

*IPC Position Paper No. 5*

## **The Role of Regionalism in Agricultural Trade Reform**

*Published by the  
International Policy Council  
on Agriculture, Food and Trade  
Washington, D.C.  
June, 1998*

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The views expressed in this position paper are those of the members of the International Policy Council on Agriculture, Food and Trade.

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## **Preface**

The IPC has been discussing the issue of regional trading arrangements within the context of the multilateral system. The topic was featured at the 17th IPC Plenary Meeting in Brussels, Belgium in May of that year, and was part of the discussions at its 18th IPC Plenary Meeting and Seminar in Calgary, Canada in October. The subject took front stage in the deliberations when the Council held the 19th IPC Plenary Meeting and Seminar in May, 1997 at the time of the IV E of the Americas in Belo Horizonte, Brazil, held to discuss the Free Trade Area of the Americas (FTAA).

A draft paper was then developed in the early months of 1998 and presented for discussion at the IPC semi-annual meeting on *FTAA, APEC and Agricultural Trade Reform*, held May 21, 1998 in Washington, DC. The final draft received the endorsement of the IPC membership at the 21st IPC Plenary Meeting, May 22, in Washington, DC.

The IPC is very grateful to Tim Josling for writing and revising the paper. It would also like to thank Rolf M. Zeeuw, Sir Michael Franklin and Peter Lacy for their help editing it. The paper reflects the views of the IPC on regional trade arrangements and should not be attributed to any other organization or individual.

## Overview

Regional trade pacts are emerging in every corner of the globe, raising numerous questions about their effect on regional and international agricultural trade. The most significant of these are whether they threaten to detract attention from the more important task of multilateral trade liberalization in agriculture and whether such arrangements risk encouraging high-cost trade within the regions involved. With another round of trade talks scheduled to start soon in the WTO, it is important to ensure that regional FTAs complement these negotiations and that the multilateral system is given highest priority.

The present position paper by the International Policy Council on Agriculture, Food and Trade (IPC) attempts to set out a strategy for the incorporation of regional trade pacts into the ongoing process of trade liberalization. It reviews the progress in agricultural trade liberalization at the regional level, with special attention given to APEC, the FTAA, the EU and the Transatlantic Agenda, and makes recommendations for how the regional and multilateral approaches can develop in a compatible fashion.

The paper argues that agriculture must play its full part in regional trade liberalization, while avoiding conflict with the WTO. Quantitative restrictions on internal trade within FTAs should be removed and the use of export subsidies and internal supports should be restricted. The question of the complementarity between the two approaches can be addressed by applying more rigorously the existing WTO rules on the acceptability of free trade areas and customs unions; requiring countries participating in FTAs to ensure that third parties are not adversely affected; binding the common external tariffs of trade blocs into the WTO schedules of commitments; and having the WTO Committees on Agriculture and Regional Trade Agreements closely monitor the activities of these blocs. The multilateral system must make use of the potential inherent in the recent phenomenon that has seen networks being set up between regional FTAs, while avoiding their pitfalls.

In these ways, and by respecting the priority of the multilateral system, the IPC believes that regional trade liberalization can play a constructive role in helping bring about a more liberal trading system in agricultural and food products.

## **Introduction**

The recent growth of regional trade pacts poses a significant challenge for agricultural trade policy and for the process of multilateral trade liberalization. These regional pacts threaten to detract attention from the task of multilateral trade reform. In addition, there is the danger that they encourage high-cost trade within regions. In the past, most regional trade agreements left agricultural goods out of their free-trade provisions, or included them only in limited ways, in deference to the political sensitivity of the sector and the potential for conflict with domestic policy objectives. Under these circumstances they had less impact on the multilateral system. However, this situation is changing, with the newer agreements including agriculture to an increasing extent. The potential for conflict with the global trade system is thus increasing. With a new set of trade talks starting soon in the WTO it is important to ensure that the regional agreements complement rather than compete with these negotiations.

In the Americas, the change to include agriculture in regional trade pacts is most noticeable. MERCOSUR, the Andean Pact and CARICOM all include agriculture in their free trade provisions, with relatively few exceptions. NAFTA also envisages a free market in agricultural goods between the US and Mexico, though for several products Canada would not be part of this market. The Free Trade Area for the Americas (FTAA), which is intended to consolidate these and other regional pacts in the Western Hemisphere, also is scheduled to include agricultural products and thus lead toward a single market in the hemisphere by the year 2005.

In Europe, the trend is less noticeable. The countries of Central Europe have included agriculture fully in the Baltic Free Trade Area (BFTA) and in a more limited way in the Central European Free Trade Area (CEFTA). In all agreements involving the EU, agriculture is still treated as being outside the realm of unrestricted free trade. The Europe Agreements, which aim for free trade between the Central and Eastern European countries and the EU, include agriculture but with quantitative limits on the most important products in order to preserve the operation of the Common Agricultural Policy (CAP). When these countries become members of the EU they will fall within the orbit of the CAP. There is no free trade in agriculture under the customs union with Turkey, the Euro-Med agreement with countries in North Africa, the discussions with South Africa and MERCOSUR on free trade agreements, and the re-negotiation of the current Lomé agreement with the African, Caribbean and Pacific countries (ACP). Moreover, proposals for US-EU free trade talks have thus far excluded agriculture. The main reason why the incorporation of agriculture is more difficult than in the Americas is because of the CAP. The benefits of the high levels of support are limited to members and to certain developing countries.

In Asia, the process of including agriculture in freer regional trade has gone even less far: The countries of ASEAN have to date been unwilling to incorporate primary agriculture as an integral part of their planned free trade area (AFTA), though some food commodities are included in the preferential tariff scheme. Similarly, the South Asian Regional Cooperation Council (SARCC) has not succeeded in opening up agricultural trade in that part of the world.

However, the Closer Economic Relations Agreement (CER) between Australia and New Zealand now fully includes agricultural goods, even requiring some changes in domestic policy to make it possible. And the Asia Pacific Economic Cooperation process (APEC) does seem to be having some impact in persuading countries in Asia to contemplate the opening up of agricultural markets.

African free trade agreements have generally included provision for freer trade in agricultural goods, as these cover a large share of trade for the countries involved. However a variety of revenue duties and informal restrictions to trade, coupled with extensive parastatal control over many of the export commodities, have made agricultural trade less than free, even when no tariff restrictions apply. Thus the longer-established agreements such as the Economic Community of West African States (ECOWAS) have not had a great deal of impact on trade flows in the region. One emerging group, those participating in the South African Development Community (SADC), may have the potential to stimulate profitable regional trade as a complement to liberal access for low-cost food and feed from outside the region.

Whether or not agriculture is included in such regional agreements has therefore become an important issue for the global trade system. To the extent that these agreements include agriculture, this gives them a new significance in the process of liberalizing agricultural trade. It also necessitates a sustained effort of coordination with the multilateral process in order to avoid detracting from the more fundamental objective of multilateral trade liberalization. To the extent that agriculture is excluded from these agreements, different concerns apply. In such cases, the sector is likely to remain protected by domestic and trade policies for even longer if it can resist improved access to regional trade partners. Moreover, the agricultural and food processing system will tend to remain localized, servicing domestic production often at a high cost and being protected from international competition.

To the extent that multilateral trade negotiations continue to bring down levels of protection in agricultural markets, both the benefits and disadvantages of alternative treatments of agriculture within free trade areas will be diminished over time. With free international trade the issue of regional preferences is moot. However, the level of protection for agricultural goods is likely to remain high for some time to come. The question of the treatment of agriculture within FTAs is therefore very relevant for the next round of trade negotiations. Now is the time to set a strategy for the incorporation of regional trade pacts in the ongoing process of liberalization.

The International Policy Council on Agriculture, Food and Trade (IPC) has been actively involved in both regional and multilateral strategies for liberalization of agricultural trade. In May, 1997, at the time of the Belo Horizonte, Brazil meeting of the trade ministers of the Americas, the IPC issued a statement urging countries in the Americas to ensure that agriculture was fully included in discussions for such regional initiatives as the Free Trade Area for the Americas. Later that year, at its annual meeting in the Hague, the IPC reinforced this message by pointing out that trade liberalization within regions should proceed within the framework of the WTO, which has rules for such deviations from the principle of non-discrimination. This statement also emphasized that the process of negotiating regional FTAs should not undermine

the global trade talks nor detract attention from them. The IPC argued that agriculture must play its full part in both types of trade liberalization.

The IPC believes that the process of regional free trade negotiations will continue, for reasons largely unconnected with agriculture. Given that regional markets will tend to consolidate, it is indeed desirable to make sure that agriculture is not left outside this process. To do so would reinforce the isolation of national agricultural sectors. A fundamental IPC objective is the development of an efficient and effective global food and agricultural system which will best serve the needs of all countries. Such a system must be built on sound global rules which do not perpetuate costly regional discrimination. The purpose of the present paper therefore is to review the progress in agricultural trade liberalization at the regional level and to make recommendations for how the regional and multilateral approaches can develop in a compatible fashion, with special attention given to the FTAA, APEC, the trade network of the EU and the Transatlantic Agenda.

### **The Dilemma of Regionalism and Agriculture**

The heart of the dilemma posed by regional trade pacts is the question of trade creation versus trade diversion. The costs and benefits of including agriculture rest in large part on the magnitude of these two effects. To the extent the reduced protection creates trade, it is an improvement. The potential drawback lies with the risk that the new supplier may not be the most efficient supplier. This diversion of trade away from other suppliers limits the benefits to the importing country and may even negate any economic advantage from the liberalization measure. The potential distortions in trade patterns arising from trade diversion have been the main reason why regional trade agreements are treated with caution. However, these regional trade pacts are allowed under the rules of the WTO.<sup>1</sup> Most of the current WTO members belong to such pacts, and their number and scope is increasing.

There are many reasons why countries engage in regional trade agreements: for security and foreign policy considerations, as part of a process of political integration, in order to preserve good trade relations with countries from which they are separating their economies after a period of political integration, to expand markets and derive some degree of security of access, or out of fear of being left behind as other countries join such groups. Given the range of motives and circumstances it would clearly be politically unwise for the multilateral system to ignore such regional initiatives. It can and should, however, define clearly the conditions under which such regional market integration should take place so as to avoid conflicts with broader trade liberalization.

#### *Agriculture: In or Out?*

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<sup>1</sup> Article XXIV of the GATT (now part of the WTO rules) allows free trade areas and customs unions as exceptions to the Most Favored Nation rule (MFN) so long as the free trade covers substantially all trade and does not put up trade barriers with other countries. When tariffs are raised as a part of moving to a customs union, compensation can be negotiated between the parties concerned.

Assuming regional trade blocs continue to flourish, an important issue is whether the agricultural sector should be included in the arrangements. To leave out such an important sector of the economy would have serious implications, but to include it may threaten the viability of the trade bloc itself. There are four major reasons to include agricultural commodities in the provisions of an FTA:

- Exporters within the region will demand improved access to import markets for their agricultural goods;
- Food cost differences among countries within an FTA will both distort trade and investment patterns and cause problems of wage comparability. Such cost differences will eventually become a cause of contention between the partners;
- If agriculture is excluded, the food sector will tend to remain national in scope and have less reason to become internationally competitive; and
- To exclude agriculture leaves countries open to challenge under the WTO (Article XXIV of the GATT, incorporated in the WTO, requires that such agreements cover essentially all trade among the partners).

There are in essence only two reasons to exclude agriculture from FTAs. In the past, much of the trade in agricultural goods came from other continents where climatic and natural resource conditions are different. Though this is less true now, it is still the case that agricultural goods tend to travel longer distances in trade. If all “efficient” suppliers of a commodity are outside the proposed FTA then it may be economically sensible to exclude that commodity from free internal trade. But the danger is that the sector may then be even less prepared for competition from third countries. Excluding it on these grounds should go hand-in-hand with reducing trade barriers to agricultural imports from third countries. In practice this is probably not the main reason why governments have sought to exclude agriculture from the provisions of free-trade areas.

The second, more important, reason has to do with the administration of policies. Most domestic agricultural price policies require protection at the border in order to be effective. As a consequence, regional free trade poses a threat to the operation of such programs. Negotiations of freer trade are therefore likely to be complicated or even derailed by domestic farm policy considerations.

If the inclusion of agriculture is indeed a threat to the workings of domestic policy, then one can legitimately ask whether this “threat” is not itself a constructive pressure for change. There are certain direct effects of regional trade agreements on domestic agricultural policies which help to push the countries concerned in the direction of policy reform. Once trade is liberalized within a region, the degree of competition becomes a matter of interest for the member countries. Subsidies clearly distort competition and are unpopular, leading to pressures to remove them, at least on goods marketed within the region. Different marketing systems may create problems, in particular if some of them appear to offer the possibility of hidden subsidies. This may put pressure on some countries to modify their parastatal marketing institutions. Thus,

there is a case for insisting on freer regional agricultural trade in FTAs partly to challenge the ability of countries to distort their domestic market.

However, many countries in recent years have moved away from the management of agricultural commodity markets in favor of such instruments as direct payments to farmers. While this has removed some of the obstacles to the incorporation of agriculture in FTAs, the decision taken in the Uruguay Round trade negotiations to implement TRQs in conjunction with tariffication, as a way of opening up markets, complicates the process of improving access within free trade areas.

### *Long-term Effects on Domestic Policies*

In addition to the challenge posed to agricultural market management by free regional trade, regional agreements also have an indirect effect on agricultural policy reform through the impact of liberalization on the effectiveness of policy. The result of this impact may be harmonization, common policy instruments, or even the abandonment of policies.

Harmonization could result because countries would want to avoid customs difficulties and develop common external tariffs to prevent trade deflection. Common policy instruments may develop since having a free border with a large neighbor is in effect to take on their tariff structure when lower than one's own. Moreover, it has long been recognized that some form of border protection (usually in the form of an import quota) is needed to make supply control effective. If the regional trade agreement removes such external protection, then such control is rendered ineffective. Such policies are made less effective or more costly by the existence of a free intra-regional market. This indirect impact may in the longer run prove to be the most significant link between regional trade agreements and the changes in domestic agricultural policies.

### **The Response of the Multilateral System**

The interaction between the regional and the multilateral trade liberalization process is clearly one of the most important structural issues facing the WTO. It was initially feared that the spread of regional trade pacts would threaten the multilateral system. At the low point of the GATT negotiations, in 1991, there appeared to be a distinct possibility that the world trading system was moving towards one of competing trade blocs. The most common scenario projected a European Bloc, based on an expanded European Community, an American Bloc, built on the US, and an Asian Bloc, with Japan as the key economy. The prospect of such a scenario caused considerable concern that it might jeopardize the Uruguay Round itself by holding out the prospect of an alternative to the GATT system. One negative feature of such blocs was their presumed propensity to exclude or discriminate against trade or investment flows from each other. Trade wars could easily erupt under such circumstances, to the particular disadvantage of the smaller countries within the blocs. Countries outside the blocs would presumably hasten to be included, to at least get some shelter from the trade hostilities.



Success in the Uruguay Round has eased the fears on this score: the strengthened multilateral system represented by the WTO offers some defense against the possibility of warring continental blocs. Despite the risks associated with setting up regional preferences, the consensus now appears to be that no great damage has yet been done. Most of the recent regional trade agreements, in particular those conceived under the rubric of “open regionalism,” conform with the requirements in the WTO that they cover most traded commodities and do not involve an increase in tariffs applied against non-members.<sup>2</sup> As most of them have been formed in conjunction with liberalization of external trade, they might reasonably be expected to promote efficiency rather than shelter inefficiency. However, concerns remain that the proliferation of such agreements can impede multilateral liberalization and impede world trade. Furthermore, such technical devices as “rules of origin” can be used for protectionist purposes. There is therefore a strong case for examining the conditions under which the two trade policy strategies of regionalism and multilateralism can be made to work in harmony in the direction of an improved global system of agricultural trade.

### *Maximizing the Benefits and Minimizing the Costs*

One way to maximize the chances of trade creation and to minimize the chance that a trade agreement diverts trade is to encourage a reduction of external protection for both the importer and the exporter at the same time as the inclusion of agriculture in the FTA. This can either be done jointly through agreement with other members on external protection, in the case of a customs union, or independently through unilateral liberalization in the case of a free trade area. Multilateral negotiations become the best way to keep down the level of protection against non-partner imports so as to avoid trade diversion. If both internal and external protection are progressively removed the regional and the multilateral paths in effect go hand-in-hand toward the same goal.

The number of countries that are involved in a free trade area also makes a difference for the likelihood of trade diversion. The wider the geographical range of the regional trade bloc the more likely it is that “natural” trade partners (i.e. those that can supply goods at the lowest cost without the aid of subsidies or preferences) will be included in the same bloc, and hence trade diversion will not be a problem. Trade blocs should therefore pursue expansion when acceptable candidates present themselves.

### *Making Use of Regional Opportunities*

Just as the global system has to search for rules which encourage efficient agricultural production to the ultimate benefit of consumers, so regional trade has to come to grips with trade rules internally which avoid conflict and promote “efficient” production and distribution. Though tariffs are usually set at zero on trade within the region, other trade impediments can

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<sup>2</sup> “Open regionalism” is a phrase that has come to be used for some combination of low external protection and open membership and in addition meets the demands of the WTO, namely conformity with Article XXIV of the GATT (Bergsten, 1997).

persist. The question is whether the regional agreements can solve these trade conflicts, and if so whether the solution is likely to be in the interests of the multilateral system. It would seem that the range of solutions to problems within free trade areas are very similar to those which would strengthen the multilateral system. These include converting non-tariff import barriers to tariffs, restricting the use of export subsidies, limiting domestic subsidies to those that do not distort trade, and improving the compatibility of standards and regulations so as not to constitute undue impediments to trade.

Some of these can indeed be tackled effectively at the regional level. Quantitative restrictions on internal trade have usually been removed within free trade areas as they are seen as preventing the development of integrated regional markets, as took place in NAFTA. But such QRs are now also outlawed by the WTO, and so should no longer pose a problem. In their place have come the TRQs, both in regional trade agreements and as a result of the Uruguay Round, where they often accompanied tariffication to preserve or create some market access. These TRQs need to be expanded steadily over time to allow trade to increase. To the extent that they are increased within regional blocs the degree of preference will tend to rise. TRQs on third country imports should also be increased so as to avoid potential distortions of trade.<sup>3</sup>

The need for regional trade pacts to deal with internal export subsidies is that internal competition will be distorted by the use of such subsidies. There will thus be a tendency over time to phase these subsidies out regionally. However this is likely to be a slow and uncertain way to deal with the problem of export subsidies, and so this is an area where strong multilateral action is likely to be more effective.

By contrast, domestic subsidies may well be easier to deal with at the regional level. As these subsidies tend to distort competition within the region, there will be pressure to remove them or make them trade neutral (i.e., decoupled from output). This will bring them in line with the WTO green box criteria. In other words, both regional and multilateral pressures act in the same direction and their resolution is mutually reinforcing. Unless countries try to devise ways to distinguish payments from production destined for the regional market from that competing with third countries, a scheme which would be difficult to enforce and of dubious legality under the WTO, the regional approach in this case poses no threat to the multilateral.

As for sanitary and phytosanitary standards, it seems very likely that regional trade blocs will be tempted to increasingly develop their own rules on standards and health and safety regulations. Not only are differences in these standards a potent source of trade conflict, but companies will insist on the reduction of unnecessary duplication of paperwork, product testing, and regulatory approval which follows from having different standards in a free trade area. This could be detrimental to the elaboration of global standards and could disrupt international trade. Hence the further development of international standards remains important, to avoid competing

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<sup>3</sup> The importance of expanding TRQs in the context of the next Round of trade negotiations is emphasized in Josling (1998).

standards in different trade blocs. Although in the absence of international standards, however, it is likely that some of the regional standards will become *de facto* global norms, this is another case where international leadership is desirable to forestall any discrimination among regional blocs.

### *Strengthening the Multilateral Response*

Four possible ways can be distinguished to strengthen the complementarity between regional and global trade rules. Each of these steps supports the multilateral system without provoking a direct clash with the forces which are working for regional trade integration.

First, the existing WTO rules on the acceptability of free trade areas and customs unions should be applied more rigorously. The requirement that “substantially all trade” be covered should be clarified. Omitting a major sector of the economy such as agriculture should not be possible, and even omitting a handful of sensitive commodities should only be allowed if the existing (and potential) trade in those products is negligible. Moreover, the rule could be further strengthened by agreeing that the exemption is of a temporary nature, and that in time all trade would be covered. In this way the waiver from the application of “most favored treatment” for free trade areas and customs unions in Article XXIV could be seen as depending on a comprehensive merging of national markets rather than a selective liberalization of those that are less sensitive.

Second, as a condition of the free trade area or customs union being accepted by other WTO members, the countries participating should be required to ensure that other countries are not adversely affected. This should be done primarily through reductions in the tariff levels against third countries. Presently, countries can ask for compensation if tariffs go up, but the most common cause of trade diversion arises from a switch in suppliers which can take place even if no tariffs increase. It would be useful to require reduction in applied tariffs when regional trade blocs are set up or expanded.

The third useful step involves economizing on scarce resources. In most cases, countries which are members of regional trade groupings, even customs unions, still negotiate in the WTO as independent countries. Tariff schedules bound in the WTO are in almost all cases also national.<sup>4</sup> It might help to reconcile global and regional trade liberalization processes if countries bound the common external tariffs of their trade blocs (where they exist) in the WTO schedules of commitments. These are often lower than the tariffs bound in the schedules for the individual member countries. This would help build the regional process into the multilateral, by giving the common external tariffs some international significance.

How far should one go in supporting the legitimacy of the regional trade bloc external policies? Should trade blocs be encouraged to negotiate as single units? If so, the impact on the

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<sup>4</sup>The European Union has a single tariff schedule, and negotiates as a unit. But members of other trade blocs behave in Geneva as if they had no obligations to the bloc.

negotiations would be two-fold. It would reduce the number of participants in the talks, presumably making progress easier. But it would put a premium on the blocs being able to come to a common position and being able to change that position as negotiations proceeded. But the direct negotiation on the policies of groups would have the very salutary effect of putting the spotlight on them rather than on the individual countries that make up these blocs. Eventually this type of recognition of their significance in the multilateral system is inevitable.

The fourth step that could usefully be taken at the multilateral level is to ask the Committee on Agriculture, in conjunction with the Committee that oversees free trade areas and customs unions, to report on the activities of these blocs in the light of the process of multilateral trade reform. Such reporting could include monitoring of trade flows and preference levels, as well as policy changes which have significance for the multilateral system. Circumstances where a conflict between regional and global liberalization and trade reform is likely could be identified and discussed. Trade blocs would in this way be obliged to defend their actions in the light of the application of global rules and objectives. Other countries would have an opportunity to question such developments rather than relying exclusively on the dispute settlement process to challenge cases of conflicts. Such additional ongoing scrutiny would greatly improve understanding about the magnitude of the conflict between regional and multilateral trade processes and rules in agriculture.

### **The Contribution of Free-Trade Networks**

A new set of trade pacts emerged in the 1990s which could be called free-trade networks (FTN), with the characteristic that they were not confined to single geographic regions. This new breed of supra-regional FTNs includes both APEC and the FTAA. These are different from traditional regional trade blocs in that they have overlapping membership (several countries participate in both) and hence join rather than isolate continents. Moreover, they can include both countries and existing trade agreements as components. In this way they build on current agreements (FTAA) or are neutral toward them (APEC, which includes members of ASEAN, the CER, Mercosur and NAFTA). Though they differ among themselves in certain crucial ways, in particular in their treatment of trade with third countries, the FTAA and APEC both represent new ways of negotiating reductions in trade barriers.

One rather less formal variant is the “New Transatlantic Agenda” agreed in 1995 between the EU and the US, which at present is concerned with such issues as mutual recognition of standards and testing. This could over time become a pre-cursor to a more formal trade agreement between the US, Canada and the EU. The EU and the ASEAN countries have already been discussing informal trade agreements of their own, and the EU and MERCOSUR have been actively discussing a full free trade agreement.<sup>5</sup>

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<sup>5</sup> A free trade agreement between MERCOSUR and the EU could be signed in 1999, but several issues remain un-resolved. The extent to which agricultural goods are included is an obvious sticking point in these talks. To expect the EU to grant preferential access to Argentine and Brazilian farm products is unrealistic, but to exclude such goods would not satisfy the MERCOSUR countries and would be of dubious legality within

FTNs go some way toward addressing many observers' objections to the narrower regional blocs. They are large enough to contain low-cost suppliers of most products; they can absorb new members easily; and so far each has endeavored to comply with the WTO. In this sense they are each examples of "open regionalism." They do, however, still provide a challenge for the multilateral trade system, summed up in their application of the "most favored nation" principle. This challenge is even stronger than that of more limited regional groups because of their wider geographical reach. If they negotiate free trade among members and do not "multilateralize" the tariff reductions to other countries then they are behaving as regional blocs writ large. The FTAA is in this category, as are the networks being negotiated by the EU. But if they do extend the benefits to all WTO members they are in effect conducting multilateral negotiations, to the delight of "free riders" who pick up the gains but don't have to contribute to the tariff reductions themselves. Some have suggested that APEC adopt this "unconditional MFN" position. In reality, it is more likely that the MFN treatment will remain conditional on all beneficiaries contributing to the reduction of tariffs.<sup>6</sup>

Whatever the modality of negotiations, FTNs seem to have galvanized countries into making fairly precise commitments to future liberalization. For this reason the multilateral system needs to come to terms with free-trade networks and make use of their potential to go further than each of the component countries and trade blocs.

#### *Free-Trade Networks and Agriculture*

This new supra-regional FTN architecture is particularly interesting from the perspective of international trade in agricultural goods. Networks which span the regional blocs will not be able easily to dodge the issue of agriculture, as the problems of agricultural trade will tend to be internalized by the nature of the processes. The US, for example, could become a member of at least three trade pacts (the Americas, Asia-Pacific and Transatlantic) together covering all the major markets for its goods. One can hardly imagine political support for any agreement that excluded such a major sector of US exports.

Supra-regional trade networks do not in themselves solve the problem of the reluctance of importers to open up their markets. However, the political calculus might change enough for some serious liberalization to occur in agricultural markets as a result of such blocs. The US, for instance, will be in a stronger position to suggest major changes in farm product access in Asian countries if it offered benefits negotiated in APEC. Even domestic subsidies may be forced to conform with subsidy and competition rules within supra-regional agreements such as the FTAA. In each case the threat is of exclusion, and the cost of such exclusion could be high.

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the WTO.

<sup>6</sup> Thus APEC will offer to extend negotiated trade access to (say) Europe so long as Europe offers similar liberalization. If Europe agrees (along with other non-APEC countries) then the liberalization will have become "multilateral": if Europe declines the liberalization will have proved to be regional (and hence discriminatory) in scope. (See Bergsten, 1997b).

Despite some obvious dangers in this emerging trade architecture, it offers opportunities for freer agricultural trade on a regional basis. The challenge it provides is how to ensure that it leads in the end to freer agricultural trade world-wide.

### *The FTAA and Agriculture in the Americas*

The bold but optimistic target set by the countries of the Americas at the Miami Summit calls for a Free Trade Area of the Americas (FTAA) by 2005, one that would include removing agricultural trade barriers. This is not out of line with the plans of the individual regional trade agreements. By the year 2005 there should be virtually no agricultural trade barriers left between the US and Mexico, though Canada will have to catch up with that schedule by means of steep reductions in intra-NAFTA tariffs for some sensitive agricultural commodities. The same would be true in Latin America, Central America and the Caribbean, if current timetables for liberalization are followed.

The development of integrated regional agricultural markets in the Americas is in general a healthy outcome of the process of national trade and agricultural policy reform in the region, coupled with the formation or strengthening of regional trade agreements of the “open” variety. The degree of uneconomic trade diversion has been kept low by the reduction in external protection in many of the countries, particularly in Mexico and Latin America. External protection is also falling in the US and Canada, though this will need to be accelerated to assist the process of developing competitive industries on a regional basis. The region-wide development of agricultural markets is finding institutional expression in the FTAA discussions and the political will for this will be put to the test during the negotiations which started in April 1998 in Chile. Freer trade within the region should itself have a profound impact over time on the structure of the agricultural sector in the Americas and the policies that are employed to regulate and support it.

The task ahead for the FTAA in the agricultural area will involve some degree of coordination of domestic policies to prevent conflict in the region. But more important than coordination is agreement on the overall strategy to be pursued. This agreement should perhaps include the commitment to continue individual national reforms to free agriculture from the excessive attentions of the state; to stick to or accelerate the timetables established for intra-regional trade liberalization; to pursue the path of integration of the individual trade agreements in the Americas; and to develop a common approach to multilateral agricultural trade issues. The integration of agricultural markets in the Americas are likely to take imagination and political skill to line up support and overcome the opposition to such liberalization.

### *Integrating the Greater European Agricultural Market*

The European agricultural market is widening rapidly. Several of the countries of Central Europe will become members of the EU around the year 2003. If the same “instant accession” arrangements as were negotiated with the recent EFTA countries are followed, there could be a

single market in agriculture comprising perhaps 21 member states of the EU in Europe within five years.<sup>7</sup> This market will expand further as more countries of Central and Eastern European Countries join the EU.

Clearly, the most difficult challenge for the EU in the next decade is how to absorb up to 10 more countries from Central and Eastern Europe. These countries have low incomes at present (on average only eleven percent of the EU-15 average). But they have good potential for steady economic growth, and high expectations on the part of their consumers. The workers in these countries are potentially mobile and will undoubtedly come looking for jobs if none are available at home. The population in these ten countries is about 29 percent that of the EU-15. Thus the question is whether there will be enough economic growth in these economies that they become a source of employment, a magnet for both domestic and foreign investment and a buoyant market for goods from the EU-15.

All the changes will not be in the applicants economies. As integration takes place there will be pressure by producers in the present EU for relief from imports from the CEEC. Such 'sensitive' imports into the EU—including steel, textiles and agricultural goods—are already controlled by tariff quotas under the Europe Agreements. Everyone agrees that the markets must eventually be opened. But for the EU the extension of the CAP is a pre-condition to free circulation of agricultural goods, and the CAP applies only to members. This should, however, not prevent the EU from increasing access to its market. Too rapid an opening in advance of membership could provoke a backlash which would delay accession. Too slow a move to improve access to the EU increases the disillusion already felt in Central Europe about the willingness of the EU to take any political risks for the sake of securing democracy and establishing security. The nature of this challenge was recognized by the Commission in the Agenda 2000 report, which lays out a blueprint for adaptations in the CAP and other EU policies in anticipation of enlargement.

Enlargement negotiations have already started with those countries deemed to be most ready for accession. Transition partnerships have been devised for those not included in the first wave of new members. The process of convergence among the agricultural sectors of Europe will start well before entry. To this end, the Europe Agreements need to accelerate the increase in quotas on imports from the CEEC and improve the administration of those quotas so as to avoid giving so much of the benefits to the importers. The EU is already using the market access guarantees negotiated in the Uruguay Round to increase imports from the CEEC. The aim should be to move quickly to trade that is less restricted by quantitative barriers.

The tasks before the EU in preparing for entry are daunting, but feasible if the logic of the 1992 reform is applied and if further reforms have been enacted. The cereal price level for the expanded EU need not be different from the future reduced level for the current members. A

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<sup>7</sup> Some form of transition period is likely to have to be agreed to avoid too sharp a change in national price levels. But the Europe Agreements themselves are in effect allowing applicant countries to align their policies with those of the EU in advance of accession. See IPC, (1997c) for a full discussion of the agricultural issues involved in enlargement of the EU.

relatively light intervention system, at a low price level, coupled with a set of bound tariffs (and a maximum applied duty rate) for imports, should support the wider European market. The strategy should be to achieve the creation of an integrated Europe-wide agriculture sector as swiftly as possible, at a level of protection compatible with the EU's growing responsibility in world markets. This is one of the reasons why a continued reform of the CAP is necessary: to allow for a reasonably rapid CEEC accession. From the point of view of multilateral trade liberalization, early CAP reform is also the key to the EU taking a more positive and less defensive position in the 1999 Round.

In the longer run another set of issues will confront Europe as it expands to the east. The countries of the Former Soviet Union (FSU) have yet to take their full place in the global trade system. The trade relationships among these countries themselves are not yet settled, with several of the members of the Commonwealth of Independent States (CIS) agreeing to form a customs union in 1995 but little tangible progress having been made. Agricultural trade currently does not flow freely among these countries, hindering their attempts to develop competitive farm sectors and reliable food supplies. A Partnership and Cooperation Agreement between the Russia and the European Union has also been concluded which promises Russia *mfn* treatment for its exports to the EU, but this does not extend to preferential trade. Russia, the Ukraine and other countries in the region are currently applying to join the WTO, and this should be accomplished as soon as practicable in order to expand agreed trade rules to this important part of the world.

#### *Agriculture and the Transatlantic Agenda*

One of the most important tasks for the Transatlantic partnership may be to define and improve commercial relationships between the US and the EU. This issue has recently been revived by a Europe concerned that the US is drifting into isolationism or an obsession with Asia. As a result, there has been considerable discussion in the past decade on the need for a new Transatlantic Treaty to keep the US engaged in Europe. This Treaty, by common agreement, would have to have an economic component. What this economic component could be is less clear. Some have argued at various times for a Transatlantic Free Trade Area (TAFTA), but governments have not been willing to go this far.<sup>8</sup> Instead the EU and the US signed at the end of 1995 a joint declaration for a New Transatlantic Agenda, including an Action Plan which promises action on economic as well as security issues. More recently the issue has been raised again, with Sir Leon Brittan's call for a Transatlantic Marketplace and Frost's suggestion of a North Atlantic Economic Community (NATEC), an economic counterpart to NATO.<sup>9</sup> This latter formulation would apply the APEC approach to trade negotiations, encouraging others to join in the agreed liberalization to avoid the introduction of preferences from which they would be excluded.

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<sup>8</sup> Presumably, the enthusiasm for a TAFTA would rise again if APEC were to achieve trade liberalization within the Asia-Pacific region to the exclusion of Europe. The EU is unlikely to be willing to accept less favored access into the US market than that enjoyed by Japan.

<sup>9</sup> See Frost (1997) and also Stokes (1996).



Could such an agreement include anything meaningful on agricultural trade? In agriculture any discussion of US-EU relations carries with it the fear of failure and frustration, borne of the experience with the Uruguay Round and the previous twenty years of tension. The temptation to leave out agriculture from any transatlantic trade agreement will be great. Agriculture would obviously represent a possible sticking point in any FTA discussions. But difficult trade issues must be faced rather than avoided if the transatlantic agenda is to be credible. Political support for an agreement that omitted agriculture would be difficult to secure in the US. However, the opportunity should not be lost for an improvement in trade relations in such an important area. Indeed, if domestic policy trends continue in both the US and the EU, there could be the opportunity for dramatic change in trade relations in agriculture in the not-too-distant future. This could take the form of an agreement to mutually forswear the use of export subsidies in certain markets; an agreement on domestic policies that would make them consistent with the Green Box category of “decoupled” support; and an agreement on the mutual development of quality and health standards and on mutual recognition of each others sanitary and phytosanitary measures. However, care will have to be taken to resist the temptation to establish new trade preferences across the Atlantic.

### *Agriculture in the APEC Process*

In the Asia-Pacific region, the APEC (Asia-Pacific Economic Cooperation) process calls for “coordinated unilateral” trade liberalization, extended to non-APEC members through the “most-favored nation” rule of the WTO, by 2010 for developed and 2020 for developing countries. By that stage APEC itself could have expanded to include several more Latin American countries and may even have spread to South Asia. Agriculture is deliberately not excluded from this process, though some countries will have to change their levels of agricultural protection rather rapidly if this target is to be met.

The potential importance of APEC for agricultural trade reform should not be underestimated. By setting a date by which free trade is to be achieved, and by specifically rejecting the attempts of some members to exclude agriculture from the commitment, the APEC process has raised its sights beyond that of the WTO. When APEC was first discussed, few would have thought it likely that any meaningful agreement could have been negotiated in the area of agriculture. The question that therefore arises is how credible is it as an indication of what will actually happen.

The decision to move to free trade and investment among APEC members represents a triumph of collective courage by heads of government over the politics of protectionism. Having placed the issue at a broad strategic level, above that of special interests and ministries on the industrial side, it was logical to include agriculture. But it still required significant soul-searching on the part of Japan and Korea to agree to this step. The way in which the free trade goal is to be reached is even more unusual. The process relies heavily on coordinated unilateral action (the APEC National Action Programs) rather than the bilateral negotiations (afterwards multilateralized) of the GATT.

How does the inclusion of agriculture fit in with this process? It implies, in effect, that

each APEC country will have to bring to the table plans for the unilateral liberalization of agriculture. So far, commitments under the APEC umbrella have not gone far beyond an acceleration of Uruguay Round obligations and agreement on specific sector liberalization plans. The food sector was identified as one of the fifteen areas where the voluntary program of liberalization was to be pursued, along with oilseeds and products. This at least suggests some continued willingness to move into sensitive waters.

Why, if agricultural policies are so difficult to shift, would one expect countries to be able to “give” them away in an APEC-inspired negotiating session? Perhaps it is the novelty of the negotiating method that may give a glimmer of hope. If governments are determined to hold onto protective policies and lay them reluctantly on the table one-by-one, only a slow advance will be possible. But if one starts with a commitment to remove all trade barriers by a certain time, then the issue becomes one of method rather than principle, and the need to balance “requests” and “offers” is diminished. Of course, in the absence of a credible commitment to the timetable, the process yields nothing more than loosely coordinated unilateral action. This is not likely to be a good position for agricultural liberalization. But if the goal is credible, and countries behave as if it is possible, then the technique may work. APEC would have successfully avoided the confrontational aspects of trade liberalization by emphasizing the common property (public good) benefits of a liberal trade and investment system over the desires of individual sectors for protection.

## **Conclusions and Recommendations**

The spread of regional integration is likely to continue for the next few years. Mercosur, the European Union and ASEAN all have plans to expand membership, and other groups such as the South Asian Regional Cooperation Council could become established. The countries of the Former Soviet Union are also expected to strengthen their mutual trade ties, through the CIS and other agreements, as they develop their trade relationships. Agricultural goods should benefit fully from the opening up of trade within these trade groups. To omit the agricultural market could be counter-productive to attempts to develop competitive agricultural sectors.

The question of the treatment of agriculture within FTAs is very relevant for the next round of trade negotiations. Now is the time to set a strategy for the incorporation of regional trade pacts in the ongoing process of multilateral liberalization. The IPC therefore makes the following recommendations for the further development of regional trading arrangements within the context of the multilateral trade system:

- The negotiation of regional free trade areas should not be allowed to undermine the WTO; it should therefore go hand in hand with a comprehensive multilateral negotiation in the WTO as with the case in the GATT when the European Community was created and enlarged;
- Agriculture must play its full part in regional trade liberalization. But when FTAs include agriculture, coordination is required with the multilateral process in order to avoid detracting from the more fundamental objective of multilateral trade liberalization;

- Quantitative restrictions on internal trade should be removed within free trade areas as they prevent the development of integrated regional markets. This includes tariff-rate quotas, which should be expanded rapidly to avoid distorting trade patterns;
- The use of export subsidies should be restricted where possible within free trade areas. This is however an area where strong multilateral action is also likely to be needed;
- Domestic subsidies should be limited to those that do not distort trade. The regional approach poses no threat to the multilateral in this area; and
- Particular emphasis should be placed on the elaboration of international veterinary and phytosanitary standards and regulations in order to forestall the emergence of regional standards which discriminate among regional blocs.

In addition, there are four significant ways to strengthen the complementarity between regional and global trade rules:

- First, the existing WTO rules on the acceptability of free trade areas and customs unions should be applied more rigorously;
- Second, the countries participating should be required to ensure that other countries are not adversely affected;
- Third, the common external tariffs of trade blocs should be bound in the WTO schedules of commitments; and
- Fourth, the WTO Committee on Agriculture and the Committee on Regional Trade Agreements should monitor and report on the activities of these blocs in light of the process of multilateral trade reform.

As far as specific ongoing or emerging regional arrangements and free-trade networks, the IPC recommends:

- *The Free Trade Area of the Americas (FTAA)* -- Agreement should include commitments to continue individual national reforms to free up agricultural trade, to respect or accelerate the timetables established for intra-regional trade liberalization, and to pursue the path of integration of the individual trade agreements in the Americas.
- *European integration to the East* -- The Europe Agreements should accelerate the increase of quotas on imports from the CEEC and improve their administration to avoid giving importers too much of the benefits. The EU should move quickly to trade that is less restricted by quantitative barriers, creating an integrated Europe-wide agriculture sector as

swiftly as possible. The CAP must continue to be reformed to allow for a reasonably rapid CEEC accession and to enable the EU to play a positive role in the next WTO trade round.

- *Asia Pacific Economic Cooperation (APEC)* -- To date, agriculture has been included in the coordinated liberalization approach. The credibility of this approach and its relevance for the multilateral obligations of the countries involved has yet to be determined. Further willingness should be demonstrated to address such sensitive matters as agricultural trade liberalization.
- *The Transatlantic Agenda* -- If discussions for a Transatlantic trade pact are to go forward, agriculture must not be left aside. Agreements could be pursued in certain important areas, including mutually developing quality and health standards with the aim of seeking broad international acceptance and allowing for mutual recognition of each others sanitary and phytosanitary measures.

The multilateral system needs to come to terms with free-trade networks and make use of their potential to go further than each of the component countries and trade blocs. The pace of liberalization of agricultural trade could be accelerated by regional agreements and processes if incorporation of agriculture in the timetable of regional agreements and supra-regional networks is made on an *mfn* basis or goes hand in hand with an increase in market access for non-participating countries, either unilaterally or as part of a multilateral negotiation in the WTO. If this is in fact the case, regional trade liberalization will have played a major constructive role in multilateral trade liberalization. But where there is doubt about the compatibility with multilateral trade policy reform the priority should clearly be given to the multilateral system.

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