	9.3		13.4	12.8	
Italy	8.1	8.0		12.7	12.2		5.9	6.0		9.8	9.2	
Netherlands	8.2	9.6		12.1	12.5		6.4	7.1		8.9	8.9	
Portugal	9.0	10.7		15.8	17.2		7.1	8.7		12.5	13.0	
Spain	8.3	8.8		13.2	13.1		6.6	7.7		10.1	10.2	
Sweden	6.8	7.1		9.6	9.7		4.8	4.9		6.6	6.6	
Britain	7.5	8.0		11.3	11.4		5.5	7.3		8.3	9.7	
EC12-EC15	7.7	8.2		11.8	11.7		7.0	6.3		8.8	8.6	

MFN = most favored nation

Note: Manufacturing includes the agri-food industry (International Standard Industrial Classifications 311 to 314).

Sources: Table 2.1; OECD (1997a).

ations without a marked change of course. Ideally, the EC should react in four domains, which are presented in order of decreasing importance in what follows.

Reforming the CAP: A Two-Track Approach

The EC should undertake the long-overdue *real* reform of the CAP. During the 1960s, EC agriculture was relatively homogeneous (based on small farms), so that one CAP may have made sense—if one leaves aside the questions of the number and type of instruments used, and of the magnitude with which they were used. Today, this homogeneity no longer exists, as is shown by the increasing strains between large and small farmers, even in member-states with a strong tradition of a unique, corporatist, farm trade union. As a result, the EC farm sector requires *two* CAPs: a CAP for large farms, based on the assumption that such farms are capable of adjusting to increasing world competition with much smaller subsidies *and* far fewer constraints (such as set-asides); and another CAP for small farms, which would evolve at a slower pace toward pure income support compatible with an increasingly market-based environment. Of course, such a two-track CAP reform with a strong focus on a liberalization based on large farms in the years to come is not a perfect substitute for a complete reform of the CAP: if it lasts too long, it could generate perverse effects, to the extent that running a large or a small farm will become an endogenous decision of farmers.

But for the coming decade, a reformed “CAP for large farms” would provide enough pragmatic solutions to most of the farm conflicts between the EC and the rest of the world, and would also be the necessary ingredient for the EC’s enlargement to Central European countries. It would cover roughly 70 percent of EC farm output, and tackle all the major distortions that the EC generates in world farm trade. It would also allow a better appraisal of the EC’s comparative advantages in farm products under market conditions—and thus would reveal how wrong is the wide perception among European politicians that EC agriculture has no comparative advantages and can survive only under a world order based on quotas, closed markets, and compensatory subsidies.

Such a perception of almost no European comparative advantages in agriculture (carefully supported by vested interests) does not fit existing facts. For instance, EC exports of relatively unsubsidized, cost-conscious, differentiated products, such as high-quality wine or cheese, compare favorably with EC exports of highly subsidized farm products. This negative perception among decision makers has been challenged by experts such as Tangermann (1999), who argue that, in the negotiations of the coming round, the EC should advocate for a zero-to-zero approach or for a wider trade-off between increasing market access for certain dairy prod-

ucts (of primary export interest for EC producers) and increasing market access for certain cereals (attractive for the Cairns Group and US farmers).

It is interesting that this two-track CAP reform was timidly initiated by the Berlin Council—with several member-states (including key countries such as France and Britain) “modulating” direct subsidies. But as stated above, this effort remains homeopathic (it involves 1 to 2 percent of CAP aid) and ambiguous (modulated aid is reallocated to rural development, a notion unclear enough to constitute a potential back door to the protectionist status quo). Going further thus requires the full recognition and implementation of a principle of “modulation” based on two elements: an EC common decision to *reduce* farm subsidies by a certain percentage according to an agreed time table, and individual member-states’ decisions to use their *own*, politically acceptable, subsidy-cutting *formula* to reach this common target. For instance, the formula could be based on degressivity by farm size in member-states with a mix of large and small farms (France) or on an across-the-board approach for member-states with a more homogeneous farm population (Britain).

A More Competition-Oriented TR Policy

The second topic on which the EC should improve its trade policy concerns *technical regulations*. The EC TR policy is not the often-celebrated success. When applied to intra-EC issues, the mutual-recognition approach is still conditional on too many essential requirements (in other words, it is still too close to harmonization), and competition between conformity-assessment bodies is still too limited. Mutual recognition agreements between the EC and other WTO members have shown severe limits: although they do not deal with substance (EC and partners’ TRs are untouched) but only with equivalence of conformity-assessment procedures, they are the source of innumerable difficulties and delays.

This situation is best illustrated by the EC-United States MRA on a wide range of products: for pharmaceuticals (the US Food and Drug Administration is assessing certification equivalence, EC member-state by member-state, and is expected to grant equivalence for Britain and perhaps other member-states by December 2001, which is the supposed date of *complete* entry in force of the MRA); for electrical safety (the EC is insisting that both parties should designate the conformity bodies in each country, whereas the US Occupational Safety and Health Administration (OSHA) says that it has agreed only to allow European laboratories to apply to OSHA for approval to certify products for the US market); etc. The EC has thus both domestic and international incentives to resist the temptation to look for more harmonization, and to expand a more flexible (that is, a more market-oriented and firm-based) approach, which would be based more on trust and reputation, that is, on an increasingly unconditional version of the mutual-recognition principle.

Progress in TR issues is particularly important in agriculture. In Europe, environmentalists should logically be natural allies of a serious CAP reform effort because CAP-driven intensive agriculture has generated (and still does) ecological disasters—for instance, sharp declines in water quality caused by excessive amounts of nitrates in Western France require huge public investment paid for by taxpayers, who have paid (and still do) large subsidies to those farmers who caused the deterioration in water quality. Improving EC TR policy will also be crucial for trade and food safety issues—in particular, for an economically sound approach to labeling. In this respect, the intra-EC mad cow case will be a crucial test for both internal EC TR policy and EC trade policy in the WTO.

If EC member-states fail to put in place a mutually acceptable, workable labeling regime, the EC will be induced, sooner or later, to make food safety a powerful trade barrier not only within intra-EC trade (as shown in the mad cow case, which reveals the CAP as a key source of troubles, and hence as the ultimate destroyer of EC common beef markets; see box 4.7), but also against EC imports from the rest of the world. By contrast, if EC member-states succeed in creating an honest labeling and monitoring regime (including a cross-monitoring system whereby, e.g., British veterinarians can check French cattle, and vice versa), European consumers will develop trust in the authorities that seem more trustworthy, and labeling will lose its potential as a protectionist instrument.

European farm lobbies are well aware of these profound relations between TRs and the CAP. They have noticed the increasing public perception of farmers as polluters, particularly in the rural areas directly exposed to environmental deterioration. This awareness explains why, when defending multifunctionality, EC farm lobbies have shifted away from environment-based arguments and toward food safety considerations, flaunting themselves as protectors of domestic “good” food only to get troubles, as shown in the mad cow case.

Market Access in Manufacturing

EC trade policy should improve its *manufacturing* component in two important ways (leaving aside the question of “preferences” for developing countries, to be examined in chapter 6). The EC attitude toward antidumping reform should shift from loose neutrality to active leadership—if the EC does not want to be seen as hypocritical by suggesting negotiations on antidumping after initiating more antidumping cases in 1999 than in any year since it began to implement such procedures (see appendix B).

Moreover, the EC should launch an initiative for early implementation of the Uruguay Round commitments on textiles and clothing—all the more because the EC industry is repeating that it has made all the adjustment efforts required by the EC commitments under the Uruguay Round

agreement, so it is now competitive by world standards. Such early implementation is most likely to be a case of time-asymmetric liberalization in a multilateral context (see chapter 6 for illustrations in a bilateral context), to the extent that, at the end of the coming round, the EC will almost certainly get reciprocal concessions from developing countries in the form of decreased tariffs, and better antidumping disciplines, in this sector and in other sectors.

Free Movement of Goods: A Basic Enforcement Problem

The EC must solve an increasingly worrisome problem: effective respect for the free movement of goods *within* the EC. This problem does not refer to the cases where intra-EC trade is interrupted by inopportune decisions from public authorities (e.g., spare parts for motor vehicles seized between Spain and Italy by French customs). The existing EC legal regime can cope with this first type of problem, although too slowly (the infringement procedure should be made more rapid).

Much more worrisome, however, is the increasing basic law enforcement problem in Europe. A growing number of powerful vested interests (farmers and truck drivers being the best known) have used brute force (blockage of roads and railways, destruction of transported products or trucks, etc.) to extract a systematic exemption from obeying the law, without any noticeable intervention by the police of the member-states involved. In this respect, the EC needs a provision (and the determination to enforce it) much closer to the US Commerce Clause than the existing texts, which consist of a mere Council resolution coupled with a Commission regulation adopted in 1998. Of course, any progress in this domestic domain would also constitute an essential improvement in foreign access to EC markets.