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The Case for Further Reform of Agricultural Trade

Why do we need further negotiations on agricultural trade so soon after the Uruguay Round? If agricultural policy reform is progressing satisfactorily—as countries modify their domestic farm programs to meet budget constraints and new notions of the limits to government activities—why contemplate further trade negotiations now and risk potential international conflicts? Why not leave well enough alone for a few years and revisit agricultural trade when domestic policies have finally changed? It is tempting to allow these domestic forces to work toward a liberal trade regime for agricultural goods and to postpone further multilateral efforts to improve trade rules. Unfortunately, such a strategy is unlikely to bring about a reformed trade regime.

Domestic and international policy reform are mutually reinforcing. In fact, they are two parts of the same process. Domestic reform has deemphasized commodity price support in favor of more direct payments to farmers and, hence, allowed the changes in the trade system that were embodied in the Uruguay Round. In turn, the new trade rules disallow the use of nontariff barriers that were used to support prices and, hence, pushed domestic policy change in the same direction. If additional trade reform is not pursued in the next few years, the gains from domestic reform could well be lost. These linkages between the domestic and international reform processes constitute the core of the case for further reform of the trade system for agricultural goods.

Five reasons can be distinguished to pursue agricultural trade reform. Each is a plausible justification for reform. Together, they make a compelling case for further trade reform. First, the Uruguay Round has exposed the extent of countries' agricultural protection. The picture that has emerged is of high tariff peaks for agricultural goods towering above the more modest tariffs for nonagricultural goods. Such uneven protection carries a high cost both to the countries with the trade barriers and to the trade system as a whole. Second, a further attempt to improve the international rules for trade could motivate efforts to formulate domestic agricultural policy in many developing countries, particularly in Asia. The dynamics of protection are such that countries often need the restraint and guidance of international agreements to make otherwise untenable domestic policy choices possible. Third, reform would lock in and underpin the painful changes in agricultural policy that are occurring in the advanced industrial countries and in a number of middle-income economies. The reforms, a constructive response to the poor performance and high cost of previous policies, need to be undertaken within the guidelines of international trade rules. Fourth, further agricultural trade reform would help reduce trade conflicts, which have bedeviled trade relations among developed countries for many years. Improving trade relations has a potentially large benefit at a time when the focus of the international system should be to foster peaceful solutions to global issues. Fifth, agriculture has a significant role to play in the future development of the international trade system. It is a vital part of the political accord that is needed for continued global economic integration and growth. To omit it would weaken that accord significantly.[1] Each of these reasons for reform of agricultural trade is discussed in turn.

Reducing Levels of Agricultural Import Protection

Around the world, agricultural markets are highly, if unevenly, protected from imports. The high tariff levels that were bound in the Uruguay Round for agricultural goods stand out as a major distorting feature of the trade system. Because of the succession of GATT rounds, manufacturing tariffs are now at modest levels in most industrial countries and in an increasing number of middle- and low-income countries. Many of these tariffs are around 5 to 10 percent. By contrast, agricultural tariffs average above 40 percent, with tariff peaks (megatariffs) of over 300 percent. Table 1 shows

1. These five reasons are not unrelated. High tariffs give exporting countries an excuse to continue protecting their domestic agriculture, which in turn leads to aggressive export policies. This contributes to the tensions of the trade system and undermines the confidence of trading countries in the ability of the system to provide foodstuffs on a reliable basis. Removing both the high protection levels and the need for export subsidies improves the credibility of the trade system and, hence, is an important part of the multilateral bargain among countries.

Table 1 Average unweighted ad valorem bound tariff rates, post-Uruguay Round, for 10 agricultural products in 20 countries[a]

Product	Tariff rate
Grains	46.7
Oilseeds	41.7
Fats and oils	41.6
Meats	39.3
Milk	40.7
Dairy products	47.1
Sugar	48.7
Fresh fruits and vegetables	35.5
Processed fruit and vegetables	35.3
Other agricultural goods	24.4

a. The countries are: Australia, Brazil, Canada, Chile, Colombia, European Union, India, Indonesia, Hong Kong, Japan, South Korea, Malaysia, Mexico, New Zealand, Philippines, Singapore, Sri Lanka, Thailand, United States, and Venezuela.

Note: The table shows the unweighted average ad valorem tariff of the numerous individual tariff lines relating to the product groups identified. Two cautions should be noted. First, the unweighted average tariff does not distinguish between the importance of the individual items either in the current trade basket or in any potential pattern of trade. Second, the average omits specific tariffs that cannot be averaged without assumptions about the level of world prices. An ambitious attempt to convert the specific tariffs often found in agricultural trade into ad valorem equivalents has been proceeding at the World Bank (Ingco and Hathaway 1996). This indicates that specific tariffs are often higher than the ad valorem tariffs. More importantly, the Japanese and South Korean protection on rice imports is not yet in the form of a tariff and is not included in the table. Nor is the EU protection on grains, as this is limited to a level below the bound tariff. The bound tariffs can overstate the level of protection actually applied: several Latin American countries apply tariffs that are well below their bound levels.

Source: WTO Secretariat.

the ad valorem tariff for a number of agricultural goods averaged over 20 major trading countries in North America, Asia, Europe, and Latin America. But the averages hide the tariff peaks, which effectively block trade. Canadian dairy imports are a well-known example of such megatariffs: the tariff on butter is 351 percent and on cheese is 289 percent. Even by the year 2000, these will still be at 299 percent and 246 percent respectively (International Agricultural Trade Research Consortium [IATRC] 1994). Poultry tariffs are also above 200 percent in Canada.[2] The United States has megatariffs for sugar and dairy products, as does Japan for grains, sugar, and dairy products.

2. Canada has lower tariffs on most other agricultural import items. India is an example of a country with consistently high tariffs, with an unweighted average bound tariff for unprocessed agricultural goods of 97 percent and for processed agricultural goods of 139 percent. Hong Kong, a country with no agricultural production, is at the other end of the scale with a zero tariff for agricultural goods.

There is little doubt that agricultural protection as evidenced by these high tariff levels remains one of the major distortions in the world economy today. As a result, domestic prices are pushed far above those on the international market. In such instances, the allocation of resources among sectors is grossly distorted, and consumers of foodstuffs bear a heavy burden to support high-cost local production. The importing countries themselves have a strong economic interest in reducing the cost of foodstuffs to consumers and improving the efficiency of their own resource use. In many cases, the high tariffs contain considerable "water," with imports unable to compete after having paid the tariff. Many of these high tariffs result from the conversion of nontariff barriers (often at levels above the tariff equivalent) and, hence, preserve the intent to exclude imports. In other cases, the bound tariffs are above the levels actually in use, and the distortion is potential rather than actual. However, such tariffs should still be reduced to make market access more transparent. Countries could use the reduction of these tariffs as bargaining chips in negotiations to gain better access to foreign markets.

Why does it matter if tariffs are high for agricultural goods relative to those in other sectors of the economy? By raising domestic prices above the cost of imports, the government gives farmers the wrong incentives to produce and reduces the contribution that the sector makes to the national economy. The cost of inputs into the production process can easily exceed the value of output.[3] Under these circumstances, the contribution to the output of the economy is negative.

Poor countries can ill afford to have a major part of their economy unproductive, especially when the distortion is financed by a tax on food. Moreover, the rest of the economy will feel the pull of resources toward the agricultural sector. Support for one sector puts a burden on others. In many countries, agriculture is significant enough to have noticeable macroeconomic impacts, distorting the wage rate and the exchange rate. Governments that give direct payments from the government treasury to agriculture, instead of (or in addition to) the protection offered by tariffs, must raise taxes and curtail other desired spending or run large budget deficits. Even rich countries where agriculture is a small part of the economy can find such side effects a drag on the economy.

These side effects might be tolerable if the protection of the agricultural sector helped to achieve some broader social goal. Few would push for freer trade if it compromised consumer access to food or devastated rural

3. A simple rule of thumb is to compare the value added in a sector (often called the "gross margin" in agricultural activities) with the nominal rate of protection (or more accurately the adjusted nominal rate netting out input tariffs). If, for instance, the value of output is 35 percent above the cost of inputs but the output is protected at a rate of 40 percent of the world market price, the cost of inputs exceeds by 5 percent the world market value of the output. The sector is yielding negative value added at "social" prices.

economies, and agricultural protection is often justified on the grounds of food security and rural well-being. But these notions are a weak rationale for the perpetuation of gross distortion of agricultural incentives. Food can be purchased by any country with foreign exchange: absolute food shortages are rare and fleeting and usually a result of administrative mismanagement or political turmoil. A country's best guarantee of food security is a diversified export sector that provides the funds for needed imports, along with a sound macroeconomic policy to keep those exports competitive.[4] Neither is rural development, except in the short run, helped by encouraging high-cost food production. Development is most successful when farmers and others in rural areas produce products that consumers demand and, hence, are prepared to pay for. Dependence upon artificial markets, whether maintained through high import tariffs or direct intervention in the market by means of price supports, blocks the signals from the consumer and distorts production and investment decisions. In the long run even the producers are harmed by the lack of market orientation. Moreover, the cost of inefficient food production is borne disproportionately by the poor, who spend a higher percentage of their income on food. Agricultural protection is a regressive policy that poorly serves both developed and developing countries.

The reason for the prevalence of high agricultural tariffs despite their economic drawback is simple. Agricultural protection, like that in other "sensitive" sectors of the economy (e.g., textiles, steel, and shipbuilding), serves one purpose—to protect the profits of those in the industry from erosion due to competition. It is the fear of reduced incomes and asset values, including land prices, rather than food shortages or rural depopulation that often makes it so difficult to remove high levels of protection.

Much of the rhetoric of the agricultural policy debate reflects attempts to build alliances between farm and other groups to support the concept of agricultural protection. Such alliances serve to confuse the issues by linking maintenance with rural development and food security, but they also makes it easier to change such policies once the political mood shifts. As experience over the last decade has demonstrated, when the average (i.e., urban) politician decides that it is no longer in the interest of the country to maintain high commodity prices and insulated markets, reform can be swift. The farm sector does not necessarily suffer a drastic cut in income when such changes are introduced. Direct payments can be introduced to compensate for price reductions and more competition in agricultural markets. Several examples of such compensation policy reform now exist. Farm interests faced with reform know that others have

4. There are serious problems of internal food distribution and lack of food access by the poor in developing (and even in developed) countries. But these concerns are also not well addressed by encouraging uneconomic production and wasting national resources.

learned to live with the opening of markets. The Uruguay Round gave this process a boost by discouraging payments tied to production, which have a direct distortionary impact on trade, and encouraging those that are "decoupled," where the effect on trade is considerably less or so indirect as to be difficult to identify. The next round of trade talks can give the impetus for more countries to switch from price support to decoupled direct payments and, hence, move toward less distorted trade.[5]

Restraining Agricultural Protection in Asia

We know from careful studies of agricultural protection in Asia that nations can fall prey to the temptation to increase agricultural price supports at particular stages of development, when the manufacturing sector is booming and agriculture seems to be struggling, and then find it difficult to remove such support at a later stage when the rural sector needs the pressure of market forces to become competitive (Anderson and Hayami 1986). This has happened in Japan and South Korea, as well as Taiwan. Table 2 shows the dramatic rise in domestic prices for basic farm commodities relative to border prices in these three countries in their "take-off" stages. In the mid-1950s Japan began to push up farm support prices in an attempt to keep farm incomes in step with the burgeoning nonfarm sector. By the late 1960s, the same process was repeating itself in South Korea and Taiwan. Though protection was in all cases highest in rice, the other grains, livestock products, and even fruits and vegetables were heavily supported.

Because of economic growth in the region, many other developing countries in Asia have been grappling with this problem over the last few years, including China, Indonesia, India, the Philippines, Malaysia, and Thailand. The temptation to move toward a protective agricultural strategy has been growing. China already grants somewhat higher protection to its agricultural sector than to most other sectors. Indonesia has recently reformed its industrial trade policy but has been hesitant to extend reform to the agricultural sector. If growth resumes in India, another country with enormous potential to influence world trade, it will face the same

5. Other things about the landscape of agricultural protection, in addition to high tariffs, are worrisome. In particular, the proliferation of tariff rate quotas (TRQs) has led directly to a number of trade disputes. Some of these have revolved around the allocation of the TRQs; others concern the quantities involved and the growth of market access. The problem that TRQs pose is that they generate profits for those that are allocated the quotas, setting up in turn a vested interest in their perpetuation. Those that do not have such quota allocations will tend to complain, thus ensuring both restricted access and trade frictions. This issue of quota allocation has become entangled with another issue, that of the prevalence of state trading in agricultural goods. Where the quotas have been allocated to parastatal trading firms, the private sector has been quick to protest.

Table 2 Nominal rates of protection for agricultural commodities: Japan, South Korea, and Taiwan, 1955–82 (percentage difference between domestic and border prices)

		1955–59	1960–64	1965–69	1970–74	1975–79	1980–82
Rice	Japan	50	72	99	160	263	249
	South Korea	−14	−9	6	55	138	154
	Taiwan	−31	−8	−13	4	58	144
Wheat	Japan	37	62	97	127	276	278
	South Korea	−22	−8	18	16	47	128
	Taiwan	48	25	39	32	57	92
Beef	Japan	113	142	165	146	284	181
	South Korea	3	5	55	88	281	354
	Taiwan	−4	8	20	37	162	153
Average[a]	Japan	44	68	87	110	147	151
	South Korea	−15	−5	9	55	129	166
	Taiwan	−21	2	2	17	36	55

a. Average of eight common agricultural commodities: rice, wheat, beef, barley, corn, soybeans, pigs, and chickens.

Source: Anderson and Hayami (1986, 22).

dilemma. At present, India has relatively closed markets but internal price levels comparable to those on world markets. Whether India will develop an open market for agricultural goods or move to support its farm population with the proceeds of nonagricultural growth is a key question.

The recent financial troubles in many of these countries and the possibility that it may be some time before rapid growth returns do not remove the need for open agricultural systems. Indeed, the need for economic reforms in the financial sector is tied to the maintenance of open markets and the removal of unnecessary government regulations on commerce. An open food and agricultural system would complement the restructuring of the Asian economies by removing the possibility of future distortions, just as the increased competitiveness of their own agricultural sectors that should follow from the currency devaluations will help the process of trade liberalization in the importing countries. In any case, the issue of the type of agricultural and food strategy to pursue in the region will certainly come to the fore in the next few years.

Further agricultural trade reform will help these countries avoid the problems that Japan, South Korea, and Taiwan have experienced with high-cost food industries. It will make increases in border protection difficult by reducing bound tariffs. Constraints on domestic support will avoid wasteful competition through subsidies on water and fertilizer. If the next round of multilateral trade negotiations deals with state trading, further pressure would be put on Asian countries to deregulate their internal food markets to the advantage of consumers and entrepreneurial farmers.

Of the Asian agricultural issues, perhaps the most significant is the path of agricultural policy in China. Will the agricultural sector of the world's most populous country become more protected as the manufacturing sector develops, along the lines of Japan if not to the same degree? Or will it bypass the stage of heavy protection and tight state control of basic crops and head directly for a market-oriented agricultural system?[6] China appears to be prepared to try the road of modest protection and open markets. Levels of protection are relatively modest by international standards, though still high relative to other sectors in China. Clearly China cannot afford to burden itself with high-cost foodstuffs. Unlike Japan and South Korea, it has no structural food deficit. Land resources, if properly managed, will always be able to produce the major part of domestic food consumption. It either can focus on domestic needs by aiming for self sufficiency or it can encourage specialization, including the development of export industries based on imported raw materials. The latter would benefit rural development and raise incomes. But China is also likely to be concerned about the security of food supplies from abroad and the possibility of food shortages and high prices. Thus, the reform of the world trade system in agricultural products should be completed so that China can participate with confidence in international trade and be accepted as a reliable partner by other countries.

For countries such as Indonesia, the Philippines, Thailand, Malaysia, and India the question is also one of alternative development paths. Most of these countries no longer tax their agricultural sectors. But industrialization is already putting a strain on agricultural incomes, and the temptation to increase protection is considerable. Is there a convincing alternative to the state-dominated food system that features high price policies (e.g., Japan, South Korea, and Taiwan)? Would an "open" food system built upon free trade, or modest trade barriers at the least, be a more secure basis for the growing Asian economies? The future of agricultural trade depends as much on the answer to this question as on any other. At present, the WTO agricultural trade rules are relatively ineffective in pushing Asian countries toward a system based on open markets. A further step toward reform is needed, perhaps led by the APEC countries. An open food system in the Asia Pacific region would set an example for other areas of the world and could rapidly lead to an open system at a global level. If countries could be persuaded to move down this path (and it is already explicit in the APEC target of free trade and investment for all countries in the region by 2020), then this could be the most important driving force

6. Jeffrey Garten (1997) raises the same question with respect to industrial policy. Will China try to repeat the experience of Japan in state encouragement of export firms and limit imports to those that bring in needed technology? Before the South Korean economic crisis, others suggested that the Chinese might opt for the *chaebol* model of industrial organization found in South Korea.

behind global agricultural trade reform since the repeal of the Corn Laws by the English Parliament in the middle of the 19th century.[7]

Securing Agricultural Policy Reform in the West

The slow but fundamental changes that are taking hold in the agricultural policies of the major industrial countries also need the encouragement and underpinning of international agreements. Changes in these policies have generally improved the climate for agricultural trade, in contrast to the policy changes in the 1960s and 1970s, which led to more trade conflicts. For instance, the Uruguay Round was able to take advantage of the 1992 reform of the European Union's CAP and get firm commitments on future policy directions and support levels. But agricultural reform in many developed countries is still at an early stage. It must go forward to avoid a swing back toward the costly and ineffective policies of earlier times.

Calculations made by the Organization for Economic Cooperation and Development (OECD) in its 1997 report (OECD 1997a) show the magnitude of the task ahead. The size of total transfers to the farm sector from taxpayers and consumers as a result of the mix of agricultural policies used by OECD members has changed little in the last decade. It averaged $280 billion per year from 1986–88, at the start of the Uruguay Round, and rose to an estimated $300 billion per year in 1996 (see table 3).[8] Agricultural policy transfers are greatest in the European Union, with Japan and the United States transferring income at just over one-half the European level. On a per-farmer basis, corrected for part-time farming, transfers to Japanese farmers averaged about $30,000 in 1996, which is well down from the previous year but still higher than in the late 1980s. US transfers per farmer have stayed rather constant over the same period, at just over $27,000. (Transfers per hectare are much larger in Japan than in other OECD countries, however, because farms are smaller.) Inflation has reduced the value of those transfers by 35 percent and growth in income and population has reduced the burden on the rest of the economy from

7. The repeal of the protectionist Corn Laws, which bore a resemblance to the European Union's CAP for grain a century later, led after an interval to the expansion of agriculture in the Americas. Those European countries that did not take advantage of cheaper overseas grain fell behind in the process of industrialization (see Tracy 1964).

8. The measure of total transfers includes benefits from price support policies and subsidies as well as all farm-related government spending. Not all the benefit goes to farmers, of course, with input suppliers and marketing agents also being supported. Moreover, new entrants to the sector may already have "paid for" these benefits in the price of land and other assets. Landlords should also be presumed to benefit from higher rental rates as a result of the transfers. These are additional reasons why the move toward targeting and decoupling payments is likely to make transfers more effective in the future.

Table 3 Agricultural policy transfers by country, 1986–96
(billions of US dollars)

	1986–88	1993–95	1994	1995	1996
Total Transfers					
European Union	114.1	132.5	128.5	138.6	120.3
United States	68.2	74.1	76.4	62.4	68.7
Japan	62.5	89.9	87.2	100.5	77.4
Canada	7.3	6.1	5.8	5.7	4.8
OECD	278.9	332.1	328.2	332.9	297.1
Transfers per farmer					
(full-time farmer equivalent)					
European Union	12,785	18,657	18,336	19,478	17,474
United States	27,892	29,384	30,285	24,742	27,240
Japan	17,280	31,647	29,402	38,440	30,091
Canada	15,742	14,085	13,750	13,318	11,225
OECD	11,100	15,651	15,440	15,955	14,493
Transfers per hectare					
European Union	851	953	944	951	825
United States	159	174	179	146	161
Japan	11,705	17,553	17,013	19,618	15,107
Canada	99	84	80	78	66
OECD	236	284	280	284	254

Source: OECD (1997a).

2.2 percent to 1.3 percent of GDP. But the absolute size of the transfers to one small and declining part of the economy is still remarkable, and those transfers are still vulnerable to both economic reform and straightforward budget-cutting pressures.

The transfers effected through specific policies for a more limited range of commodities have for many years been captured by the OECD in their calculation of the Producer Subsidy Equivalent (PSE), the payment that would have to be given to offset the income effect of a removal of those policies. The total value of this part of the transfer rose slightly over the decade, from $160 billion to $166 billion (see table 4). Relative to the value of output, the PSE for the products considered for the OECD member states was estimated at 36 percent in 1996, down from 40 percent in 1995 and 45 percent in 1986–88 (OECD 1997a). Expressed with the border price as a base, the level of protection (called the Nominal Assistance Coefficient by the OECD) for producers fell from around 80 percent to about 50 percent over the decade. Calculated on the basis of consumer prices (i.e., not including direct payments) the level of protection fell from 60 percent to 30 percent over the period. However, this improvement is largely the result of firm world prices in 1996 and could easily be reversed if these prices collapse.[9]

9. These numbers tend to confirm the impression from the unweighted ad valorem tariffs of a level of protection of about 40 percent for agriculture as a whole.

Table 4 Producer subsidy equivalents (PSE) and nominal assistance coefficients (NAC), OECD countries, 1986–96

	1986–88	1995	1996
PSE (US$ billion)	159	180	166
PSE (percentage)	45	40	36
NAC (producer prices)	1.8	1.6	1.5
NAC (consumer prices)	1.6	1.4	1.3

Source: OECD (1997a).

Latin America provides the most direct case for locking in agricultural policy reforms by means of trade policy changes. As history has demonstrated, economic reforms in the region can easily be reversed by a change in regime. In the past decade, country after country has liberalized agricultural markets by a combination of low border protection, deregulation of domestic markets, and macroeconomic reforms that encourage trade and investment. To lock in these reforms, governments have been actively seeking trade agreements with other countries on a bilateral, regional, or multilateral level. A trade agreement constrains future governments by raising the cost of a reversion to protection. Export interests are developed, and these are likely to resist such a policy reversal. For Latin America, the reforms can be cemented both by an expansion of access into the North American market or by further multilateral reform. It is in the interests of countries outside the region to encourage the multilateral path. Conversely, failure to continue the process of policy reform at the international level makes it more difficult to continue the current economic policies in Latin America. Domestic agricultural sectors will argue that they should not be alone in having little protection in an incompletely reformed world market. Any breakdown of the regional trade accords is also likely to encourage a resurgence of protectionism within Latin America. Agricultural trade in the region will be among the first casualties.

In Europe, locking in domestic reform takes a somewhat different form. The WTO schedules are beginning to constrain domestic decisions in the European Union. The 1992 CAP reform was a reaction to both external and internal constraints and pressures. Tighter external constraints will translate directly into more reform however much domestic interests may protest. But in the case of Europe the proliferation of regional trade pacts is also putting pressure on the CAP. Both the extension of regional trade liberalization (i.e., the Europe Agreements with prospective members that would lead to accession to the European Union and the negotiation of free trade areas with the countries of the Mediterranean littoral) and the WTO commitments are firm constraints on the CAP. Policymakers are well aware of these linkages. The recently announced plans of the

European Commission for the near-term development of the European Union, known as Agenda 2000, include suggestions on CAP reform that are clearly framed within the WTO constraints and, indeed, anticipate the tightening of those restrictions in the next round of trade negotiations (European Commission 1997). Relaxing this pressure would send the wrong message. Any decision to postpone or abandon further talks on multilateral trade liberalization would have a negative impact on the internal debate on CAP reform. Even in the apparently internal matter of EU enlargement the WTO constraints play an important part. In addition to the expected budget cost through higher subsidy costs of expanding membership to such large agricultural countries as Poland and Hungary, the impact on the European Union's export subsidy limits has to be taken into account.[10]

Multilateral reform has another specific role in agricultural policy change in this region of the world. The countries of Central and Eastern Europe emerged from their long period of central planning and embraced relatively open markets. However, in agriculture, the tendency has been to drift toward more protection both in anticipation of joining the European Union and as a reaction to pressure on markets from dumped commodities and restricted access to nearby markets (OECD 1997b). Such a drift toward protection is not in the interest of these countries but is difficult to resist in light of EU accession.[11] Further trade reform now can help these countries maintain a strategy of reasonably liberal policies in the interim and can push the European Union to more open markets by the time the prospective members join. A further round of trade talks would be a significant factor in this strategy. It would help develop Central and Eastern Europe's comparative advantage as a supplier of processed agricultural goods for the Central European markets rather than as a supplier of unprocessed goods that would add to the unsalable surpluses of the western part of the continent. Hence, a new round may help them escape the trap that Western Europe has been caught in for some decades and from which it only now is slowly emerging: excessive resources in inefficient agricultural sectors.

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10. The European Union's export subsidy limits probably would be revised, presumably by adding the allowable subsidies of the new members (less the subsidies on trade between old and new members) to those of the European Union. But these countries often did not claim subsidies in their schedules adequate to cover their expected surpluses, in which case the WTO constraints will become tighter with enlargement.

11. This is one of the few clear-cut cases of a direct conflict between the regional and the multilateral trade paths with respect to agriculture. At a time when these countries would like to maintain a relatively open market for agricultural goods, they are under pressure to introduce CAP-like policy instruments in anticipation of membership. Sweden actually had to reintroduce some market intervention measures when it joined the European Union in 1994.

In Canada, regional and multilateral trade reform is helping to improve and cement recent domestic policy shifts. NAFTA avoided some of the most sensitive issues, such as the highly protectionist provincial marketing boards for dairy products and poultry, but did much to free up cereal, oilseed, and beef trade. The URAA forced Canada to restrain the provincial marketing boards by converting the nontariff barriers by which they controlled imports to tariffs, albeit at a high initial level. Both NAFTA and the WTO pressured Canada to remove its long-standing transport subsidies for exported grain. Canada's farm support policies now mainly comprise income payments, and the federal government has reduced drastically its involvement in agricultural markets. However, more WTO pressure will be needed to get better market access for imports of the products still highly protected.

In the United States, the link between domestic reform and regional and international trade liberalization is subtler. Congress has made it clear that "farm bills are not made in Geneva." Yet US agriculture is integrated more than ever into the world economy, and US decisions in the area of agricultural policy are conditioned by external events. Moreover, the URAA, though it does not demand major short-run adjustments to US agricultural policy, does constrain future policy options. The Farm Bill of 1996 established a commission to look at the government's future role in agricultural markets. Members of the commission will have to consider the WTO schedules and rules, though their public statements may not make much of this link. At a more fundamental level, the United States needs the discipline of stronger trade rules to help open markets overseas. It follows that strengthening those rules will constrain US policies and help to prevent the United States from slipping back into expensive manipulation of commodity prices on the domestic market, which has been the feature of farm policies from 1933 on.

The case of Japan shows clearly the possibilities and limitations of attempting to influence domestic policy reform by multilateral negotiations. Japan's opposition to the consideration of domestic policies in multilateral negotiation conformed with the desire to avoid pressure on its internal pricing and distribution system, which inflated the internal price of rice and several other products. However, external pressure from the United States, Australia, and other exporting countries, as well as successive GATT rounds, has opened up much of Japanese agriculture to imports and appears almost to be an accepted way for the Japanese government to make changes that would be difficult to accomplish in purely domestic discussions. Now that the internal marketing system is opening still further, continued external pressure seems more useful than ever in promoting these changes, which are healthy for the Japanese economy as well as for exporting countries.

Reducing Damaging Trade Conflicts

Agricultural trade conflicts have weakened the trade system as a whole and the market for agricultural goods in particular over the past 30 years. Hudec (1993) has calculated that in the years 1948–89, 43 percent of the disputes that came before the GATT related to agricultural products (a total of 89 agricultural disputes). Tangermann (1997) reports that there were 18 agricultural disputes before the WTO (29 percent of the total) from 1995 to mid-1997. Agricultural disputes in both periods were disproportional to the value of trade, though perhaps not out of line with the level of protection and trade interference. The visibility and intractability of the agricultural disputes has set them apart.

In particular, three sets of conflicts have soured trade relations. The first is the conflict between temperate zone exporters and the European Union. Led by the United States, those countries that export grains, dairy products, and oilseeds have complained repeatedly about the CAP and its impact on world markets (Josling 1993a). At first, the objection was to the shrinking market in Europe, as trade diversion took place with the encouragement of high trade barriers. Next, the issue was the use of export subsidies as the European Union tried to keep surpluses from depressing the internal market; and the United States retaliated with its Export Enhancement Program (EEP), which was expressly targeted at those markets where the European Union was increasing its market share. A decision in a further WTO round to abandon the use of export subsidies would be the most significant factor in building a more constructive trade relationship between the United States and other exporters on one side and the European Union on the other.

More recently, some of the most contentious EU-US agricultural trade issues have been in the area of Sanitary and Phytosanitary Standards (SPS) and other more technical trade issues. These include the dispute over the import of hormone-treated beef into Europe, the potential ban by Europe of imports of beef by-products (specified risk materials) that may harbor vectors of bovine spongiform encephalopathy (BSE, or mad cow disease), and the debate over the regulation of the use and labeling of genetically modified organisms (GMOs). Removal of these irritants from transatlantic relationships would also be a major accomplishment of new multilateral talks or, alternatively, of a bilateral deal. As such, it would contribute significantly to the restoration of harmonious transatlantic trade relationships—long an objective of politicians on both sides.

The second broad set of complaints concerns exporters' access to the growing markets of Asia. In part, this reflects Asia's rapid economic growth, which is bound to cause some friction as imports expand rapidly. But the root of trade tensions in these cases has tended to be not the expansion of Asian imports through economic growth but the high cost of imported goods to domestic consumers caused in part by an internal distribution system that outside suppliers see as unfair. Examples are the wholesale and retail systems in Japan and the shelf-life regulations in South Korea. Further trade talks would have to deal with some of these issues, at least those rooted in agricultural or food legislation as opposed to general structural impediments to trade.

A third set of trade problems has arisen between developed and developing countries over the years. These include the widespread barriers to imports that developed countries put up for goods that might compete with domestic farm production, such as sugar and beef. More recently, there have been conflicts over preferential access for the agricultural commodities of developing countries (such as bananas), the need for adequate supplies of cereals as food aid when world prices are high, and the impact on domestic markets in developing countries of dumped surpluses of dairy goods from industrial-country producers. Each of these issues is ripe for settlement, and each would improve trade relations disproportionately to the amount of trade involved.

It is clearly worth taking steps to avoid conflicts and, thus, contribute to the strength of the trade system. Trade conflicts have high economic costs, because profitable trade is forgone, particularly when the parties concerned launch a succession of retaliatory moves. Perhaps as important, such conflicts sap the support for the system, polarizing interests and leading to the notion of trade as a struggle between countries rather than a mutually profitable exchange of goods among firms and an expansion of choice at the lowest cost to consumers.

Including Agriculture in Global Trade Liberalization

Trade liberalization rests on an implicit agreement among countries that all will gain from more open exchange. Countries have to reconcile domestic sectors to changes that will leave some facing more intense competition. Such internal political reconciliation is made more difficult, if not impossible, if the government cannot point to some overarching national benefit that will follow from trade liberalization. In some cases this may be the fear of being left behind in the general process of global integration, but this is not a very satisfactory basis for constructive policymaking. More positive motivation is probably needed. Domestic constituents need to feel that they gain from participating in a global trade system that protects their rights and gives them new opportunities.

In general, the tariff levels on manufactured goods imported into developed countries are now low. However, access is often restricted by administrative protection through product standards and contingent protection through antidumping duties. Developing-country protection on manufactured goods is often much higher, and access to the local market for

Table 5 Share of world value added in agriculture and manufacturing (percentages)

	Agriculture	Manufacturing
Low income	29.2	5.9
South Asia	10.2	1.2
Less India and China	8.5	0.8
Lower-middle income	20.2	6.8
Upper-middle income	15.3	6.9
High-income	36.2	81.4

Source: World Bank, *World Development Indicators* (1997).

services is often highly restricted. Recent trade negotiations have given developing countries more secure access to the developed markets (by limiting the scope for import restrictions) in exchange for better developed-country access to the expanding markets of developing countries (through lower tariffs on imports from the developed countries). Bergsten (1997a) has called this the "grand bargain" that is necessary to give the political momentum for the next round of trade talks. This bargain covers more than just the conditions of access for manufactured goods. It must also include services and intellectual property rights, extend to investment and competition, and at least be supportive of parallel activities undertaken to correct global environmental problems and prevent labor abuse. Above all, it has to offer something substantial for developing as well as industrial countries and not seem to impose trade rules that favor only a few countries.

The role of agriculture in this bargain is crucial. Despite the recent impressive growth in the manufacturing sectors in developing countries, developed countries still account for the bulk of manufacturing activity, as shown in table 5. The same is not true for agriculture, where developing countries provide over 60 percent of the world's value added. Although export patterns diversify with development, nonagricultural exports are still a much smaller share of total exports for most developing countries than for developed countries. The way the world trade system for agriculture develops is of strong interest to relatively few in the developed countries, but it is the lifeline to development for many in the poorer parts of the world. As these countries develop, they will make even more use of agricultural markets, as exporters and importers. These countries would find it quite unacceptable to continue a system of developed-country domestic farm policies that dictated what commodities could be traded and on what terms.

The bulk of the most egregious protection in world agricultural markets is still found in the developed countries, particularly the European Union, Japan, and the United States. Most of the agricultural policies that cause disruption on world markets also occur in these countries. If those countries that are still heavily engaged in exporting agricultural goods on world markets are to agree to further trade talks, there must be good prospects for better access to the markets of developed countries and less market disruption from their policies. This view, associated in the Uruguay Round with the Cairns Group of small and medium agricultural exporters, has been championed by New Zealand and Australia. The Latin American countries will clearly continue to take this position, both at the multilateral (i.e., the WTO) and regional level (i.e., the FTAA talks). The incidence of high tariffs in the agricultural sector relative to manufacturing is a serious concern for such exporting countries.

Other developing countries depend on imported foodstuffs and will need assurances that supplies will not be arbitrarily restricted or taxed. Many Asian and African countries will likely take this view, though they too are becoming concerned with market access for their agricultural exports. The threat of export taxes and quantitative restrictions by the exporters of basic foodstuffs is a significant constraint to the wholehearted commitment of developing countries that import to the international system. The persistent use of export subsidies by the developed countries gives concern to both competitive exporters and to those countries trying to develop domestic sectors that are competitive with imports. An important part of the agricultural component of the bargain will therefore have to deal with supply assurance and export subsidies.

However, the bargain will have to include more than market access and export taxes. As developed countries end special preference schemes given to developing countries as part of their postcolonial development policy, more emphasis may need to be placed on investment funds that take the place of commodity-linked transfers. Investment in developing-country agriculture is likely to play a role in growth and in the emergence of a strong, competitive sector. Improvements in investment conditions benefit both developed and developing countries. And as the larger economies of the formerly centrally planned world join the WTO, other countries will need assurance that they will benefit from the significant increase in the size of world markets without undue disruption.

The terms of the agricultural part of the grand bargain might therefore require that exporters of agricultural goods have improved access to industrial country markets, that importers have firmer assurances on continuity of supplies, that preferential schemes be phased out with adequate facilities for diversification, that new members enter with relatively open markets to share the benefits with all countries, and that market disruption by export subsidies finally be curbed. A deal that covers these issues would make a worthwhile counterpart to the deal between developed and developing countries on manufacturing and service trade.