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## The impact of regionalism on the multilateral trading order: French tariff bargaining in the Uruguay Round

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# Kieler Arbeitspapiere

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**The Impact of Regionalism on the Multilateral Trading Order:  
French Tariff Bargaining in the Uruguay Round**

by  
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August 1995



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## **Abstract**

**This paper analyzes the GATT negotiations during the Uruguay Round and shows that France was induced to accept a more free trade oriented package due to her integration into the European community. The importance of the European economic and diplomatic relationships led France to accept a GATT deal which she felt would be disadvantageous. Further, the paper investigates how this finding fits into the literature of the political economy of trade policy and how it can be incorporated into a game theoretic model of endogenous tariff making.**

**Key Words: Regionalism; Uruguay Round; European Union; Tariffs; Bargaining Model**

**JEL Classification: C78, F13, F15**

## Introduction

The focus of this paper is the role of the European Community as a regional bloc during the Uruguay Round of the GATT talks. The Uruguay Round took more than seven years to complete, since the United States and Europe<sup>1</sup> could not find an early compromise in certain areas. Agriculture especially was an item of entrenched positions and disputes. Within the European Union, at that time still the European Community, the positions of the individual countries differed on many issues. The European Community cannot be analyzed as a unitary player on the global scene, but must be seen as a team of distinct players that often has problems in agreeing on common goals. The individual European nations have different comparative advantages as well as different interests and therefore different preferences for economic policies. The countries of the European Community negotiated, however, with one voice at the GATT table. The (then) twelve countries of the European Community had to agree on a position before their negotiators were able to offer new bargains to their GATT counterparts. Furthermore, the European countries were supposed to accept the results of their negotiators. Acceptance was, however, not always automatic, as the resistance of France to the Blair House Accord and the following debacle showed.

The aim of this paper is to analyze what happened in the last part of the Uruguay Round. A concise history of the Uruguay Round negotiations will be given, followed by the bargaining between France and Germany in the final decisive period. The outcome of the round for agriculture will be discussed and it will be argued that the agreement is highly significant, since, as a result, trade in agriculture is for the first time governed by effective rules. Against this

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<sup>1</sup> As a matter of convenience and not out of disrespect for EFTA- and Eastern European countries, the term "Europe" will be used as a synonym for the European Community.

background it will be shown that the EC's negotiating as a bloc was beneficial for free trade. France was induced to accept a more free-trade-oriented package due to France's integration into the European community. The importance of the Franco-German relationship to France led the French to accept a GATT deal even though they felt it was disadvantageous. France placed so much weight on her relationship with Germany and her influence in the EC that in the end France was willing to overcome the immense domestic pressures of the agricultural sector.

Furthermore, it will be asked whether the existing political economy models fit the reality as reflected during that time. Can the empirical case of France and the European Community be explained by the existing models? The suitable approaches within trade policy will be discussed and it will be suggested where an extension of models would be appropriate to formalize the findings. Trade policies are formed by the interactions between governments and interest groups. This endogeneity of trade policies is especially fascinating for the analysis of regional blocs. The paper will attempt to capture the features of this case in a game theoretic model of endogenous tariff making.<sup>2</sup>

To allow a clear analysis, the focus will be on three participants: the US, France and Germany. Within the European Community only France and Germany will be the countries considered. This simplification is justifiable, since France and Germany are *de facto* the main players within the European Community. An agreement on the Franco-German axis is always necessary for any dealings of the European Community. Furthermore, the focus on Germany and France in analyzing the dispute over the agricultural issues of the GATT negotiations is especially appropriate, since the two countries represent well the

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<sup>2</sup> Endogenous tariff theory has stimulated many research contributions over the last twenty years. Magee, Brock and Young produced as well as seminal papers also a book-length treatment of this subject (1989).

polar beliefs of the European Community.<sup>3</sup> While it is true that the other ten players are also important as they have the power to veto any agreements which seem to demand unbearable sacrifices, the dealings during the Uruguay Round showed that the agreements and disagreements between Germany and France in effect determined the policy of the European Community.

### **A Brief History of the GATT Negotiations during the Uruguay Round**

Under the auspices of the General Agreement on Tariffs and Trade, seven rounds of multilateral trade negotiations were held before the Uruguay Round. The results of the Tokyo Round (1973-79) were threatened by the global recession at the beginning of the 80's and by the debt crisis of the developing countries.<sup>4</sup> The United States proposed the initiation of a new round and in 1982 trade ministers met in Geneva, but the negotiations quickly collapsed due to French resistance to negotiate about any cuts in subsidies in agriculture.

In 1986 a new GATT round was finally launched in Punta del Este, Uruguay. Under pressure from the Americans and the newly-formed Cairns group of farm exporting nations, the European Community had reluctantly agreed that agriculture should be on the agenda for the first time. The Cairns group was established in 1986 with the goal of opening the world's agricultural markets.<sup>5</sup> These exporters of agricultural products suffered from the severe competition for

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<sup>3</sup> According to Padoan (1994), France and Germany also differ in comparative advantages: France enjoys a comparative advantage in agriculture, whereas Germany has a comparative disadvantage in this sector. The comparative advantages of Germany lie in the scale-intensive and specialized suppliers sectors.

<sup>4</sup> During 1981-82 most economies went through a severe recession and were faced with rising unemployment. World trade declined in both value and volume terms. Schott (1994) offers more background information about the negotiating history during the Uruguay Round.

<sup>5</sup> The Cairns group consisted of 14 countries: Argentina, Australia, Brazil, Canada, Chile, Colombia, Fiji, Hungary, Indonesia, Malaysia, the Philippines, New Zealand, Thailand and Uruguay.

export markets by the US and the EC. The export subsidies of the EC lowered the world prices for some commodities below the costs of producing. Falling agricultural exports in the US led to the widening of export subsidy programs. These developments forced many exporters of Cairns group countries out of the market.<sup>6</sup>

All GATT countries became members of a Trade Negotiations Committee which had the function of supervising the round. Below the Trade Negotiations Committee there was a Group for Negotiations on Goods, subdivided into 14 categories including tariffs, textiles, tropical products, subsidies, agriculture, intellectual property, the settlement of disputes, and the organization and policing of world trade. Parallel to this mechanism for the negotiations on goods was the Group for Negotiations on Services, which was kept separate to prevent trade-offs between concessions in services and concessions in goods.

From the beginning, it was apparent that agricultural disputes might derail the entire round. While the seven previous GATT rounds had reduced the average tariff on manufactured goods from 40 per cent to 4 per cent, protection levels for agricultural products had remained unaffected.<sup>7</sup> The negotiating governments believed, however, that a compromise could be reached. In reality the gap between the EC, the US and the Cairns group positions was just as large

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<sup>6</sup> See Tangermann's (1994) account of how small- and medium-sized agricultural exporting countries suffered under the burden of competition of the two agricultural "super-powers".

<sup>7</sup> In 1955 the US requested an exemption of agriculture from the GATT regulations in order to maintain their quantitative import restrictions on dairy products. Baldwin (1994) uses the 1955 GATT agricultural waiver as an example to show that the US was generally able to secure special privileges for itself due to its hegemonic role after World War II. In the following rounds the US wanted to deal with the agricultural sector in the same way as with the industrial sectors, whereas the European countries claimed that agricultural policies had to be excluded from any negotiations.



two years after the beginning of the round as at the start.<sup>8</sup> The US demanded the elimination of subsidies, while the EC wanted to retain its Common Agriculture Policy unchanged. Several members of the Cairns group announced that they would not sign any agreements unless agriculture was included.

In 1990, agriculture accounted for only 6-7 per cent of total US-EC trade. The EC exported to the US agricultural products worth about \$4.5 billion and received from the US imports of around \$7 billion. Given the small share of total bilateral trade, it is remarkable that agriculture has caused so many trade conflicts between the EC and the US.<sup>9</sup> However, the agricultural trade disputes between the US and the EC frequently concerned third-country markets. The US world market share in agricultural commodities fell from almost 20 per cent for most of the 80's to 12 per cent by 1988, rising back to 14 per cent by 1991. The EC market share in global agricultural trade increased during the same period from around 12 per cent in the 80's to 14 per cent by 1991.<sup>10</sup>

A major reason why agriculture is a very complex issue for policy makers and negotiators lies in the long tradition of income support for domestic agricultural producers. Both the US and the European countries have had policies of income transfer to farmers since the 1930's. The strong public support for different protectionist programs, especially within France, will be described later in order to highlight the difficulties faced by the governments in restructuring their policies.

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<sup>8</sup> The agricultural negotiations collapsed completely at the Ministerial Meeting in Montreal in December 1988. Tangermann (1994) gives an account of the early proposals of the different countries which were always judged as unacceptable by some other countries.

<sup>9</sup> 12 out of the 17 GATT disputes between the EC and the US have involved agriculture. A description of these disputes can be found in Anania, Carter and McCalla (1994).

<sup>10</sup> The US and EC export shares of the world agricultural market are cited from Anania, Carter and McCalla (1994).

By December 1991 progress had been made in many of the 14 areas of negotiation; however, the dispute over agriculture remained. The US and the Cairns group were pressing for cuts of 90 per cent of the European export subsidies to farmers. At this stage, the GATT director Arthur Dunkel compiled a comprehensive draft agreement consisting of previous accords completed during the first five years of the negotiations and proposed compromises for the unresolved issues. The Dunkel text remained the basis for debate until the conclusion of the round and concentrated the efforts of the negotiations to seven problematic areas - agriculture, textiles and clothing, market access, services, GATT rules, intellectual property and dispute settlement. Arthur Dunkel set Easter 1992 as the deadline for the participants of GATT to settle their differences. The Americans scaled down the size of their demands on agriculture but an overall accord was still impossible to reach. Political factors obstructed the negotiations, with the Americans reluctant to give concessions before the November presidential elections, and the French government restrained by the Maastricht referendum in September 1992 and the legislative elections in March 1993.

The Uruguay Round had shifted almost completely at that time from the intended multilateral activism envisaged by the idea of GATT to bilateral talks.<sup>11</sup> Whereas at the beginning of the negotiations several countries and groups like the Cairns group played important roles, the final period of the round was dominated by bilateralism. The most important and also most complicated bilateral negotiations occurred between the EC and the US. The other bilateral dealings between the US and Japan or Korea were conducted mainly to ensure that any resulting agreement of the EC-US talks would be acceptable to these countries.

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<sup>11</sup> Anania, Carter and McCalla (1994) state that the start of the round and its first steps had been characterized by "multilateral activism", but that bilateralism prevailed in the crucial stages of the negotiations, which designed the final agreement.

The North-South dialogue expected in the *Uruguay-Round*<sup>12</sup> was marginalized by the dominance of the agricultural trade dispute across the North Atlantic. The Uruguay Round progressed slowly, not because it was impossible for so many countries to agree on diverse issues, but because the two most important trading groups could not find common ground on agriculture.

In May 1992, the European Community managed to reach an accord on internal reforms of the Common Agricultural Policy, which opened the way for further negotiations. It was in November 1992 when US and EC negotiators met at the Blair House in Washington and finally agreed on a framework of cuts in farm support. In the key areas of the dispute the Blair House Accord included the following points:<sup>13</sup>

- Reduction of domestic support by 20 per cent over six years from a 1986-88 base was to be achieved using a total aggregate measure of support instead of considering each commodity individually. Cuts could be spread across all domestic subsidy programs rather than being enforced on a product-by-product basis.
- Volume of subsidized exports was to be reduced by 21 per cent and the value of export subsidies by 36 per cent over six years. As mentioned earlier, both the US and the EC had introduced support programs that had grown over the years into massive farm exporting subsidies, that had been distorting world agricultural trade for years. The Blair House Accord promised not only an

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<sup>12</sup> Elliott (1993) has claimed, that Punta del Este was chosen as the starting point of the round in order to stress the importance of the developing countries for the trade talks and to reflect the belief that the new round would be principally dominated by North-South negotiations. Schott (1994) believes that the expected North-South focus never emerged since the dramatic economic policy reforms in many developing countries often included the trade reforms that were initially the objective of the GATT talks.

<sup>13</sup> The cited figures and a description of the Blair House Accord can be found in Schott (1994).

end to the escalation of agricultural subsidies, but also a reduction of the current levels.

- Direct compensatory payments under production-limiting programs, as introduced by the EC in 1992 and as practised by the US with deficiency payments, were to be exempt from the policies that had to decrease their level of support.

The accord specified a reduction in farm subsidies from the 1986-88 base in six equal installments, thereby demanding disproportionately larger decreases for the early years in the areas where subsidized exports in 1993 exceeded those of the base period. Commodities that had experienced export increases between the base period and 1993 would have to lower their volume of subsidized exports by the recently gained increase and by the foreseen proportional cuts from the base. This requirement was rejected by France as unacceptable for her farmers, who had only recently increased their volume of subsidized exports for certain agricultural products.

The structure of the European Community was such that France could prevent the European Community from accepting the proposed accord. During the Blair House talks with the US as well as during all the GATT talks, the European Commission negotiated for the European Community. The role of the Commission is to propose the common European economic policies. Then the Council of Ministers, which includes a representative from each government, must decide on the proposals by a majority vote. However, as described in more detail later in this paper, a single country can veto a trade policy that is alleged to be contrary to fundamental national interests. The French government refused to ratify the proposed Blair House Accord. As a result, the European Community either had to demand further modifications of the agreement or find a way to convince France to give in.

## **The French-German Negotiations after the Blair House Accord**

The terms of the Blair House Accord were viewed as unacceptable by the French, but the agreement gave all sides a point of reference for further negotiation on agriculture and allowed them to work on other areas of disagreement, like the issue of market access. France maintained that the agreement would drive French farmers off their farms and also otherwise badly hurt French agriculture. Especially the requirement of the large cuts in subsidized exports from the beginning of the agreement led France to reject the Blair House accord. France had gained more from the increased EC market share in global agricultural trade (particularly in the grains sector) than any other EC country and had therefore more to lose through the required reductions of subsidized exports.<sup>14</sup>

The French position put a lot of pressure on Franco-German ties. Germany was a firm supporter of the Blair House agreement, which she viewed as ending all disagreements between the EC and the US on agricultural trade reform. The German government asked France to be more flexible in terms of the GATT talks in order to let the negotiations conclude before the new deadline of December 1993. Germany stated - as did the EC Commission - that the conclusion of the Uruguay Round, based on the Blair House Accord, would not require any further changes of the European Common Agricultural Policy (CAP). France maintained that the Accord would result in further drastic costs to EC farmers in addition to the burden of the CAP reform the EC had agreed upon in May 1992.

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<sup>14</sup> Murray (1993) states that France's farming lobby was fighting the Blair House Accord so vehemently since France was asked to take a large share of the cut in subsidized farm exports within the European Community.

The Franco-German alliance faced another crisis in the summer of 1993 due to the divergence between Germany and France over monetary policies. The Bundesbank refused to cut its principal interest rates. France was suffering from a recession and wanted lower interest rates to stimulate investment. Because the franc was linked to the German mark, France could not lower her interest rates without a corresponding reduction in German rates. The resulting currency crisis in the EC monetary system on August 1, 1993, produced both an agreement for wider bands of up to 15 per cent between the European currencies and an exchange of accusations between Germany and France. France accused Germany of selfishness in her refusal to help save the embattled French franc from the attack of speculators. Furthermore, the French government claimed that the high German interest rates were responsible for the slowdown of the European economy and the lack of new investments by firms. The German minister for economic affairs stated publicly that he did not think the German policy of keeping high interest rates had prevented France from resolving her own problems and that France should not think low interest rates would necessarily mean an increase in investment.<sup>15</sup>

Soon, however, the leaders in both countries stressed that the Franco-German alliance was both too strong and too important for either state to let temporary disputes threaten its existence. It was clear that Germany and France wanted to end their disputes, but the differences over issues like the GATT talks and interest rates were very great at that point. The interaction between France and Germany in the time between summer and December 1993 reflect that France was under more and more pressure to accept the GATT agreement, but also that Germany was willing to help the French government to avoid a situation that would be domestically judged as a French defeat.

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<sup>15</sup> This statement and a description of the exchange of accusations between Germany and France during the crisis in summer 1993 can be found in Mei (1993).

Before the Franco-German summit at the end of August 1993, the French Prime Minister Balladur said that he was still firmly opposed to any unilateral and "unequal" concession by the French side in the GATT negotiations with the US. He emphasized, however, that the good understanding in relations between France and Germany was the basis on which the future of Europe rested. Then, at the summit, the German Chancellor Kohl said at a press conference that he agreed with Balladur's contention that there were enormous problems with the agricultural part of the Uruguay Round negotiations. Kohl stated that a compromise had to be found that was acceptable for everyone. After the summit German officials stressed that Germany's doubts were not a question of new negotiations of the Blair House Accord, but a question of how to deal with the difficulties that would arise when the agreement came into force. The Germans believed that returning to the negotiations over agriculture would only delay the signing of the GATT and would not offer any new prospects for an agreement between the US and Europe. Settling the GATT would help to lead the German and European economy out of recession and was of political importance for the German elections in the year 1994. Germany tried to show the French government that France was left with few other possibilities than to drop the demands for further negotiations of the farm deal.

The French were running out of options. The only possibility was a veto of the GATT agreement within the European Community that would have isolated France and led to a diplomatic crisis both within the EC and between the EC and the US. The rejection of the GATT agreement would have led in a strictly legal sense to the maintenance of the status quo, but for the momentum of liberalization of world trade it could have been a deadly blow. However, the French government needed an agreement that might save face at home. Balladur had committed himself to fight any serious limitation on French farm exports during

the spring parliamentary elections. Aware of this French dilemma, the US Trade Representative Mickey Kantor stated that the US would not rule out a certain amount of flexibility on conditions that would not require the renegotiating of the Blair House agreement. For example, interpretations of marginal points could be added to the agreement. In December 1993 the EC and the US negotiators agreed to further modifications of certain aspects of the Blair House accord. Specifically, the requirement for the immediate sharp cuts in export subsidies was changed. However the accord offered a conclusion with a relatively quick (faster than many expected) restoration of market-driven pricing of agricultural exports.

### **The Final Agreement of the Uruguay Round**

The resulting Agreement on Agriculture included the main elements of the Dunkel Text. The new Agreement kept unchanged from the Dunkel Text the tripartite structure of 'market access', 'export competition' and 'domestic support'. In each of these three areas the targeted rates of reduction and new rules were defined:<sup>16</sup>

For 'market access' the agreement included for the base of 1986 to 1988 a tariffication of Non-Tariff-Measures, a reduction of new tariffs by 36 per cent on average and by 15 per cent at least and an increase in minimum access commitments from 3 per cent of domestic consumption to 5 per cent. In establishing the equivalent tariff of a market access restricting policy, flexibility in the selection of the base price during the base period allowed countries to set very high tariff levels.<sup>17</sup> Even after being reduced by at least 15 per cent the resulting tariffs for some goods were still more than 100 per cent. The

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<sup>16</sup> The following figures come from Tangermann (1994) and Josling (1994).

<sup>17</sup> Under the 'rice clause' Korea, Japan and some other countries can exceptionally keep some Non-Tariff barriers. Otherwise tariffs are the only market access restricting devices for a government.



Agreement on Agriculture did not achieve a significant immediate liberalization for these goods. The real achievement was in the conversion of non-tariff restrictions into tariffs. During the preparation for the Uruguay Round negotiations, tariffication was seen as so difficult to achieve that the GATT Committee on Trade in Agriculture instead considered the setting of clearer rules for the use of non-tariff measurements. In this respect, the quantifying of non-tariff import barriers that can then be more easily monitored and reduced is significant.

In the area of 'export competition', the volume of subsidized exports from a base of 1986 to 1990 had to be reduced over six years by 21 per cent and outlays on export subsidies by 36 per cent.<sup>18</sup> This measure ensured that the world market share held by subsidized exports was controlled and decreased over time. No new export subsidies could be introduced. From an economic perspective, defining the reduction of export subsidies per unit instead of total volume would have been preferable. The choice of limiting the quantities exported with subsidies reflected that the volume of trade was easier to monitor, but risked even further involvement by the government in order to fine-tune the control of supply.

'Domestic support' was subject to a 20 per cent reduction in the total aggregate measurement of support from a base of 1986 to 1988. The restriction on total instead of product-specific measurement of support permitted the retention of a wide variety of options to be used by domestic agricultural policy makers. Furthermore, exceptions to the 20 per cent reduction in total aggregate measurement of support were granted: Under 'production-limiting programs' certain mechanisms of domestic support like the European compensation

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<sup>18</sup> As in the other provisions of the Agreement, developing countries have to fulfil only two-thirds of the required reductions, i.e. reduction of volume of subsidized export by 14 per cent over ten years and a decrease in expenditure by 24 per cent over ten years.

payments and US deficiency payments were exempted from the reductions.<sup>19</sup> All these exceptions were a blow to the free-trade advocates. On the positive side, however, the domestic measures a government could use without violating GATT obligations were explicitly defined. The Agreement on Agriculture is less restrictive in the area of domestic support than hoped for by many negotiators at the beginning of the Uruguay Round. It reflected the difficulties governments had in accepting the loss of this instrument for supporting producer interests.<sup>20</sup> Considering the circumstances, the decrease in the level of domestic support was all that could realistically be expected at that point.

The Agreement on Agriculture was highly significant, since for the first time in the history of GATT, trade in agriculture was governed by effective rules. Through the dispute settlement mechanism these rules could be effectively enforced. The governments had agreed to legally binding agricultural policies and from now on were limited in the design and administration of farm support programs. The Uruguay Round Agreement covered all policy measures affecting international trade and obliged all participating countries to undertake specific commitments in the agreement's implementation. Previous rounds of the GATT scheduled only tariff reductions for each individual country and excluded export subsidies or total support measures. The advancement in this area underlined the success of the Uruguay Round.

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<sup>19</sup> Under the 'green box' policy, domestic support measures that have minimal impact on trade are also excluded from reduction commitments. Such measures include general government services, for example in the areas of research, disease control, infrastructure and food security.

<sup>20</sup> Tangermann (1994) claims that against the given background, the Agreement on Agriculture is a "remarkable achievement".

The positive<sup>21</sup> evaluation of the Uruguay Round is based on its progress in long-term trade liberalization and not necessarily on its short run effects. Theoretically, the immediate commencement of free trade could have been the outcome of the GATT round. Realistically, what was achieved was already the maximum attainable at this stage. The Agreement will not have, in the near future, drastic effects on the support policies of the EC, the US and Japan. The EC and the US could accommodate the required reduction in domestic support and export subsidies programs without any radical cuts in any agricultural policy.

Various estimates have been made of the overall impact of the Uruguay Round agreement on world trade: The GATT Secretariat put the average annual increase in total output at approximately 3.5 per cent compared with the less than 3 per cent increase that would have been achieved without an agreement.<sup>22</sup> Mickey Kantor, the US Trade Representative, estimates that in the first 10 years the Uruguay Round alone will create six trillion dollars in new gross product in the world, one trillion of this amount will occur in the United States.<sup>23</sup> A high percentage of these benefits will occur due to the reduction in distortional policies within agriculture. Even with a bit of skepticism about these claims of economic growth, the conclusion of the Uruguay Round was a great achievement. By reaching an agreement, the danger of a collapse of the GATT system was overcome, avoiding trade recriminations and a descent into disruptive and dangerous global trade conflicts. The gains of the Uruguay Round are highly significant, especially for agricultural negotiations in the long run. They

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<sup>21</sup> Economists' assessments of the outcome of the Uruguay Round are divided. Deardorff (1994) concludes that the economic effects of the Uruguay Round are small. Lawrence (1994) states in his comment on Deardorff's paper that "the round's achievement are considerably more significant than [Deardorff] suggests" and that the "effects should be characterized as large rather than small."

<sup>22</sup> The estimate of the GATT Secretariat was cited in "Agra Europe"(1994).

<sup>23</sup> Mickey Kantor quoted this figure from McGraw Hill in his "Remarks on the GATT", Federal News Service, December 20, 1993.

overshadow the fact that certain concessions had to be made. The Uruguay Round signals fundamental change in the direction of the agricultural sector and has the potential to transform the perceptions of governments about their roles in production, processing and trade in agricultural commodities. The GATT agreement will eventually prevent nations from supporting agriculture without regard to cost, either to their national treasuries or to other nations.

### **What did France give up and why did France give in?**

The analysis of why France resisted giving up a costly and distorting subsidy program for her farmers for so long is connected to her political history as well as to the very effective lobbying of agricultural interest groups. France and most other European countries have had a different political standpoint compared to the US about the role of the government in determining the income of particular groups and in achieving national economic goals. Support programs by the US government such as for agriculture or the textile industry are the exception rather than the rule. Intervention of the state in order to help certain sectors within Western Europe has been more pronounced. In the 1950's France had extensive support programs for most key industries, which she influenced with the control of credit, raw materials and imports. The level of state intervention has been gradually reduced in most EC countries but the amount of subsidies to declining industries like agriculture, shipbuilding and coal mining is still extensive. Compared to Britain and Germany, France's government plays a significant role in the direction and control of industrial activity such as the automobile industry.<sup>24</sup>

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<sup>24</sup> Baldwin (1994) discusses the extensive government intervention of the European Community countries in the post-World War II period.

In addition to this tradition of governmental influence on economic affairs in France it is important to take into consideration the French public's belief that farmers deserve assistance more than any other sector. It can be argued that no other industrialized country offers as much influence and subsidies to her farmers as does France.<sup>25</sup> Many of the French voters value the benefits conveyed by traditional family farming such as the preservation of the natural environment and are therefore willing to accept a special (and costly) treatment of the agricultural sector. French agricultural subsidies enable small farmers to keep the countryside the traditional way and to avoid the scenario of an abandoned and barren landscape.

Furthermore, the farmers are favored by the distortions of the French electoral system. Firstly, though active farmers make up only 4 per cent of the electorate, they deliver 8 per cent of the vote in national elections due to their high turnout rate. Secondly, the French electoral system gives the farmers a disproportionate chance to become elected officials. More than a third of the country's mayors are active or retired farmers. The municipal councils elect indirectly the members of the French Senate. As a result farmers are over-represented in the French upper house. The Balladur government needed the farmers as a part of Senate majority during the last year of the Uruguay Round and was therefore not in the best position to ignore the Senators' preference for protecting agriculture.<sup>26</sup>

As a result of strong migration from farms to the city, rural areas also receive more seats in the National Assembly than are justified by the number of

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<sup>25</sup> One explanation offered for this phenomenon is the French obsession with food and their "quasi-religious" respect for the producer of French food. A discussion of this cultural influence on the commercial interests is given by Dale (1993).

<sup>26</sup> Under the title "In France, the Farmer is King" Stokes (1993) gives an account of the peculiarities of the French political system that allows the agricultural sector to exert great pressure.

inhabitants. Additionally, the French presidential election system makes it hard for a candidate to ignore the interests of the farmers. The runoff system of choosing which two candidates proceed to the second round allows the farmers - belonging mainly to the conservative parties - a great deal of influence in selecting the conservative candidate. For example, in 1988 the farmers accounted for nearly every fourth vote for the conservative winner of the first round, Jacques Chirac. Both Chirac and Balladur were keen to become the conservative candidate of the right for the presidential election in 1995. Balladur as the Gaullist prime minister could not afford to be too tough on the farmers. French industrialists were convinced that a GATT agreement was essential for the future health of the nation's trade sector. However, the industrialists could not mitigate the influence of the powerful farm lobby. The disproportionate domestic political power of the French farmers blocked for a long time any European agreement to a multilateral cutback on trade-distorting agricultural support. French agriculture, which holds the greatest share of the European export market for food commodities, has more to lose than the farming sector from any other European Community country. The French government insisted for a long time that the common agricultural policy already inflicted a burden on the farmers and that the farmers should not bear additional costs caused by GATT. The French government wanted to maintain the status quo in the European agricultural policy, but gave in eventually due to the pressure of her European partners.

In Germany, there was a widespread belief that the mechanism of domestic agricultural support had become too costly and troublesome. Like France, Germany had a well organized and influential agricultural sector that wanted to keep its subsidies and was willing to fight with determination any threat of reductions. German as well as other European officials believed that these domestic problems could be solved internationally through modified trade rules and agreements for lower protection. The negotiations of the Uruguay Round

were therefore seen as a way to force the domestic agricultural sectors of the European countries to give up their perceived right to massive subsidy flows. As discussed above, however, it was exactly this connection with the domestic agricultural policies that made the final agreement of the Uruguay Round so hard to reach, since no solutions to the problems of agricultural trade rules could be found without changing the fundamental issues of domestic farm policies. Within Germany there had been a long consensus of the government and industry that a GATT agreement would be vital for the German economy, since many industries depended on free market access for their export goods. Germany held firm to the international trading system as the root of her post-war prosperity and believed that the conclusion of the new GATT round would be important for Europe because it meant the continuation of building up competitiveness, the opening of new export markets, and the restructuring of industries without radical displacements. If subsidies to the agricultural sector had to be cut to achieve this objective, the political and economic gain was seen to be higher than the political loss.

German industrialists challenged the French view that the Blair House accord would seriously hurt the European farmers and stated that just 10 per cent of France's annual agricultural exports of around 200 billion French francs were subsidized to non-EC countries and accounted for less than one per cent of total French exports.<sup>27</sup> In addition, the German association of exporters and importers accused the French government of an outdated sentimental attachment to her farmers even though they accounted for only seven per cent of France's gross domestic product and five per cent of her jobs.<sup>28</sup> The German association representing companies in export and import wanted the conclusion of the GATT

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<sup>27</sup> Murphy (1993) cites with these figures the president of the Federation of German Wholesale and Foreign Trade (BGA), which represents 126,000 companies involved in imports and exports.

<sup>28</sup> Quoted in Murphy (1993).

round and was therefore rather outspoken in its criticism of the French position. The Association's judgment of the French government's outdated sentimental attachment to the agricultural sector seems, however, to capture the fact that the French government based its decision not on economic, but on political calculations. Germany used all the different channels available to influence France and persuade the French government to accept the GATT agreement.

After months of dispute over the Blair House Accord, France was fully aware that a failure of the Uruguay Round on trade liberalization would be blamed on France. More importantly, a failure would provoke a European political crisis and almost certainly another European monetary crisis. France would have lost her hard-fought-for credibility in economic and monetary affairs. The French government had great ambitions for its role in Europe in the time after the ratification of the Maastricht treaty and would risk the implementation of Maastricht should GATT fail. France was committed to work out a joint economic convergence program with Germany, but a refusal to sign the GATT agreement would have endangered the Franco-German axis and isolated the country within Europe. This perspective led some in the French government and public to question the wisdom of maintaining a standpoint apart from all others on the GATT. For all these reasons, France finally dropped her opposition to the reduction of agricultural export subsidies and received as a concession a flexible time schedule to cushion the impact on her farmers at the beginning of the implementation period. The agricultural sector was brought under GATT discipline and France rejected the temptation to embrace protectionism.

The importance of the Franco-German alliance and of the European Union in convincing the French government to finally accept the GATT agreement was recognized by observers. A newspaper report in August 1993 (four months before France eventually gave in) stated that "the perceived need in both Paris



and Bonn to preserve the goal of a European Union which has economic and monetary collaboration at its heart, is likely to be the catalyst that brings France into a common position on the GATT issue."<sup>29</sup> Why then, did it take the French government so long to accept the GATT agreement? After the Blair House Accord, accomplished by the European Community negotiators, France could react in one of three ways: 1) (Reluctantly) accepting the proposal as the best deal available for the European Community, 2) Completely and permanently refusing the deal, or 3) Declining to accept the Blair House Accord immediately in order to gain time. Time could be useful to the French government to postpone the agreement to the GATT until after the parliamentary elections or perhaps to obtain concessions from the GATT partners or compensation for French farmers through the European Community.

The influence of the vociferous and powerful French farm lobby made it impossible for any French party to endorse the Blair House Accord without risking the loss of an important part of the electorate in the up-coming parliamentary elections of spring 1993. Supporting the GATT agreement with the scheduled reductions in subsidized exports would have meant for either of the French main parties - socialist or conservative - having to endure the accusations by the farm lobby of betraying France's fundamental interests. An immediate acceptance was therefore not feasible for the socialist government which had to calculate the effect on the elections. The conservative party of Balladur fought the parliamentary elections of spring 1993 on a platform that was heavily dependent on a strong anti-GATT position and promised a commitment to fight any serious limitation on French agricultural exports.<sup>30</sup>

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<sup>29</sup> Agra Europe (1993).

<sup>30</sup> A description of Balladur's election promise to "unravel the Blair House agreement" is given in Agra Europe (1993).

After Balladur won the parliamentary election, he had to face the difficulty of combining this extreme standpoint with the realities of the European Community. As described above, the situation was such that a complete refusal by France to accept reductions in subsidized exports would have endangered the whole process of further European integration. With the election passed, the French government wanted to turn to its objective of reinforcing the agenda of the European Community and was determined to begin a new phase of the European Economic and Monetary Union in January 1994 as scheduled. Balladur felt that the preservation of the European Community, even with unfavorable consequences for the French farmers, would be more valued by the French electorate at that stage than a European economic and political crisis in order to please the agricultural sector. The French government changed to a more constructive posture regarding the Blair House Accord which eventually led to the French agreement to the GATT deal.<sup>31</sup>

As expected, the French and other European farming organizations denounced the Agreement on Agriculture as totally unsatisfactory and stated that "Europe sold out to the US".<sup>32</sup> The Committee of Agricultural Organizations in the EC and the General Committee for Agricultural Affairs called for the continuation of the "golden principle"<sup>33</sup> of Community preference for all agricultural products against cheap imports, effective rebalancing of border protection to limit imports of substitutes into the EC and a genuine safety clause against currency and world market price fluctuations for all agricultural products. In France, the Federation Nationale des Syndicats d'Exploitants Agricoles

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<sup>31</sup> The loss of Balladur in the first round of the presidential election in April 1995 might indicate that he miscalculated the effects of an agreement to the GATT round on the electorate. The other conservative candidate Chirac, who has frequently backed farmers' call for more protection, surpassed Balladur in popularity and became president of the French Republic.

<sup>32</sup> Agri Service International (1993).

<sup>33</sup> Agri Service International (1993).

(FNSEA) said the Geneva agreement was "bad for agriculture" and the few changes made to the 1992 Blair House agreement in the last few days had not affected its substance, nor mitigated its "perverse nature".<sup>34</sup>

In conclusion, this analysis of the negotiations during the Uruguay Round indicates that a very beneficial multilateral free-trade agreement was reached due to the pressure of a regional bloc on a member country which had the power to block any deal. France gave in since she had so much to lose in influence and standing within the European Community, particularly with Germany. The diplomatic ties between France and countries outside a highly-integrated economic and politically entity would have also suffered greatly in the case of a rejection of the GATT agreement. It was, however, the great interdependence of France with Germany and the other European Community countries that substantially increased the stakes. Faced with risking a split within Europe, the French government under Balladur chose to sacrifice its influential and politically powerful agricultural sector.

It could be argued that the fact that European countries negotiated as one bloc made it harder for the US to force a deviant country into agreement. If France had negotiated alone, could not the US have more effectively threatened France with sanctions for refusing to accept free-trade agreements? History offers a good answer for this scenario. In the Kennedy Round, when the European Community was far more loosely tied together and the US was the undisputed global hegemon,<sup>35</sup> it was not possible for the US to get agriculture on the negotiations-table.<sup>36</sup>

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<sup>34</sup> Agri Service International (1993).

<sup>35</sup> Of course, during the Cold War there were two political super-powers. For world trade politics, the United States had a hegemonic status, that allowed her to dominate and shape agreements, by and large, according to her preferences.

<sup>36</sup> Claimed by Lawrence (1994).

## French Tariff Bargaining under a Political Economy Perspective

The beginning of the 90's has seen important episodes of regional integration. Developments like the increased cohesion within the European Community and the signing of the North American Free Trade Agreement have led to the concern that regional trade agreements might have adverse effects for multilateral co-operation. This is, however, a recent concern. Among economists there existed a widespread belief that regionalism was compatible with GATT.<sup>37</sup> The formation and widening of the European Community appear to be huge motivating forces for the Kennedy round and the Tokyo round of multilateral GATT negotiations initiated in 1962 and 1974.<sup>38</sup> Non-European nations were afraid to lose market shares within the European Community to European competitors. The counterbalance to the liberal internal trade policy would be a substantial reduction in the external tariffs. It was judged that the best way to encourage the European Community to adopt such measures was a new trade agreement. Concerns about the adverse effects of regional trade agreements have recently grown due to the rise of the "new protectionism" of voluntary restraint agreements and antidumping actions and thus, many economists have tried to assess the relationship between regional blocs and protectionism. Specifically, the policies of the European Community on world trade have been closely examined by recent formal analysis. The researchers used different approaches and the rest of this paper will investigate where and how the analysis of the recent GATT round fits into the literature.

One important part of the literature focuses on tariff bargaining between regional blocs. Krugman (1991) uses a model of  $N$  identical countries and  $B$

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<sup>37</sup> Bagwell and Staiger (1993) quote Bhagwati that the perception in the 1960's was one of a general compatibility between regionalism and GATT.

<sup>38</sup> As asserted and documented with historical evidence by Bagwell and Staiger (1993).

identical blocs. Each of the countries produces one differentiated product, whereas the consumers consume all goods. The countries of one bloc take the policies of the other trading blocs as given and impose a welfare-maximizing tariff on goods from countries outside their own bloc, but do not restrict the imports from bloc-members. The model suggests that as countries integrate into larger and larger blocs, each bloc gains a greater market share in the other blocs. The increased market power raises the tariff level and decreases welfare.<sup>39</sup> The welfare loss occurs because the integration causes trade diversion and higher external tariffs. Therefore Krugman's simple model predicts that the existence of the European Community has negative effects on the multilateral trading order. However, the model does not reflect reality well enough, since it assumes that all blocs increase in size at the same rate and since it neglects for example the effects of comparative advantage.

The issue of comparative advantage for this model is investigated by Bond and Syropoulos (1993b), who find that by including comparative advantage through a simple endowment structure, optimal tariffs can actually fall as blocs increase symmetrically. Furthermore, Bond and Syropoulos examine the case of asymmetrical extension of trading blocs and show that the membership in a comparatively larger bloc is positive for the welfare of the participating countries. Adjusting the model further to the realities of trade policies, Bond and Syropoulos (1993a) take into account that tariffs are not set in a welfare maximizing way. They assume that blocs set tariffs in a repeated tariff-setting game and analyze how the size of the blocs influences the ability of the blocs to support free trade by using trigger strategies. If a bloc defects from the agreed terms of free trade,

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<sup>39</sup> Of course, when the world consists of just one bloc, the world welfare is maximized. Krugman (1993) showed in a revised model that for world welfare the worst number of blocs is three. Krugman warns that the result of his highly stylized model is fragile and emphasizes that real-world trade policies are set through negotiations and not through completely noncooperative actions.

the other blocs retaliate with a perpetual trade war. Bloc size produces two conflicting effects: on the one hand, the larger the blocs are, the larger are the incentives to deviate from free trade. On the other hand, larger blocs will lead to greater welfare losses in the case of a tariff war. Simulation results indicate that the first effect outweighs the second one: as trading blocs increase in size it becomes more difficult to sustain free trade. Additionally, maintaining free trade is more difficult, the greater the size differences of the blocs.

How do these insights relate to the actual world and to the GATT rounds? The last finding about the size differences can be connected to the evolution of the European Community. Before the European countries were integrated, the US could dominate the smaller and separate countries more easily. After integration the EC and the US became more equal. This would indicate that the European integration made it easier to maintain free trade.

Similar to the models described, Bagwell and Staiger (1993) presume that countries are unable to make binding international commitments, but have to rely instead on self-enforcing arrangements. Bagwell and Staiger believe that enforcement issues are central to an understanding of the dynamic behavior of trade intervention in a world where countries attempt to maintain cooperative trade policies. Based on this belief Bagwell and Staiger analyze the effects of regional trade agreements on the ability of countries to maintain cooperative multilateral tariffs. Focusing their examination on the period of transition, during which a regional free trade agreement is negotiated and implemented, Bagwell and Staiger find that the tension between regional free trade agreements and multilateral liberalization is temporary. As the new trading pattern gets more established, multilateral cooperation returns to its previous levels.

Generally, the models of tariff bargaining described reveal important insights, but rest on specific assumptions and produce different predictions when the assumptions are modified. For example the discount rate is crucial for the effects of the trigger strategies, since it determines the balance between the immediate gains from defections and the later costs of the resulting trade war. In addition, the more general assumptions of these models, such as that integration would take place throughout the world, make their use for the analysis of EC behavior problematic, since the European process is more an isolated instance of advanced integration. Granted that formal analysis has to rest on assumptions, it still has to be stated that no model of tariff bargaining is yet available that fits the realities of the EC and its internal and external relationships well enough to permit a formal analysis of the Uruguay round negotiations.

Another important part of the existing literature examines the negotiations that take place within the European Community. This approach seems to be more suitable for the modelling of the negotiations between France and Germany during the Uruguay round. Winters (1994) analyzes the process of European Community decision-taking to answer the question of whether the EC has led to greater protectionism than would have occurred in its absence. He investigates whether the EC is more or less protectionist than one would expect given the objective features of its component economies and its member governments' protectionist preferences. Winters's focus is on the mechanism of policy making within the EC. The European Commission proposes policies whereas the Council of Ministers accepts or rejects the proposals, though it also can amend the proposals unanimously. The Commission is independent of the national governments, whereas the Council includes representatives from each government. The acceptance of the Commission's proposals requires a qualified

majority of vote<sup>40</sup> and a rejection of the proposal leaves the status quo in place.<sup>41</sup> Often the status quo suits the national governments, but renders the Commission powerless. The Commission tries to work out compromises between the European countries in order to get proposals accepted by the Council. The need for compromising between the countries can be modelled in such a way that this decision-making structure would lead to increased protectionism.

A model used by Winters can be modified for the case of GATT negotiations. It is assumed that France, Germany and Italy are the only members of the European Community and want to decide on the best strategy of negotiations during a GATT round. In the discussion about protection of agricultural goods all three countries agree that protection is harmful to and expensive for the EC. Furthermore, it is assumed that each country produces one kind of agricultural commodity. If an agricultural commodity is protected, the country with the protected good receives from the protection a benefit of  $c$  due to the increased surplus of the producers within this country. However, all three countries share the cost of this protection consisting of the sum of the deadweight loss,  $d$ , of transferring  $c$  through protection and the amount transferred,  $c$ . In the case of similar population size and GNP, the cost of protection to one country equals:  $-(c + d) / 3$ . The Community decides by simple majority whether it should negotiate with the GATT partners that agricultural products can be protected within Europe.

Each of the three countries accepts that if it votes against the protection of agriculture, its agricultural product will not be protected. If the countries vote against the protection, the net costs are zero. The costs and benefits of voting for

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<sup>40</sup> A qualified majority vote requires 54 out of 76 votes (for the Community consisting of twelve member countries). The votes within the Council are distributed among the countries approximately according to population size.

<sup>41</sup> A single country can veto any Council decision, if essential national interests are threatened.



or against protection can be determined for a country such as France. By voting for the protectionist measure, France increases the probability that the costly measure passes, but gains some compensating benefits if it passes. By voting against the protection, she saves all countries some cost, but does not gain any compensating benefit, if the measure passes. Assume that France believes that the other countries have incentives to vote for the protection and has therefore to choose between the cost of  $-2(c+d)/3$  if she votes against the measure and the cost of  $-3(c+d)/3 + c = -d$  if she supports the measure. France will vote for protection when the deadweight losses are less than twice the transfer. This game illustrates therefore that countries might support measures that are costly to them. In a sophisticated community, countries would see the incentives for each other and would find a way of ensuring that the net costs are zero; i.e. that they all vote against the protection. However,  $c$  and  $d$  differ between the countries in the real world and national governments within the European Community have the incentives to seek the protection of goods when the benefit is higher than the share of the cost.

The insights gained from the analysis of the negotiation between France and Germany during the Uruguay round suggest that a model of decision making would have to incorporate the influence of the regional bloc on its members. This influence consists in the pressure to force members into a common policy but also in the value the members place on the existence of the bloc. The advocates of an integrated Europe believe that there are great economic and political benefits of a regional bloc. Integrating the European economies will yield greater efficiency, more choice and more prosperity. Uniting politically will give Europe greater possibilities to have decisive influence on world affairs. The French government was a strong supporter of further European integration and valued this benefit of the European Community highly. A crisis within the European Community caused by the French failure to sign the GATT agreement would have endangered

the political and economic advantages of the European Community to France. No model exists yet within the literature about European Community decision-taking that builds in the perceived benefit of the European integration to member countries. This benefit might outweigh the domestic costs of a policy that is wanted by the Community member countries, but rejected by influential domestic groups.

A simple game theoretic model of endogenous tariff making illustrates a possibility of including the value of the European Community to member countries. Within the framework of the previous model, assume that the French government perceived to gain the benefit of  $b$  if agriculture was protected.  $b$  consists of the increased producer surplus,  $c$ , and the domestic political gain,  $p$ , in terms of winning the approval of influential groups. As described, the French government was faced by a vociferous agricultural sector and by a public that was willing to bear the costs of supporting farmers. The costs of protection to France would be the transfer from consumers to producers,  $c$ , and the deadweight loss,  $d$ . The French government would therefore support protectionist measures as long as  $p$  was greater than  $d$ . Insisting on protection of the agricultural sector would have led to a diplomatic crisis with Germany. As shown, the consensus within Germany was more liberal and Germany wanted the GATT round to lead to increased free trade and less protection in the agricultural sector. For France, the costs of trouble with Germany (representing the whole of the EC),  $T$ , would be very high, since the advanced integration within Europe would make a crisis at that point very costly. The costs of trouble,  $t$ , with the non-integrated countries such as the US over France's insistence about agricultural protection would have been relatively smaller due to the lower interdependence.  $t_1$  stands for the imaginative cost of trouble with the non-integrated countries, assuming that the European Community did not exist, and  $t_2$  is the costs of trouble with the non-integrated countries assuming that the EC exists.  $t_1 > t_2$  and  $T + t_2 > t_1$ .

Taking the diplomatic problems into account, the cost-benefit analysis for France changes. Without European integration, France would have supported protectionism as long as  $p$  was greater than  $d + t_1$ . Considering the domestic situation of the French government with upcoming elections it seems reasonable to assume that  $p$  was greater than  $d + t_1$ . With European integration and a looming European crisis in the case of a failure to sign the GATT, France would have supported agricultural protection when  $p$  was greater than  $d + T + t_2$ . As mentioned,  $T$  would have been very large and it can be conceived that  $p$  was actually smaller than  $d + T + t_2$ . This would allow the conclusion that France accepted to sign a more free trade orientated GATT than wanted by France due to European integration. It is conceivable that  $T + t_2$  is greater than  $t_1$ . This result means that the final outcome of the GATT was less protectionist than if France and Germany had negotiated individually. Germany outside a European Community with France - even in conjunction with all the other countries - would not have caused so much diplomatic trouble and costs to France as in the case of a integrated Europe. The need for an agreement during the Uruguay round between Germany and France made Europe as a whole less protectionist than if these countries had negotiated individually.

This game theoretic model of endogenous tariff setting indicates one way of capturing an important aspect of regional blocs in a formal model. However, there is yet ample room for more sophisticated models of the negotiations between countries during multilateral talks. Within the existing literature, quite different approaches have been tried for the analysis of regional blocs. Decision-taking models seem to offer the best direction for modelling the negotiations that took place within the European Community during the Uruguay Round, but do not yet offer a suitable version.

## Conclusion

When an incidence of actual trade history like the Uruguay round is considered, it is difficult to determine objectively what would have happened if the European countries had not been integrated. It is commonly stated that the creation of the European Community meant that all European Community countries liberalized on average, but that the effect on the more liberal economies is unclear. Was German liberalism constrained by the Community, and is Germany today more protectionist than she would be without the European integration? Attempts to assess the effects of the EC on world protectionism in comparison to what would have happened had it not been created, have been criticized as "rather unscientific".<sup>42</sup> Our assessment of the impact of European integration on the multilateral trading system (as in the case of a GATT round) might draw the same criticism, since one just can not determine exactly what the actions of the individual European countries would have been in the absence of integration. Nevertheless, the analysis of what happened during the negotiations of the GATT and within the European community sheds light on the effect of a regional bloc. Examining the behavior of the individual countries and of the sum of integrated countries reveals insights, that can be used to decide whether claims about protectionism of blocs are justified. It has been shown that being a member of the European Community had a liberalizing effect on France during the Uruguay Round. France was led to accept a GATT deal that included stronger free trade policies than wished and fought for by France. The existing approaches do not yet include the appropriate models to determine the conditions under which the conclusion regarding France could be generalized. In this respect, the investigation into the bargaining within the EC during the Uruguay round delivers a vital contribution to the existing literature about the relationship

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<sup>42</sup> Winters (1994) cites authors that use speculation about what might have been different without the creation of the European Community for their assessment of the effects of the EC on world protectionism. Winters grants that this is a natural approach, but nevertheless a rather unscientific one.

between European integration deepening and protectionism against non-member countries and calls for further research.

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