GATT and reform of the CAP

Kirrane, Chris

October 1992

GATT and reform of the CAP

Chris Kirrane

Abstract

Agriculture is at the centre of the Uruguay Round multilateral negotiations, with the United States refusing up to now any compromise in GATT in the absence of an agreement on agricultural policy reform. At the same time, the European Community has started to reorient its Common Agricultural Policy. After difficult negotiations between Member States, the philosophy of the CAP was profoundly changed last May. Focusing on cereals, the reform sharply reduces support prices and replaces them with budget support. A minimal compromise in GATT thus becomes probable, since the United States may adopt a less intransigent stance than at the beginning of the current round of negotiations, its commercial interests being centred on the major crops and largely satisfied, in terms of cereals, through the Community initiative.

Although agriculture plays an unprecedented role in the current round of multilateral GATT negotiations, the Uruguay Round, from its launch in 1986 in Punta del Este to date, seems to follow a familiar scenario: ambitious statement of intent on the need for greater liberalisation of trade in agricultural products and a rapid deterioration of the debate in a clash between the United States and the European Economic Community (EEC). The novelty lies in the almost universal recognition that it is urgent to reform not only agricultural trade policies but also domestic support policies, and in abandoning the reference to the special status that had allowed legitimate derogations from the general GATT rules (waiver in the United States, variable levies and refunds in the EEC, etc.). The novelty also comes from the fact that, to date, the United States, the countries of the Cairns Group and developing countries still refuse any compromise on the various issues (goods, services, intellectual property, etc.) in the absence of an agreement on agricultural policy reform.

The agricultural negotiations in the Uruguay Round tend to be reduced to an opposition between the United States and the EEC. The United States emphasises the need for reform of all agricultural policies and for specific commitments for import access, export competition and domestic support policies. The EEC adopts a more stance defensive, accepts a 'certain' decline in international support, asserts that the latter will automatically result in a reduction in export subsidies without the need for additional commitments on this point. This opposition is not new, and characterises the rounds of negotiations after the creation of the Common Agricultural Policy (CAP): Dillon Round in 1961-62, Kennedy Round in 1964-67 and the Tokyo Round in 1973-79. The United States has always adopted a maximalist position in the early stages of these rounds, finally accepting a more limited agreement and the postponement to the next cycle of a real reform of agricultural policies. The scenario of the current cycle is therefore similar to that of rounds previous, at least until today. Will history repeat itself, with the United States adopting a more uncompromising position and accepting a minimal compromise, as solutions to fundamental problems are once again postponed for the future? An examination of the fundamental facts of the issues at stake and the most recent proposals of the United States would lead to such an outcome of the negotiations.

Nevertheless, the new fact is the recognition by the Member States of the Community that a reform of the CAP can no longer be avoided. The support of domestic prices at levels significantly higher than world prices, is indeed difficult to justify economically, in the medium and long term. Constantly postponed, this necessary reform of the CAP has been on the agenda since at least 1968 (Mansholt Plan). The various measures adopted over the past ten years have not called into question the functioning Organisations of the Common Market(CMOs), with the exception, however, of the milk CMO regulated by a production quota since April 1984 and, in to a lesser extent, fiscal stabilisers introduced in 1988 for grains and oilseeds. Their primary objective was to curb the growth of agricultural expenditure, but because they did not call into question the basic principles of the CAP and in particular the support of market prices, they did not make it possible to improve their functioning in a sustainable way.

Although it has some points in common with previous proposals or measures, such as the withdrawal of productive resources, the CAP reform compromise, adopted by the Member States on the occasion of the Council of the European Communities from 18 to21 May, 1992, differs markedly in its overall coherence, whereas the previous reforms mainly resorted to expedients peculiar to this or that production. It implies a profound support of modalities, since direct aid to production factors largely replace aid for products. It does not respond to the logic of budgetary savings, even if it remains decisive in a long-term perspective, because it aims to obtain positive effects on demand domestic. It emphasises the need for market forces to play a greater role, while trying to integrate the constraints of environmental preservation, rural and regional development, and the international agricultural context. Although the Commission has always stated, at least officially, that CAP reform and GATT negotiations are two separate issues, the CAP reform, adopted outside the GATT framework, must nevertheless be interpreted in the light of the positions of the Contracting Parties of the Uruguay Round, and in particular in the light of those of the Community and the United States. This reading of the reform makes it possible to analyse to what extent the latter is consistent with the negotiating positions of the Community in the GATT and to what extent it meets the American requirements. It helps to understand how the reform responds to both internal needs for change in the CAP and external pressures, amplified and coordinated in the Uruguay Round. The reform thus appears as a real initiative and not a passive reaction to these pressures.

Examination of its contents in relation to the most recent compromise put on the negotiating table (‘Dunkel’ compromise of December 1991), will show that it satisfies certain points but not others. Thus the EEC obliges, by a strategy of movement, the other negotiators to position themselves in relation to its form whose modalities go beyond the commercial logic of the GATT. The EEC is thus taking a step in the direction of the compromise, without however submitting to it, which makes it possible to seriously consider an agreement that is forthcoming but much less ambitious than the initial declaration of the current round of negotiations. At the same time, the fundamental data are still present and provide a better understanding of the pressures that will continue to be exerted in the coming years on the sectors that are hardly concerned by the current reform.

We will first recall the logic of the negotiating positions of the two main players in the Uruguay Round, the United States and the EEC, before assessing the impact of the reform, based on scenarios for the 1996 horizon. We will discuss the scope of the reform at the community, French and international levels.

The first American proposal in the Uruguay Round, or ‘zero option’, was put on the negotiating table in 1987, aimed at a complete elimination of support for agriculture by the year 2000. It was immediately rejected by the EEC because it led to a dismantling of the basic principles of the CAP: high domestic prices disconnected from World prices and levies and variable refunds system. The EEC proposed, in response, to adopt a two-step process: short-term actions to stabilise the most unbalanced markets and prevent these imbalances from becoming worse; and reductions in longer-term support levels, measured using the Global Measurement of Support indicator.

The proposals of these two actors evolved in the direction of a ‘certain’ rapprochement; they remain nevertheless, quite distinct because each of them is inspired always by the same logic as at the beginning of the cycle: simultaneous commitments on all policies for the United States, commitment to the sole reduction of domestic support and refusal of a specific prohibition of export aid for the Community. The permanence of these positions of principle explains the impossibility of finding a compromise acceptable to both contracting parties. It also explains the favourable reception by the United States of the various compromises, especially the latest Dunkel compromise, which gave pride of place to American positions, and their refusal by the Community.

A detailed examination of the economic and political bases of the positions of the two actors then makes it possible to better understand their proposals, to identify the main points of disagreement and to the outline contours of a possible compromise. The major concern of the United States is to mitigate, and if possible reverse, the negative consequences of the CAP on trade in grain and animal feed ingredients, the main US export interests.

The United States never really accepted the principles of the Common Agricultural Policy, mainly because a high level of Community protection on cereals meant a reduction in this market. They have always considered the Community mechanism of variable levies and refunds as contrary to GATT rules. They also sought preferential access to the Community market (unsuccessful during the first enlargement of the EEC, but successfully with the entry of Spain and Portugal). US commercial interests in meal protein and corn byproducts are also closely linked to the Community grain policy. These products are exempt from import duties on entry into the Community. These exemptions represent earlier concessions made by the EEC under the GATT which, at the time of their signatures, did not appear to be important but, over time, have had far-reaching consequences. The gap between domestic prices of cereals and world prices of other ingredients in animal feed has indeed favoured substitution between these two types of products in feeds. In addition, the persistence of this gap has also influenced the evolution of animal feeding techniques, by promoting the use of protein meal and by-products, and by negatively affecting trends in the use of cereals for animal nutrition and positively those of imported products. Thus, from 1984/85 to 1990/91, the share of cereals in animal diets decreased from 56.9 to 49.0%, that of meal protein increased from 15.0 to 19.0%, and that of corn gluten feed increased from 3.0 to 4.1% [Agra Europe, 1 November 1991]. The importance of the Community market and the desire to maintain the pressure on C MO Cereals explain the United States' constant refusal to harmonise Community protection on these products, either by taxation or by setting import quotas. They also explain the US concern to limit the development of the EU oilseed sector. This could only be achieved at the cost of a considerable increase in expenditure (ECU 3.4 billion in 1990). This aid system was the subject of an unfavourable Community arbitration by a panel of the GATT at the end of 1989.

Even if there is in the United States, at least in some circles, a desire to reform more their own agricultural policy generally in the current negotiations, their commercial interests and comparative advantages over grains and oil seeds explain their commitment to separate import access policies, export competition and domestic support. This concern is still reflected in the latest US proposal.

The Community's defensive attitude to the GATT is driven more by internal concerns -correcting the consequences of past agricultural policy decisions - than by commercial interests. Measures taken since 1984 (introduction of milk quotas in April), and especially since the Summit of Brussels February 1988 (restrictive price policy, co-responsibility taxes applied to cereals and milk, mechanism of the Budget Stabilisers based on Maximum Quantities Guarantees for cereals and oilseed crops, etc.), have the primary objective of curbing growth in the spending budget. The Community's proposals seek therefore to preserve the principles of the CAP and, to correct if possible, some of the perverse effects of concessions made in previous rounds.

The EEC has always considered that the CAP was not negotiable and rejected the principle of separate negotiations on export competition policies, access to imports and domestic support. In particular, as the mechanism of levies and variable refunds is a logical consequence of domestic policies, the reduction of domestic support will have to automatically reduce protection and export subsidies. As a result, the EEC agreed to negotiate the reduction of domestic support, as measured by the Global Support Measure, but rejected the principle of specific commitments on export subsidies. The pricing advocated by the United States was also rejected, again because it implied a challenge to the mechanism of variable levies. The Community then proposed a ‘different pricing procedure’ with maintaining a certain variability of protection and rebalancing on products for which the Community considered protection too weak. The tariffs advocated by the Community clearly illustrate its concern not to call into question the foundations of the CAP and to correct the negative effects of previous decisions. In fact, the management costs of the cereals markets and oilseed crops largely explain the Community's desire to ‘complete’ the Common Agricultural Policy on the different ingredients of animal feed. Attempts to introduce a tax on oils and vegetable fats were unsuccessful. This objective was quickly replaced by that of a harmonisation of the protection, the reduction of support then appearing as a concession to the taxation of these imports.

The Community position during the Uruguay Round is, moreover, consistent with that adopted in previous cycles, and particularly during the Kennedy Round, when the Community wanted the various contracting parties to agree to negotiate a ‘certain’ reduction in the ‘amount of support’. The United States had rejected this offer, considering that it allowed the EEC to legitimise the mechanism of variable levies and restitutions and to maintain a high level of protection. The US interest would undoubtedly have been to adopt a more flexible attitude by agreeing to negotiate the reduction of the amount of support, which would at least have made it possible to constrain the further developments of the CAP. The logic of the Community position is reflected in its proposal November 1990.

The Community refusal of compromises in the GATT The points of disagreement between the two main negotiating are therefore still parties very numerous today, neither of them having accepted to make, pursued, United States, of policy internal for the EEC. The Ministerial Conference in Brussels from 3 to 7 December 1990, which was supposed to close the eighth round of the GATT negotiations, ended in failure, despite the final attempt of the Swedish Minister of Agriculture, Mat Hellstrom. The Community rejected the Hellstrom compromise, which, in its view, was too close to the US theses by explicitly recognising the need for specific commitments in the three areas of domestic support, subsidies export and access to imports.

The GATT negotiations were still deadlocked at the end of 1991. The United States had certainly adopted a less intransigent stance, accepting for example a reduction in export subsidies limited to 35% [Agra Europe, 6 December 1991]. The Commission of the European Communities, for its part, and despite the protest of several Member States (France in particular), admitted in February 1991 the principle of binding commitments specific on three aspects of the negotiation. Nevertheless, the United States and the EEC remained divided on pricing, rebalancing, the reduction of export subsidies, the classification of support measures in the various tolerance categories, the inclusion of credit for measures taken unilaterally since the beginning of the cycle, and the maintenance of unilateral retaliatory measures by the United States (Section 301 of the Trade Act).

GATT Secretary-General Arthur Dunkel, acting as Chairman of the Trade Negotiations Group, was supposed to close the talks by the spring of 1992. We know that this was not the case, since the Dunkel compromise was rejected earlier on 23 December 1991 by the Council of Ministers of the Community as it was, like the previous ones, considered to be a fine balance in favour of US theses. This text is, however, the basic document of the current discussions. It clearly shows that the measures envisaged correspond to a significant weakening of the ambitious ministerial declaration of Punta del Este, which is far from the initial objective which was 'the completion of greater trade liberalisation'. However, it opens the way to a minimum agreement, as the CAP reform partly meets the proposed commitments. The Community's desire to reform the Common Agricultural Policy, outside the framework of the GATT and without waiting for the outcome of the cycle to be known, is indeed the major event that has changed the game of negotiation by allowing the Community to take the initiative for the first time since 1986.

The Community initiative for the reform of the CAP deficit in most agricultural products at the time of its creation, the EEC quickly reached, then passed, self-sufficiency in temperate zone products thus ensuring the security of its supplies, that is to say one of the initial objectives of the Treaty of Rome (Article 39). The mechanisms set up in a net import regime, which are part of a policy of import substitution, that could be reformed in time to handle a situation of growing structural surplus, highlighting a number of perverse effects at the level and hierarchy of community prices (Demarty , Delache and Deroin-Thévenin , Leon and Mahé , Burrel, Buckwell , Guyomard and Mahé). the Commission also recognised the urgent need for reform, based on the following observation - guarantees existing prices, directly related to production, lead therefore to an increase production -the only way to absorb the additional production would be to increase intervention stocks - already overcrowded - or export to world markets already oversupplied -current mechanisms necessarily serve to incite increases re intensity and volume of production, leading to increased risks to the environment; - the rapid increase in budgetary expenditure, which largely benefits a small minority of farms, does not solve the inherent problems in agricultural income in general. In light of this analysis, the Commission proposed, first in February 1991, then in July of the same year, objectives and guidelines for the future Common Agricultural Policy, and far from suppressing intervention and liberalising agricultural markets, the project was definitely opening a new era in the design of agricultural intervention in the Community, in particular by means of a reorientation of support for the factors of production and at the expense of the prices of products. The text finally adopted in May 1992 is certainly substantially the original project, particularly with regard to the objective of refocusing support on small producers, but the Commission's philosophy is partly preserved.

The CAP reform addresses the problems of the agricultural sector in a holistic way, but it is obviously focused on cereals, which play a central role. The logic of the reform is therefore clear and can be summarised by the following sequence: - a significant and rapid decline in the price of cereals is necessary to regain the internal market, and in particular the most elastic outlet, that of the 'animal feed; - this reduction, offset by the offer for cultivated areas by a system of flat-rate aid per hectare, should encourage producers to opt for less intensive farming techniques, which should slow down the increase in yields, and therefore of the production.

The reform of the oilseed CMOs is closely linked to that of the CMO cereals, the objective being that there is no particular incentive to opt for one production at the expense of another. Support is also provided by an aid system. The fall in the price of animal feed should benefit in the first place the production of pigs, poultry and eggs and, to a lesser extent, those of beef, sheep and milk. For these three products, the advantage linked to the fall in cereal prices will depend on the rate of incorporation of into fall the rations (and the possible decline in the cost of land): the most extensive livestock producers will therefore have a lower price benefit from the decrease in the price of cereals. Aid for cattle (beef and sheep meat) is therefore modulated according to size criteria (herds) and extensification (loading per hectare). The drop in prices of imported ingredients for animal feed, induced by the reform itself, should reinforce the drop in livestock costs.

Finally, the reform does not affect the other sectors (milk), or not at all (sugar), but subsequent adjustments are announced. Decisions in May 1992 call into question some of the initial Commission proposals. Although the spirit and logic of the initial proposals of the Commission have been maintained, the reform adopted in May represents a challenge to some the modalities of the February 1991 and July 1991 projects, which are more ambitious and more consistent with the long-term objectives of an agricultural policy adapted to the requirements of a post-industrial economy.

In the July 1991 draft, the modulation of aid for cultivated areas disappears. A modulation of the set-aside compensation is however maintained. The compensation is finally the same for all the frozen hectares, whatever the size, in the reform decided last May. In the Commission's proposals, budgeting and individual modulation of support income was a major novelty, breaking with the tradition of price support. Indeed, one of the paradoxes of these proposals is that they were, in large part, a response to the explosion of budgetary costs, but that they led, at least in the short term, to an increase in expenditure because from the transfer of the weight of consumer and user support to taxpayers. The individual modulation of the aid according to size criteria of farms and herds and loading limits tried to remedy this by reducing the budgetary cost of the reform, as well as the inequality of the redistributive effects of the CAP.

While some budgeting of support is maintained in the CAP reform adopted last May, the modulation of the latter is practically totally eliminated. More generally, the changes to the Commission's July 1991 text correspond to attenuations of the original proposals: for cereals, a price reduction of 29% instead of 35%; for milk, lowering the price of butter by two times 2.5% instead of three times 5%, no decrease in the price of the powder, and no predetermined reduction in the quotas; for beef and veal, removal under the load conditions threshold of eligibility for premiums of the exclusion(replaced by a capping threshold), reinforcement of premium levels and relaxation of payment criteria; payment of premiums for corn fodder, etc. These changes should result in a smaller reduction in Community agricultural income, but also in increased expenditure.

In addition, the fixing of base areas for field crops and reference herds by region for beef and sheep meat amounts to favouring present producers at the expense of entrants into the industry, and to freeze current structures by postponing some number of problems to the future, and in particular that of the mobility of these premium rights, which is necessary but insufficiently specified in the reform adopted and leaves some issues unresolved. Two main questions, inevitably related, remain: the permanence of direct aid amounts and the classification in the GATT of direct aids as decoupled instruments or not. The levels of the various direct aids are specified only during the transition phase, that is to say until 1997. No information is provided beyond this, and it is not clear whether the aid will be indexed to inflation rates, kept fixed in nominal terms or gradually reduced. The latter hypothesis would, presumably, make it possible to reach an agreement in the GATT insofar as the direct aid granted as compensation for the lowering of prices and the freezing of surfaces could then be placed in the 'blue box'. That is, allowed during the transition phase and then subject to reduction.

An initial analysis of the content of the reform certainly leads one to think that it is going in the right direction, but also to wonder if it goes far enough. Are the new signals sufficient to guide European agriculture towards greater economic efficiency, integrating environmental and spatial concerns and towards harmonious international integration?

Bibliography

BINSWANGER, HP.,. RUTTAN, VW., et al : Induced Innovation: Technology, Institutions and Development, The John Hopkins University Press, Baltimore and London, 1978.

BUCKWELL, A: European Agriculture in Transition, Wye College, University of London, United Kingdom, 1992.

BURELL, A: "The historical and political context of the reform of the CAP and the proposals of Commissioner Sharry", French Society of Economy Rural, Montpellier, November 1991.

CARD: Determining Winners and Losers from a GATT Agreement: The Importance of Basic Periods and Rules, Iowa State University, Ames, GATT Research Paper, 1991.

Commission of the European Communities: The Commission's Proposals for the Development and Future of the Common Agricultural Policy: Reflection Paper, C0M (91) 100 final, 1991.

Commission of the European Communities: The Development and Future of the Common Agricultural Policy, COM (91) 258 final, 1991.

Council of the European Communities, General Secretariat, 1579 Council meeting, Communication to the press, 6539/92 (Presse 85), 1992.

DELACHE, X. and DEROIN-THEVENIN, M: "The reforms of the Common Agricultural Policy: balance economic and prospects for France" , Economy and Forecasting, No. 91, pp. 101-107, 1989.

DEMARTY, J.L: "The Common Agricultural Policy at the Crossroads", Prospective Economics International, No. 35, pp. 27-37, 1988.

FOCUS, GATT Newsletter, various issues.

JOSLING, TE., SANDERSON, FH. and WARLEY, T K. : "The Future of International Agriculture Relations: Issues in the GATT Negotiations," In Agricultural Protectionism in the Industrial World, Sanderson FH Ed., Resources for the Future, Washington DC, 1990.

SENAT, Committee on Economic Affairs and Planning: Information Report, No. 254, Paris, 1992.

SURRY, Y: "A model for the transmission of guaranteed grain prices in the European Economic Community ", Cahiers d'Economie et Sociologie Rurales, No. 22, pp. 9-35, 1992.

TRACY: Agriculture in Western Europe: Challenge and Response 1880-1980, Granada Publishing, 1992.