

## **THE URUGUAY ROUND AND TRADE LIBERALIZATION**

- **The Uruguay Round of GATT was important, as it represented the first significant attempt to reduce agricultural protection since Britain's repeal of the Corn Laws in 1846 (Anderson, 1994)**
- **111 countries of GATT signed the Final Act in Marrakesh in April 1994, and at the same time brought the WTO into existence**
- **From the beginning of the Uruguay Round, agriculture was a key in the negotiations - specifically, a key link was made between domestic farm policies and agricultural trade**
- **The Tokyo Round, which ended in 1979, had a weak set of codes aimed at curbing non-tariff barriers, anti-dumping rules, and export subsidies**
- **By the mid-1980s, with falling world prices, export subsidy programs appeared, and trade disputes became more common; in the EC, subsidized exports became the main way of dealing with agricultural surpluses**

■ After the initial meeting in Punta del Este in 1986, the negotiations fell into *three* phases:

☞ The major players stated their initial positions:

- the US proposed elimination of all trade distorting programs over 10 years, leaving only “decoupled payments”

- the Cairns Group proposed a freeze on price supports, followed by phased reduction

- the EC wanted negotiated support level reductions, along with action to shore up world prices

The talks collapsed in December 1988, but were rescued in April 1989, when there was agreement to freeze support prices, and a timetable for the rest of the negotiations was set

☞ In the second phase, the form of the final agreement began to take shape:

- US proposed a strategy of focusing on rules to guide farm and trade policies:

**(a) non-tariff barriers were to be “tariffed”**

**(b) export subsidies to be banned**

**(c) domestic farm policies to be codified into acceptable, minimally trade-distorting policies vs. objectionable trade-distorting policies**

**- the Cairns Group supported this**

**- the EC agreed to tariffication, but resisted control of export subsidies**

**These ideas were pulled together in June 1990, but the EC felt it was too close to the US/Cairns Group position and rejected it, negotiations collapsing in December 1990**

**The negotiations resumed in February 1991 after the EC proposed substantial modifications to the Common Agricultural Policy (CAP) which would allow it to live with a GATT agreement**

**☞ The third phase concerned development of the details of an agreement:**

**- Arthur Dunkel, Director General of the GATT, put together a draft agreement in December 1991, focusing on the structure of:**

**(a) “market access”**

**(b) “export competition”**

**(c) “domestic support”**

**- This was modified a bit in the Blair House Accord in November 1992 between the EC and US, and subsequently modified in the Final Agreement in December 1993**

- The Agreement established a new set of rules for agriculture, resulting in a legally effective binding of tariff rates and constraints on domestic farm policies that distort trade - agricultural trade has been brought under the rule of international law**
- The basic structure of the Agreement is made up of the three areas of market access, export competition, and domestic support, the focus being on definitions of rules, and reductions in the levels of protection (see Table 1 |)**

**Table 1: Key Elements of Uruguay Round Agreement on Agriculture**

	<b>Rules</b>	<b>Liberalization*</b>	<b>Safeguards/ Accommodations/ Guarantees</b>
<b>Market Access</b>	<ul style="list-style-type: none"> <li>- change non-tariff barriers to tariffs</li> <li>- establish TRQs</li> <li>- bind all tariffs</li> </ul>	<ul style="list-style-type: none"> <li>- reduce tariffs by 36% on average over 6 years</li> <li>- reduce tariffs for each item by 15%</li> </ul>	<ul style="list-style-type: none"> <li>- guaranteed market access to exporters via TRQs</li> <li>- special safeguard measures for importers</li> </ul>
<b>Export Subsidies</b>	<ul style="list-style-type: none"> <li>- defined limits on existing export subsidies</li> <li>- no new export subsidies</li> </ul>	<ul style="list-style-type: none"> <li>- reduce expenditure by 36% over 6 years</li> <li>- reduce volume by 21% over 6 years</li> </ul>	<ul style="list-style-type: none"> <li>- adherence to food aid rules</li> <li>- negotiate later on export credits</li> </ul>
<b>Farm Subsidies</b>	<ul style="list-style-type: none"> <li>- “green box” defined for allowable subsidies</li> </ul>	<ul style="list-style-type: none"> <li>- aggregate level of trade-distorting support reduced by 20% over 6 years</li> </ul>	<ul style="list-style-type: none"> <li>- many LDC subsidies exempted</li> <li>- payments under production limiting programs exempted</li> </ul>

\* Reduction amounts for developed countries

## MARKET ACCESS

- **Probably the most far-reaching element related to *market access* (see next page)**

- **original preamble of GATT (1947) sought reciprocal and mutually advantageous reductions in tariffs**

- **protection of industry should be done through least distorting means, i.e. tariffs administered without discrimination**

- **maximum tariffs should be “bound”, i.e. countries agree not to raise tariffs above negotiated levels**

- **bound tariffs are transparent, provide a degree of certainty for traders, and preserve transmission of price signals**

- **Agriculture not fully integrated into general tariff reductions during first seven GATT rounds**

- **before the Uruguay Round, only 58% of agricultural tariffs were bound compared to 78% of industrial tariffs**

## “Economic Theory” of the GATT/WTO

- **Despite economic arguments about free trade, based on efficiency gains to consumers, not force behind trade liberalization**
- **Virtually every tariff “concession” by one country in GATT/WTO due to reciprocal tariff reduction by another country**
- **GATT/WTO would seem to be driven by exporter interests, and, hence, is *mercantilist* - implies principles of WTO are economic “nonsense”**
- **Bagwell and Staiger (2000; 2001) argue GATT/WTO aids governments to escape from terms of trade Prisoners’ Dilemma**
- **Governments have an incentive to unilaterally impose tariffs as some costs of protection are shifted to foreign exporters in form of lower prices**
- **GATT/WTO exists to solve inefficiency due to unilateral setting of tariffs - i.e., aids in exchange of market access commitments and maintaining “rights” to such commitments**

**- even post-Uruguay Round, bound agricultural tariffs average over 62% *ad valorem***

**- further reductions remains a major task in the next WTO/GATT round - note: it took 8 GATT rounds to reduce industrial tariffs**

- **Achievement was to re-write rules on market access rather than large tariff reductions, and *tariffication* was a major advance**
- **“*Dirty*” *tariffication* resulted in some new bound tariffs that gave some more protection than previously existed**
- **GATT members agreed on quotas to maintain historic trade levels or increase trade - actual instrument known as *tariff-rate quotas* (TRQs)**
- **Specific requirements for allocation of quotas not specified, so that allocation and administration is an issue for negotiation in the next round**
- **How do TRQs work?**

## TARIFF-RATE QUOTAS

- TRQs not a very common instrument of trade policy (Moschini, 1991)
- TRQs not the same as quotas – no absolute maximum set on total imports over a given period
- More like a variable tariff
  - lower *in-quota* tariff is applied to imports entering under market access commitment
  - higher *over-quota* tariff levied on imports in excess of agreed market access
- As Abbott and Paarlberg (1998) note, in-quota tariffs were bound either at or above historic levels, while over-quota tariffs were often bound at prohibitive levels
- Figure 1 (a) represents domestic market - autarky price  $p^a$  determines vertical intercept of the importing country's excess demand curve (*ED*) in (b), which describes world market

- **$ES$  is relevant excess supply curve if no tariff were applied by importing country,  $ES'$  is excess supply curve including the in-quota tariff  $t^i$ , while  $ES''$  is excess supply curve including over-quota tariff  $t^o$**
- **Effective excess supply curve is made up of  $ES'$  for import levels below minimum access level  $Q$ , and by  $ES''$  for import levels in excess of minimum access level**
- **At  $Q$ , there is a discontinuity between  $ES'$  and  $ES''$ , the height of which is a function of the difference between the in and over-quota tariffs, given the level of market access**
- **Equilibrium is where  $ED$  intersects effective excess supply curve in the discontinuity**
- **Imports are the agreed level of minimum access,  $Q$ , and the equilibrium domestic price is  $p_e^d$**
- **In terms of its effect on domestic price, equilibrium is equivalent to a pure quota set at  $Q$**

- **Equilibrium in Figure 1 illustrates case where over-quota tariff  $t^o$  is much higher than that necessary to make TRQ bind**
- **Vertical difference between  $k$  and  $e$  is commonly termed *water* in the over-quota tariff, which may be due to dirty tariffication**
- **Under a pure quota, total quota rents would be given by the rectangle  $abce$ , whereas with a binding TRQ, part of this is captured by the importing country's government as tariff revenue,  $fbcg$ , leaving area  $afge$  as quota rents**
- **Who gains these rents is a function of how TRQ is administered**
  - **if rights to import under minimum level of access are auctioned off competitively by importing country, it will fully capture rents,  $afge$**
  - **if methods other than auctioning are used, rents are captured by private agents, either in importing country or exporting countries**

- Unless rights to import are freely tradable after allocation, methods of administration such as license on demand, first-come-first-served (FCFS), and historical allocation allow for *extra-marginal* suppliers to fill either part or all of the quota  $Q$
  - effective excess supply curve can be rotated up from  $h'g$  to  $h'e$  to approximate higher production costs of extra-marginal suppliers
  - this inefficiency is added to the usual deadweight loss triangle, which is  $ejc$  when measured relative to free trade, and  $eig$  when compared to a simple *ad valorem* tariff of  $t^i$
- In addition to equilibrium drawn in Figure 1, three other equilibria are illustrated in Figure 2
- *Case 1*,  $ED_1$  does not intersect excess supply at all, autarky price  $p^a = p_1^d$  is globally lower than border price inclusive of in-quota tariff, as a result of which there are no imports and, hence, *zero fill* of the TRQ

- In *Case 2*,  $ED_2$  intersects  $ES'$ , which is below minimum access level  $Q$ , so that there is *partial* TRQ fill at  $q'$ , in-quota tariff is binding, the equilibrium domestic price, inclusive of tariff  $t^i$ , being  $p_2^d$ , so that effects of TRQ are equivalent to a tariff
- *Case 3* is equilibrium already outlined in Figure 1 where  $ED_3$  intersects excess supply in the discontinuity
- *Case 4*,  $ED_4$  intersects  $ES''$ , such that over-quota tariff is binding, amount imported  $q''$  exceeds  $Q$ , i.e., there are over-quota imports, and equilibrium domestic price is  $p_4^d$  inclusive of the over-quota tariff  $t^o$

Tariff revenue consists of area  $fbcg$  due to application of in-quota tariff on  $Q$  units imported under agreed minimum access, and area  $eijh$  due to application of the over-quota tariff on  $q'' - Q$

In addition, compared to *Case 3*, owners of rights to import under the minimum access now earn larger quota rents of  $afge$ , which is clearly larger than rents earned in *Case 3*

- depending on method of quota rights allocation, some of these rents may be paid out to extra-marginal factors of production, adding to the inefficiency of the TRQ
  - deadweight loss of *Case 4*, relative to the free trade equilibrium, is the area *hjk*
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- 1,425 TRQs notified to the WTO by 43 countries
  - For OECD, average in-quota tariff of 36% and average over-quota tariff of 120%
  - Total tariff revenue of US\$ 26 billion, and quota rents of US\$ 16 billion
  - Only 36% of TRQs are filled, the average fill-rate being 61%
  - Common methods of administration are licenses on demand, first-come-first-served, and historical importers, accounting for 49% of all TRQs – auctions account for only 5% of all TRQs

## **EXPORT SUBSIDIES**

- **Agreement attempted for the first time to ban new *export subsidies*, and a reduction of existing subsidies**
- **During the late-1980s, US and EU engaged in a subsidy “war”**
- **Over 1995-2000, 25 WTO members reported export subsidy commitments of US\$ 96 billion, the EU accounting for almost 70% of these commitments**
- **In terms of notification of actual use of export subsidies, not all use has been reported to the WTO, but reported use has been less than the commitment at US\$ 36 billion, the EU accounting for 88% of used export subsidies**
- **In the EU, the highest export subsidy rates are for sugar 73%, and dairy products 57%**
- **Magnitude of export subsidization does appear to have fallen in the EU for the period 1995-2000**
- **US and Cairns group want complete elimination of export subsidies, while EU and Japan want to discipline food aid and export credits**

## **DOMESTIC SUPPORT**

- **Uruguay Round recognized domestic farm support policies as major sources of trade distortions**
- **Countries agreed to limit spending on trade distorting programs, and to exempt other types of programs:**
  - **“Green Box” policies are considered minimally trade-distorting, e.g., environmental payments, disaster relief, income insurance programs, decoupled income support**
  - **“Blue Box” policies are considered to have trade effects, but have production limits embedded in them, payments being based on fixed yields and acreage**
  - **“Amber Box” policies are considered to be most trade-distorting**
- **By 2000, approximately 75% of US domestic support was Green Box, compared to 33% in the EU**
- **Since 2000, EU has continued to shift domestic farm support towards direct payments, but there was some “back-sliding” in the 2002 US farm bill with increased coupling of support to production**

## SUMMARY

- **Market access most far-reaching element**
  - **tariffication has the benefit of making protection more transparent**
  - **to secure visible gains, the Agreement called for “minimum access opportunities”**
- **Agreement attempted to ban new export subsidies, and a reduction of existing subsidies**
- **Significant link made between domestic farm policies and trade**
- **Why was the Agreement eventually accepted by the major players? Given the various breakdowns in the negotiations, many observers actually suggested dropping agriculture. Two things ruled this out:**
  - **It would have been unacceptable to smaller and developing country members of GATT**
  - **Dropping agriculture would have been a bad move politically for major players:**

**- for the US, it would have been a lost chance to secure cuts in farm subsidies in Europe and Asia, as well as using “fast-track” to reform US farm programs**

**- for the EC, farm policy reform necessary under GATT was no different to what it had to do in terms of reforming its own internal farm policies**

**■ Agricultural protection in the industrial countries represented a political equilibrium in the absence of trade-negotiating possibilities. Once trade talks began, protection to agriculture could be lowered for several reasons:**

**- dissemination of information about the costs of protection reduced sympathy for farm policies**

**- coordination of spillover effects across countries, liberalization in industrial countries would raise farm prices, reducing low-income problem of farmers in developing countries**

**- trade talks reduce protection because of exchange in market access across industries and sectors**