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Monika Hartmann*

New Developments in International Agricultural Trade

A Threat or a Chance for LDCs and CEECs?

The nineties have seen a number of developments which will have major consequences for international agricultural trade. Will the changed conditions in the world agricultural markets enable less developed countries (LDCs) and Central and Eastern European countries (CEECs) to exploit their comparative advantages better, or will the reforms further squeeze them out of the industrial countries' markets?

The nineties are a decade of change and upheaval for international agricultural trade. The conclusion of the Uruguay Round in the course of the decade set the parameters for world farm trade well into the next century. The agricultural reforms in the European Union and the intensive efforts to achieve integration in North America, Europe and Asia will also have a decisive effect on trade in agricultural products and foodstuffs. In connection with many of these reforms at unilateral, bilateral and multilateral level, the debate about environmental and food quality standards is gaining importance, and there is increasing international pressure for such standards to be more comprehensively embodied in the GATT. This will have further consequences for world agricultural trade.

The question arises whether these more recent developments in international agricultural markets represent a threat or a chance for less developed countries (LDCs) and Central and Eastern European countries. Will the changed conditions in the world agricultural markets enable these countries to exploit their comparative advantages better, or will the reforms further squeeze them out of the industrial countries' agricultural markets, with all that entails for the lasting development of these regions?

This article aims to provide preliminary answers to these questions. It will examine the influence of various significant developments in the world agricultural markets for the developing countries and the Central and Eastern European economies in

transition, focusing especially on the reform of the European Union's Common Agricultural Policy in 1992, the GATT agreement, the worldwide attempts at regional integration and the growing importance of environmental and quality aspects in international agricultural trade.

The EU's Agricultural Reform of 1992

The reforms adopted in May 1992 opened a new chapter for the European Common Agricultural Policy. The main elements were drastic reductions in the prices of beef, cereals, oil seeds and protein plants, the implementation of a cyclical land set-aside scheme and direct transfer payments to compensate for losses of income.¹ These considerable changes in the underlying agricultural policy of the EU will have far-reaching implications for the production and consumption of agricultural products and trade in such goods. As the European Union is a large economic area, the reform can be expected to have an impact on the level, the stability and the structure of world market prices as well as repercussions on non-member countries.

As regards the level of world market prices, the international prices of crops can be expected to rise substantially as a result of the sharp reduction in prices in the EU and the implementation of the cyclical land set-aside scheme, particularly if the price

¹ A detailed description of the reform measures is given in BMELF (Federal Ministry for Food, Agriculture and Forestry): Die Agrarreform der EG, Bonn 1993.

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compensation payments prove to have little effect on output. The reforms in the cereals sector will have two opposing indirect effects on products via feed prices. While in the EU meat and dairy production will tend to rise as a result of the fall in cereals prices, and hence put pressure on world market prices, rising cereals prices in world markets will lead to a cut in animal production in the rest of the world and hence to a rise in world market prices for such products. The qualitative aspect of the effects on world market prices can therefore not be clearly predicted, particularly where products that do not require large areas of land are concerned. As the EU reforms included additional price-reducing measures in the beef and dairy sector,² the net effect is expected to be a rise in world prices in these markets. Apart from the effects on the level of prices, the specific shape of the EU agricultural reform is also leading to changes in the structure of prices. Protection is being significantly reduced in some areas while other markets such as the highly protected EU sugar and milk market remain completely or largely untouched by the reform. The reform will therefore probably exacerbate the distortions caused by the EU in the structure of prices on international agricultural markets.

No marked change can be expected in the absolute degree of instability of world market prices, as the maintenance of the system of variable levies and export subsidies continues to enable the EU virtually to fix prices. In view of the expected rise in the world market prices of most agricultural products, however, there probably will be a reduction in relative price instability in the international agricultural markets.

What impact will the world price effects have in the developing countries and the Central and Eastern European economies in transition? Over the short term they are likely to have adverse implications for Third World countries in particular, as the reforms do not apply to the developing countries' traditionally important export products such as sugar, fruit and vegetables, while EU protection against products that are important imports for these countries, such as wheat and maize, is being greatly reduced. The effects of the EU agricultural reform on each country

depend on its trade status in the markets in question, its domestic policies and the adjustment measures adopted.

Leaving aside domestic policies for the time being, the exporters of temperate zone plant products, and especially the exporters of cereals and oil seeds, are the clear winners of the reform of the CAP. Both the real income and net export receipts of these countries will increase as a result of the changes in world market prices. Countries that were originally net importers but which become net exporters in view of the rise in world market prices and the resulting technical advances may also achieve welfare gains; beyond this they will experience a clear improvement in their foreign exchange balance. On the other hand, countries that continue to import the products in question after the implementation of the EU agricultural reform may suffer a loss on two fronts; as well as a fall in real income, they will suffer a deterioration in their foreign exchange balance if import demand elasticity in the markets in question is less than unity. The distribution effects of the reform are the same, whether countries are net importers or net exporters. Consumers in those countries will have to accept welfare losses as a result of rising world market prices, while producers will experience an increase in real income.³

The repercussions of the EU agricultural reform on third countries will be far more varied in the area of animal production. On the assumption that world market prices for animal products will rise, this implies significant welfare losses for net importers of these products. In that case, Third World and CEE countries must endure not only a deterioration in their terms of trade in these markets but also further losses in the form of increased prices for animal feed. Even net exporters among Third World and Eastern European countries may suffer real losses of income as a result of rising world prices in these markets if the improvement in their terms of trade is outweighed by the rise in animal feed costs induced by the EU reform.

The picture is further complicated by the existence of domestic agricultural policies and macro-economic distortions in developing and CEE countries.⁴ Even in the markets for cereals and oil seeds, net importers (exporters) among the third countries may be among the winners (losers) of the EU reforms if they protect (discriminate against) their agricultural sector by providing import subsidies (export subsidies). Furthermore, the European Union has concluded a series of agreements with developing countries and

² Milk quotas were cut by 2% and intervention prices for butter by 5%. The quota reduction has not yet been implemented, however.

³ M. Hartmann: Wohlfahrtsmessung auf interdependenten und verzerrten Märkten. Die Europäische Agrarpolitik aus Sicht der Entwicklungsländer, Kiel 1991.

⁴ M. Hartmann, op. cit.

economies in transition under which it has granted them agricultural trade concessions; although the concessions are minor as regards the products that traditionally enjoy a high degree of protection in the EU, they are of some significance for certain countries. As the EU reforms will tend to lead to a lowering of threshold prices and a rise in world market prices, the result is an erosion of preferences for favoured nations. Neglect of this aspect will therefore lead to an overestimation (underestimation) of the possible welfare gains (losses) in the poor regions. These remarks show that the qualitative aspect of the net welfare effects on developing countries and economies in transition is affected by a multitude of factors. Only by knowing the determinants in individual countries and regions can one predict the sign of the welfare effects. Initial empirical studies indicate a predominance of welfare losses in Third World countries, especially over the short term. By contrast, the economies in transition appear on the whole to benefit from the reform of the CAP.⁵

GATT: Reduction in Protectionism

The Uruguay Round of the General Agreement on Tariffs and Trade appeared to offer the possibility of largely eliminating the pronounced distortions in world agricultural markets. After seven years of difficult negotiations, an agreement was reached on 15th December 1993 which fell far short of the original expectations. The main agricultural provisions of the agreement, which all signatory states⁶ must meet within six years from 1995, are the following:

- product-specific reductions of 21% in the volume of subsidised agricultural exports and 36% in the amount of export subsidies (reference period: 1986-1990);
- a reduction of 20% in domestic support at aggregated level; payments not linked to production, such as the direct subsidies within the framework of the EU agricultural reform, are excluded (reference period: 1986-1988);

⁵ M. Hartmann: Die EU-Agrarreform aus Sicht der Länder der Dritten Welt und Osteuropas, in: W. Grosskopf, C.-H. Hanf, F. Heidhues and J. Zeddies (eds.): Die Landwirtschaft nach der EU-Agrarreform. Schriften der Gesellschaft für Wirtschafts- und Sozialwissenschaften des Landbaues e.V., Vol. 31, Münster-Hiltrup 1995.

⁶ The developing countries were granted a transitional period of ten years and required to meet only two-thirds of the tariff reductions. The least developed countries were given a complete dispensation. The 115 signatory states account for about 90% of world agricultural trade. See inter alia United States Department of Agriculture: Agricultural Provisions of the Uruguay Round, Washington, D.C., 1994.

□ conversion of all non-tariff trade barriers into customs duties (tariffication) and their reduction by an average of 36%, but by at least 15% for each tariff position (reference period: 1986-1988);⁷

□ reduction in customs duties for a quoted volume to ensure minimum market access for product groups amounting to 3% of domestic consumption initially and 5% thereof in the year 2000.

There can be no doubt that the compromise reached with regard to agriculture amounts to a re-regulation of agricultural trade rather than a liberalisation. Among other things, the GATT agreement legitimises aspects of the quantitative management of both imports and exports of agricultural products.⁸ Nevertheless, it must be acknowledged that for the first time the GATT has succeeded in curbing the escalation of agricultural protectionism in multinational agreements and has even achieved a modest reduction in the level of protection. The impact of this complex trade agreement on world market prices and on LDCs and CEECs will be estimated in broad terms below.

The modest reduction in agricultural protection will probably induce a rise in world agricultural prices, primarily owing to the obligation to reduce subsidised exports. On the other hand, the required reduction in export subsidies will not become binding on signatory states until world market prices move back towards the low reference level of 1986-1988. The many exceptions appear to diminish the relevance of the reduction in internal protection to such an extent that it is likely to have only marginal effects on the world market. The effectiveness of minimum market access is limited, owing to the high aggregation of product groups. Finally, the impact of the reduction in tariffs must also be regarded as limited, as many of the tariff equivalents calculated as part of tariffication have been set too high. The liberalisation of imports is further undermined by the in-built "safeguard clauses", which make it possible to impose additional tariffs if world market prices fall below 90% of the 1986-1988 reference level or if imports rise above a reference level of the past.⁹

As the GATT provisions apply to 115 countries, they can be expected to cause a larger increase in world

⁷ Volume and price-related safeguard clauses permit the imposition of additional duties on products subject to tariffication.

⁸ K. Anderson: Impact of Multilateral, Regional and Unilateral Trade Reforms on Agricultural Competitiveness, paper presented at the 22nd International Conference of Agricultural Economists on "Agricultural Competitiveness, Market Forces and Policy Choice", 22-29 August 1994, Harare, Zimbabwe.

market prices than the unilateral reform of the EU's Common Agricultural Policy, particularly as the reduction in agricultural protection represents only part of the comprehensive GATT agreement. Liberalisation in other areas should generate significant worldwide gains in real incomes.⁹ Depending on the income elasticity of demand for agricultural products, this will magnify the rise in prices in world agricultural markets.

Furthermore, the reduction in protection within the GATT applies to all agricultural products, unlike that stemming from reform of the CAP. As a result, the rise in world market prices will affect all agricultural products, and will be particularly pronounced in the highly protected markets. It should be noted here, however, that the way in which the GATT agreement is formulated leaves countries considerable scope to exclude "sensitive" products from the reduction in protection. For example, there is no stipulation for a reduction in domestic support for specific products, and even the compulsory reduction in import duties amounts to only 15%. As the tariff equivalents were calculated very generously for tariffication, it may well be that no actual reduction in protection will be required in some markets. Against this background, the GATT agreements will also probably not lead to a reduction in the distortions of the world market price structure, and may even reinforce those that already exist.¹¹

Finally, it is to be expected not only that relative world market price instability will decline as a result of rising world market prices but also that the absolute level of price instability in world agricultural markets will decrease slightly. The latter effect stems from tariffication, which no longer permits countries to isolate their domestic markets completely from the world market by means of variable import levies, export subsidies or import quotas. Hence in future, changes in world market prices will induce adjustments in supply and demand in all countries and thus reduce absolute price variability in the international agricultural markets. The potential stabilisation effect of tariffication will be greatly restricted, however, by the possible levying of additional duties under safeguard clauses.

The price level changes induced by the GATT

⁹ For a discussion of these effects, see also GATT (ed.): *The Uruguay Round Agreement*, Geneva 1994, and International Agricultural Trade Research Consortium: *The Uruguay Round Agreement on Agriculture. An Evaluation*, Commissioned Paper No. 9, July 1994.

¹⁰ K. Anderson, *op. cit.*

agreements will have similar allocation, distribution and balance-of-payments effects as the reform of the CAP. The changes in the structure of world market prices should be more positive than those of the EU reform, especially for developing countries, as the highly protected export products of these countries will also experience a reduction in their level of protection. Additionally attention must be paid to the price stability aspect when analysing the effects of the agreements on the LDCs and CEECs. The expected modest reduction in price instability in the world market will reduce uncertainty for importing and exporting nations alike, thereby raising the efficiency of resource allocation in all risk-averse countries. In view of the low absolute level of incomes in developing and CEE countries and the high spending on food in relation to total expenditure, fluctuating agricultural prices endanger the livelihood of producers and consumers in those countries. This explains why poor people in particular are extremely risk-averse and the danger of resource misallocation as a result of price instability in the agricultural sector in these countries is high. More stable world market prices could therefore generate substantial welfare gains in these countries.¹² The real income gains in developing and CEE countries that will actually be generated by increased price stability as a result of the GATT agreement will probably be very small, however, as the safeguard clauses greatly restrict the potential stabilising effect of tariffication.

Moves towards Regional Integration

The Eighth GATT Round was accompanied by efforts to achieve closer regional integration in various parts of the world. Whether such trading blocs represent a danger or an opportunity for further liberalisation under the auspices of the GATT is hotly debated among academics. Critics of this new development fear that the world will be divided up into a few large trading blocs, with a corresponding increase in interregional protectionism. The advocates of moves towards closer integration, on the other hand, see the trend merely as a step in the direction of free trade.¹³ They argue that the growth stimuli induced by the creation of common markets intensify

¹¹ International Agricultural Trade Research Consortium (IATRC): *The Uruguay Round Agreement on Agriculture: An Evaluation*, Commissioned Paper No. 9, July 1994.

¹² The welfare effects in developing countries of a reduction in price instability are substantial. See P. M. Schmitz: *Handelsbeschränkungen und Instabilität auf Weltagrarmärkten*, Hamburg 1984; and M. Hartmann: *Wohlfahrtsmessung auf interdependenten und verzerrten Märkten*, *op. cit.*

political co-operation among member countries and improve understanding of the importance of open markets at global level. Whatever effect regional agreements have on the world trading system, the question arises as to the impact of the new regionalism on developing countries and the countries of Central and Eastern Europe. Are these countries the losers in such a move, or does the new regionalism also offer opportunities to accelerate development in these regions?

The first point to emerge is that the dimensions of regionalism have changed for the developing countries. The free trade agreements they concluded in the past were almost exclusively among themselves, and the experiences with this form of South-South integration were rather discouraging.¹⁴ Recently, however, there have been a few examples of closer co-operation between developing and industrial countries and between countries in transition and industrial countries, such as the North American Free Trade Agreement between the USA, Canada and Mexico, and the possible eastward enlargement of the European Union to include Poland, Hungary, the Czech Republic and Slovakia. Moves towards regional integration between industrial and developing countries are also evident in the debate taking place in the Asian Pacific region about a common market in this dynamically growing area.

From the point of view of the Third World and Eastern European countries involved, these moves towards North-South or West-East integration are highly promising on many counts. First, regional agreements of this kind encourage the hard-won structural adjustment programmes introduced in these countries in the eighties and nineties and reduce the danger that future governments will reverse the reforms; it is far more difficult to violate an international agreement with a large and wealthy country or a group of such countries than national laws. Secondly, in view of this increased political stability East-West and North-South agreements stimulate additional domestic and foreign investment in the countries involved. Thirdly, co-operation of this

kind gives the regions access to a large market, an advantage of great importance at a time of increasing non-tariff trade restrictions. Finally, such agreements promise to boost growth further by accelerating the spread of technological and institutional change.¹⁵

Countries that are not members of one of these North-South or West-East co-operative arrangements can also benefit from the integration agreements. Recent studies show that the creation of common markets often leads to a reduction in average costs, an increase in competition and welfare gains as a result of a growth in intra-industry trade in the integrated regions. The resulting dynamic growth stimuli greatly exceed the purely static gains. The growth-related external trade creation effect may outweigh the adverse effects of trade diversion to third countries.¹⁶ In the absence of these positive dynamic effects, however, all that remains for developing and reforming countries that do not belong to a North-South or West-East grouping is the negative trade diversion effects.

Environmental and Quality Aspects of the GATT

The question of differing environmental and quality standards is one of the most topical and fiercely debated issues in international agricultural trade circles and has already had a significant impact. For example, the Working Group on Trade and Environment formed by the GATT in 1971 met for the first time in 1991. In the same year the OECD in Paris began to formulate principles for integrating environmental and trade aspects. At the beginning of the nineties the United Nations also decided to make trade and the environment one of the central themes of the Conference on Environment and Development in Rio de Janeiro, and environmental considerations played a significant role in the conclusion of the free trade agreement between the United States, Canada and Mexico.

The potential for conflicts in the area of trade and

¹³ For a discussion of the various positions, see J. de Melo and A. Panagariya: *The New Regionalism in Trade Policy*. Washington, D.C., 1992; and H. G. Preuße: *Regionalisierung des Welthandels. Chance oder Hemmnis für die Entwicklung der Multilateralen Handelsordnung*, in: *Frankfurter Volkswirtschaftliche Diskussionsbeiträge*, Working Paper No. 44, Frankfurt 1993.

¹⁴ F. Forouton: *Regional Integration in Sub-Saharan Africa: Past Experience and Future Prospects*, paper presented to the conference on "New Dimensions in Regional Integration" organised by the World Bank and the CEPR, Washington, D.C., 2-3 April 1992; J. de Melo and A. Panagariya, *op. cit.*

¹⁵ Although these agreements offer many advantages for the Third World and Eastern European countries involved, they also hold a few potential dangers. For example, the conclusion of an integration agreement with an industrial country could lead to a reduction in investment from other wealthy countries, thus reducing the total foreign investment in the country in question. It is also conceivable that inefficient policies that impede growth in the industrial country in a North-South partnership could be transferred to the developing country. See also J. de Melo and A. Panagariya, *op. cit.*, and J. C. Brada: *Regional Integration in Eastern Europe: Prospects for Integration within the Region and with the European Community*, paper presented at the conference on "New Dimensions in Regional Integration" organised by the World Bank and the CEPR, Washington, D.C., 2-3 April 1992.

¹⁶ H. G. Preuße, *op. cit.*

the environment is particularly great in trade between industrial countries on the one hand and Third World or Central and Eastern European countries on the other, as environmental and quality standards differ enormously between these two groups. This can lead to various problems in international trade and to conflicts within the GATT.

There can be no doubt that agricultural production costs are higher in countries with stricter environmental standards. This leads almost invariably to a loss of international competitiveness and market share in agricultural products, frequently followed by demands from domestic producers for import bans or environmental tariffs on imports from countries with less stringent environmental regulations in order to protect them against "unfair" trade (environmental dumping).¹⁷ These demands quite often find support from consumers and environmental groups in the wealthy countries, which have reservations about "low-standard" imports on health and/or environmental grounds. Without question, there is a danger that this new trend is opening a new Pandora's box of protectionist demands, cloaked in respectable green credentials. The result would be the increasing exclusion of low-standard countries in the Third World and Central and Eastern Europe from the markets of the industrial countries, which would have harmful implications for development in these regions. The GATT, as the forum for multinational trade issues, is being called upon to avert this danger.

Where conflicts in the environmental and quality field are concerned, the GATT distinguishes between production and product standards. If production standards lead to no change in the product itself – in other words, if there is no difference between home produced goods and imports – the GATT permits no trade sanctions against the imports. This rule seems sensible, provided the environmental problems in question are purely domestic. Where environmental problems transcend national borders, the conflicts of interest are far more complex and require a more differentiated treatment.¹⁸

The GATT adopts a different attitude towards product standards. Most product-related environmental policies do not conflict with the fundamental GATT rules provided they are applied in a non-discriminatory manner. For example, countries can

require imported cars to be fitted with catalytic exhaust converters or special safety equipment if the same requirements apply to home produced cars. If products that may be sold in countries with low standards are prohibited from sale in countries with stricter environmental laws, this nevertheless unquestionably constitutes a trade restriction. Even if the policies apply equally to domestic and foreign producers, they often impose a far greater burden on the latter. For example, if the foreign company exports only a small part of its total output, it must accept substantial diseconomies of scale in order to meet the higher standards in the export market. At best, these laws are justified on environmental or health grounds, and they are not formulated specifically in order to discriminate against foreign suppliers; at worst, they are simply effective non-tariff trade barriers. Developing countries and economies in transition are affected particularly severely by strict environmental and quality standards, as they often do not have the human resources or facilities to meet these requirements.

The challenge for the next GATT round will be to develop rules that make it easier to differentiate between legitimate environmental standards and disguised protectionist trade restrictions. Priority should be given to environmental policies that cause little or no hindrance to trade, but in so doing it will also be necessary to weigh up the risk of not achieving a legitimate objective. Dependable rules are essential, not least to prevent solutions in "green" trade conflicts from being determined by the larger and more wealthy country.

Conclusion

This article has examined the consequences of current political developments in world agricultural markets for developing countries and the Central and Eastern European economies in transition. Its findings can be summarised as follows:

- The agricultural reforms in the EU and under the auspices of the GATT are inducing a modest dismantling of agricultural protectionism and a marginal reduction in the instability of world market prices, but without reducing distortions in price structures on international markets.
- The assessment of these unilateral and multilateral reforms from the standpoint of the developing regions and the economies in transition depends crucially on the trade position of the countries concerned in the various agricultural markets, the scale of domestic

¹⁷ GATT (ed.): *International Trade 90-91 – Including Special Topic: Trade and Environment*, Geneva 1992.

¹⁸ D. C. Esty: *Greening the GATT*, Washington, D.C., 1994.

distortions and the assumed world market price transmission.

□ North-South or East-West integration opens up the prospect of more rapid development for the developing and reforming countries involved.

□ Worldwide growth stimuli can be expected to stem from the GATT agreements in particular, but from regional integration as well, with potential positive effects on the agricultural exports and economic development of countries in the Third World and in Central and Eastern Europe.

□ The implementation of environmental and health standards brings the danger that developing and reforming countries will be increasingly excluded from the markets of industrial countries. More than in the past, these countries may in this way be prevented from exploiting their comparative advantages, with

corresponding adverse consequences for lasting development in these regions.

Current developments in world agricultural markets therefore offer a number of opportunities, but they also hold dangers for Third World countries and the Central and Eastern European economies in transition. The best strategy for these countries is to ensure the optimum use of their domestic resources by reducing the remaining domestic sectoral and macro-economic distortions. In addition, it is important that they speak with one voice in the next GATT round, which will probably be "green"; only in that way can they ensure that agricultural trade is not swamped by a green wave of protectionism, and possibly even more seriously distorted than it is by traditional agricultural protectionism.

Gerhard Fisch* and Bernhard Speyer**

TRIPs as an Adjustment Mechanism in North-South Trade

Developing countries tend to take a negative view of the protection of intellectual property rights as reflected in the TRIPs agreement, as this seems to conflict with their own developmental needs. As the following article points out, there are, however, a number of reasons why developing countries, too, may benefit from stronger protection of intellectual property rights.

During the Uruguay Round negotiations the industrial countries, above all the US, insisted that the final accord should include an agreement on the protection of intellectual property rights (IPR). A strengthening of IPR protection was necessary, it was claimed, because insufficient protection reduces investment in cost-intensive R&D activities, especially basic research. This in turn reduces innovation, which itself is the main source of global development and progress, as recent developments in both trade theory and growth theory have clearly demonstrated.

It is important to understand that the insistence of industrial countries on the inclusion of IPR protection in the Uruguay Round trade negotiations is

fundamentally due to a major shift in the pattern of world trade during recent years and the resulting adjustment challenges. For more than a decade now, world trade has grown faster than world production, which has intensified competition significantly. The adoption of an export-oriented economic policy in a large number of developing countries has given North-South trade a new dynamism based on a different structure of exchange: apart from most of the African countries, LDCs are no longer predominantly exporters of primary products, but of manufactured goods. While North-South trade was of a complementary nature for a long time, these days exports of both North and South largely consist of similar goods. This substitutive trade increases the adjustment pressure for all parties concerned and, especially, threatens large-scale displacements in the industrial countries.

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