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SCENARIOS FOR EXAMINING GENERAL TRADE AGREEMENTS

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WITH

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1 Current trade issues

Multilateral trade talks collapsed at the fifth World Trade Organisation (WTO) ministerial meeting in Cancún, Mexico, in September 2003. Efforts to move the talks back on track with a view to concluding the current round of negotiations, known as the Doha Development Round, have not yet led to any major breakthrough. In the meantime, negotiations of new regional and bilateral trade deals have rapidly gathered pace. These new regional trade agreements are not merely between neighbours and 'equal' trading partners, but stretch across continents and different levels of economic development. Today, virtually all countries are members of a bilateral or regional trade agreement or in the process of negotiating membership, and several are members of more than one agreement. Regionalism has thus become an inherent part of the global trading system. This section sketches the current trade issues as they relate to the multilateral trade talks (section 1.1) as well as the regional and bilateral trade talks (section 1.2).[1]

1.1 Multilateral trade issues

After the collapse in Cancún, WTO members met in Geneva from 22-26 March 2004 to formally re-launch the agriculture negotiations, which are seen as the key to the Doha Round. Members met again both in April and June seeking to regain momentum. More specifically, the goal of these talks has been to agree on framework modalities by the end of July 2004. The challenge is to agree on a package of proposals that satisfies both developed and developing countries before the window of opportunity is closed by the US presidential election and the changeover in the European Commission in November. At the time of writing (1 July) no draft

[1] Unless otherwise specified, the information comes from the most recent electronic issues of the *BRIDGES Weekly Trade News Digest* (retrieved from http://www.ictsd.org/weekly/index.htm).

framework text has been produced for agriculture. Yet given the accelerating intensity of the negotiations during the 23-25 June special negotiating session of the Committee on Agriculture, an agreement on a framework accord before the end of July seems possible. In summary, market access remains by far the most difficult negotiating pillar, whereas there seems to be an emerging consensus on domestic support and hopefully also on export subsidies. The next 'agriculture week' is scheduled for 14-16 July.

In an effort to spark new momentum in the negotiations, EU Trade Commissioner Pascal Lamy and Agriculture Commissioner Franz Fischler sent a letter to the trade ministers in all WTO member countries (9 May 2004), in which they asserted that there seemed to be a stronger sense of resolve to make progress on the Doha Development Agenda.[2] Yet they also stressed that in their view progress requires movement on all three pillars – market access, domestic support and export support. Other countries have also sought simultaneous action on several fronts. Members of the Cairns Group and the G-20 group of developing countries (see the Appendix for country groupings), for example, link the opening of their agricultural markets to obtaining ambitious results in the subsidies negotiations, i.e. concerning domestic support and export subsidies. Moreover, the EU has also stressed that non-trade concerns need to be included in this balance of the three pillars.

The major stumbling block in the multilateral trade negotiations continues to be *market access*. WTO members are currently discussing various tariff-reduction formulas. One proposal is to use a so-called 'blended formula', where tariffs are reduced according to a mix of three approaches: the Uruguay Round approach,[3] the Swiss formula[4] and cutting tariffs to zero. The blended formula originally emerged in a joint EU-US position prior to Cancún. The US has since strengthened its perception of the blended formula by requiring that at most 3% of all agricultural tariff lines may fall under the generous Uruguay Round band, whereas the rest should be reduced using either the more stringent Swiss formula or simply cut to zero.

The EU, members of the G-10 and certain developing countries find the US version of the blended formula too restrictive and have called for the Uruguay Round approach to be the general rule. The EU believes that the blended formula could, with necessary modifications, meet the concerns of all participants – developing and developed – about particular sensitivities. Japan (a G-10 member) has previously stated that it would not accept any methodology other than the blended formula (as originally proposed jointly by the EU and the US) since this enables shielding at least some sensitive products from radical cuts. Most of the Cairns Group and the G-20 members, on the other hand, regard the blended formula as too weak by not providing new market openings in the north. Many developing countries, including India, argue that the blended formula discriminates against developing countries, which, owing to their specific tariff profiles would have to make larger overall reductions than developed countries. As a result of the widespread opposition to the blended formula, it has not been considered realistic to include it in the modalities framework that was to be established before the end of July.

Instead, members of the Cairns Group and the G-20 group of developing countries have suggested the so-called 'banded formula' developed by former chairman of the WTO

[2] The full letter was retrieved from http://www.ictsd.org/ministerial/cancun/docs/Lamy_Fischler_9May04.pdf.

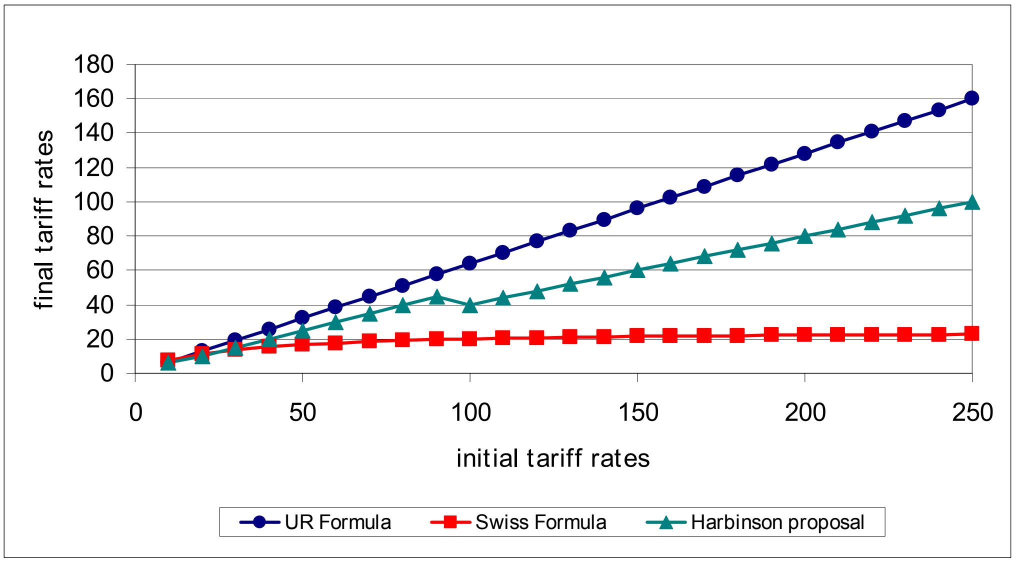
[3] Using the Uruguay Round approach amounts to negotiating a specified average percentage reduction in tariffs over a specified number of years with the flexibility of a smaller minimum reduction for individual products to be applied to certain 'import-sensitive' products (see http://www.wto.org).

[4] According to the Swiss formula, countries make the steepest cuts to their highest tariffs, thereby resulting in a much narrower gap between high and low tariffs with a built-in maximum tariff. This formula effectively addresses the problem of tariff peaks (see http://www.wto.org).

Committee on Agriculture, Stuart Harbinson, in a 2003 modalities draft that was set forth as a kind of constructed compromise solution. Under this approach, the Uruguay Round (UR) formula would be used across-the-board, but very high tariffs would be subject to much deeper average and minimum cuts than low ones. Developed countries (including the US, the EU, Canada, Switzerland and Japan) are all rejecting this suggestion, albeit for different reasons. The US criticises it for failing to bring about significant new market access. The EU, Canada and particularly the G-10 reject it on the grounds that it will not enable countries to effectively protect their sensitive sectors.

Figure 1 illustrates the more stringent nature of the Swiss formula by comparing it with a clean Uruguay Round approach and the Harbinson proposal.

Figure 1. Comparison of Uruguay Round formula,[1)] Swiss formula[2)] and Harbinson proposal[3)]



1) A uniform cut of 36% is assumed for the Uruguay Round formula. 2) A value of 25 is assumed for the coefficient of the Swiss formula. 3) The highest possible values for developed countries are assumed within each band of the Harbinson proposal.

Source: Own calculations, FAL.

Because of the strong disagreement concerning the proposed tariff reduction formulas, the Cairns Group and the G-20 have invited all members to collaborate on coming up with a new formula. The G-20 has set out basic concepts and principles to which the future methodology ought to live up to – according to their view – in order to provide fair and equitable outcomes: progressivity (higher tariffs are to be cut more than lower ones), flexibility (to take account of sensitivities), neutrality (no bias against the tariff structures of certain members) and proportionality (less than full reciprocity between developed and developing countries along the lines of the Uruguay Round approach). The G-33 group, consisting mainly of net food-importing developing countries, have sketched general criteria for a future reduction formula similar to that presented by the G-20, but have pointed out the need for developing countries to be able to designate 'special products' that should be exempted from any reduction commitment at all.

More recently (at a meeting of the Five Interested Parties or FIP, comprising the EU, the US, Brazil, India and Australia on 22 June), the US presented a new proposal combining the banded approach and the Swiss formula while also trying to address the concerns of those such as the

EU, Japan and Switzerland by applying only moderate tariff cuts to certain sensitive products. The US proposal moreover requires that the tariff rate quotas (TRQs) for such sensitive products are expanded. This 22 June proposal received mixed reactions. India and Brazil have criticised it for being unacceptable for the developing countries, in particular because it would require that elements of the Swiss formula are applied to developing countries. The G-10, including countries such as Switzerland and Japan, are unsatisfied with the limited protection the US proposal provides for sensitive products and the mandatory TRQ expansion for such products. The EU has also expressed a need for more flexibility to take account of sensitive sectors. According to a BRIDGES newsletter (30 June), the US apparently came up with a revised version of its proposal at the 23-25 June 'agriculture week'.[5]

On *domestic support* the EU seeks substantial reduction of all forms of trade-distorting subsidisation. In their letter to the WTO trade ministers, Mr Lamy and Mr Fischler state that the EU is prepared to commit itself to large reductions in trade-distorting (amber box) support as well as reduction and capping of existing blue box payments. Also, they propose that *de minimis* support should be eliminated for developed countries. More ambitiously, the EU Agriculture Commissioner would also like to see the US reform their Farm Bill.[6]

At Cancún, cotton emerged as one of the prime examples of how developed countries' agricultural support policies harm developing countries' trade prospects by driving down world prices. No deal was reached about the cotton issue at Cancún and since then a case has been filed with the WTO on this issue. The US argues that its cotton subsidies are decoupled from production. An interim dispute settlement ruling from the WTO, however, is not in favour of the US argument. A final ruling may help accelerate the removal of subsidies in the Doha Round. Another sensitive sectoral issue concerns the EU sugar regime. A WTO case has recently been filed by Brazil, Australia and Thailand.

Concerning *export subsidies*, the concept of 'parallelism' has emerged. The EU is prepared to put all the export subsidies on the negotiation table, provided that a balanced outcome emerges on market access, domestic support and non-trade concerns, and that parallel movements are made by other WTO members (essentially the US, Australia and Canada) on effectively dealing with all export subsidy components, including food aid, export credits and guarantee programmes, as well as state trading enterprises. This reflects a concern that less transparent forms of export subsidisation by other members of the WTO remain undisciplined. The US has since responded by signalling some willingness to negotiate the subsidy elements of its export credit system and the distorting elements of its food aid programme – although it is not at all clear just how amenable they are. Canada has noted that the Canadian Wheat Board, a state trading enterprise, is not up for negotiation since it has been ruled as being WTO-consistent in a dispute settlement case.

The developed countries among WTO members also have opinions about how different groups of developing countries should be treated with respect to reform requirements. The US, for example, is calling for large, emerging-market countries to open up more. US Trade Representative Bob Zoellick has said that competitive countries such as Brazil and Argentina should not expect more lenient terms and longer implementation periods, which should be reserved for the poorest developing countries. In recent speeches in Argentina and Brazil, the EU Agriculture Commissioner Franz Fischler has also stated that "opening up trade is a two way street".[7] Yet in their 9 May 2004 letter, Mr Lamy and Mr Fischler state that on both

[5] See *BRIDGES Weekly Trade News Digest*, Vol. 8, No. 23, 30 June 2004 (retrieved from http://www.ictsd.org/weekly/04-06-30/story1.htm

[6] For details of the speech by Mr Fischler see "Big prize on offer for Argentina in WTO and Mercosur farm talks", EC Press Release IP/04/566, 29.04.2004 and "WTO and Mercosur deals will boost farm trade with Brazil", EC Press Release IP/04/550, 27.04.2004.

[7] Ibid.

agriculture and non-agricultural market access, least developed countries (LDCs) and other weak or vulnerable developing countries – essentially the G-90 – should not have to open their markets beyond their existing commitments and should still be able to benefit from the market access offered by both developed and more advanced developing countries. In essence these countries should have the ‘round for free’.

Moreover, in the same letter, Mr Lamy and Mr Fischler state that all developed and advanced developing countries should provide duty- and quota-free access to all imports from the LDCs. Basically, they are calling for a more widespread version of the Everything But Arms (EBA) initiative. This suggestion attempts to address the LDC concerns about high tariffs and other market-access barriers in developing countries. On behalf of the LDC group, Bangladesh has voiced the need to increase LDC access to other developing country markets, noting that it is not only developed countries that have high tariffs and other market-access barriers.

Generally, the EU’s trading partners have welcomed the signals in the letter from Mr Lamy and Mr Fischler. The most advanced developing countries are nevertheless a bit suspicious about the suggestion of providing special treatment to the most vulnerable developing countries. They are concerned about the creation of new categories of countries within the WTO and the underlying assumption that poor countries are unable to make trade liberalisation commitments. They are also concerned about the consolidation of preferential trade arrangements.

1.2 Regional and bilateral trade issues

As previously mentioned, regionalism has become an inherent part of the global trading system. The renewed emphasis on bilateral and regional trade agreements after the failure in Cancún represents, in fact, a continuation of a trend. Since the early 1990s there has been a dramatic increase in the creation of new preferential trade agreements as well as revival and extensions of many existing agreements.

Of most recent and direct importance to the EU is its eastward enlargement on 1 May 2004. Other countries’ reactions to the enlargement are very mixed. Particularly the African, Carribean and Pacific (ACP) countries are concerned about the erosion of their trade preferences owing to the enlargement. Preference erosion can occur if the preference-giving country liberalises on a most-favoured nation (MFN) basis, if it extends more favourable preferences to other countries through, for example a free trade agreement, or if it reforms a domestic support policy that has provided the preference-receiving country with access to artificially high prices in that particular export market.

The EU sugar regime, for example, results in EU sugar prices that are about three times the world market prices and surplus production is exported using subsidies. Under the sugar protocol of the Cotonou Agreement between the EU and the ACP countries, the EU guarantees to import agreed quantities of sugar from the ACP countries, which then receive these high prices. Large, efficient agricultural exporters such as Brazil would like to see the system abolished completely, but small ACP countries, for which sugar is an important export commodity, are concerned about the erosion of this preferential access resulting from EU enlargement per se and to the expected reform of the sugar regime that – at least in part – is motivated by the enlargement.

The European Commission has outlined a draft proposal for sugar policy reform, which includes a restructuring of the production quota system and a combined volume cut, reduction of support prices and introduction of new compensatory payments. The ACP protocol and the India agreement are still to apply, although with certain adjustments to the level of the guaranteed price and removal of the refining aid. The proposal also suggests that imports within the Everything But Arms agreement are to take place at a price no lower than the ACP guaranteed price. LDCs are nevertheless very concerned that in a situation of free competition, stronger developing countries such as Brazil and the Balkan states would crowd out the LDCs on the EU market. The new reform proposal for sugar policy suggests that duty-free imports from the Western Balkans would be subject to a new quota matching current trade levels. Moreover, the EU is considering programmes to support adjustment in ACP countries, focusing on the quality and productivity of the sugar sector and on diversification.

Other (non-ACP) developing countries are also concerned about the impact of EU enlargement. Pakistan, for example, has already filed a provisional claim with the WTO seeking compensation for possible losses owing to reduced exports of Pakistani rice, leather and other products following the enlargement. Others, such as India, are more moderate by acknowledging that the potential advantage of a larger, expanded market will of course be somewhat diluted by the duty-free access provided to new member countries. Yet others such as those countries in Mercosur (Southern Common Market – Argentina, Brazil, Paraguay and Uruguay) see the enlargement as an opportunity rather than a threat.

Developing countries are also concerned about the potential imbalance in some of the agreements. The ACPs have expressed concern about the strong focus of the Economic Partnership Agreements (EPAs), which are currently being negotiated as part of the Cotonou Agreement, on the removal of tariff barriers, which would lead to increased EU exports to the ACP countries. Non-tariff barriers and supply-side constraints are mentioned as the main impediments to increasing APC exports to the EU and the ACP countries would like to see these aspects taken into account in the EPA negotiations.

A large number of other bilateral and regional trade agreements have been concluded recently or are under negotiation and will have greater or lesser impact on the EU. Japan, for example, broke a tradition of exclusively seeking multilateral trade agreements by concluding bilateral free trade agreements (FTAs) with Singapore in 2002 and with Mexico in 2004 (entering into force in January 2005). In particular, it is worth mentioning that this latter agreement provides Mexican pork producers with preferential access to the Japanese market. This will of course affect competing exporters in the EU and the US, who do not benefit from a preferential trade agreement with Japan – one of the world's largest importers of agricultural and food products.[8] The next Japanese FTA plans involve Malaysia, Thailand, the Philippines and South Korea.

Another noteworthy regional trade initiative is the consideration of a trilateral cooperation agreement to promote and facilitate trade between India, Brazil and South Africa – three countries that played a key role in the G-20 group in Cancún. They have agreed to seek convergence between the preferential trade negotiations among the three countries and their regions (Mercosur-SACU, Mercosur-India and SACU-India).

Other recent preferential trade or trade-facilitation agreements – either concluded, underway or being considered – include the following: the EU-Mercosur, the US-Dominican Republic, the Free Trade Agreement of the Americas, the EU-Canada, the US-Colombia, China-India, Chile-South Korea and Andean-Mercosur. As in the multilateral negotiations, in virtually all the regional and bilateral negotiations agriculture sticks out like a sore thumb.

2 Scenario proposals

This final section presents a set of scenarios reflecting regional and multilateral trade agreements already concluded, currently under negotiation or simply put forth as proposals that involve or affect the EU. A number of these suggested scenarios will be selected for further empirical analysis by FØI and FAL within the ENARPRI framework.

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[8] About 60% of the food consumed in Japan is imported.

Given the scope and bounds of the ENARPRI network, the scenarios discussed below are to be analysed using tools (i.e. models and data) that are readily available at the two research institutes conducting the analyses. In practice, this means that the global general equilibrium model known as GTAP (Global Trade Analysis Project) will be used in various versions for the research.

Both FØI and FAL have developed the standard GTAP model over several years of EU-related trade research and therefore have versions of the model that have been tailored to address EU-related trade issues such as enlargement, WTO negotiations and the EBA. These various versions of the model will be used as the starting point for analysing scenarios that reflect the current trade issues sketched above.

The FØI and FAL versions of the model differ in certain respects (e.g. choice of aggregation and policy details in different sectors) and careful documentation will ensure that these different outsets are fully appreciated. No large model development or data adjustment tasks will be embarked upon because of the limited capacity for substantive research within the ENARPRI network. This places limits of course on which scenarios are possible to analyse within this framework, but it is expected that the analyses will also point to areas in need of further research.

In terms of data, the new version 6 GTAP database will be used. Of vital importance to analysis of any of the scenario proposals described below – particularly in relation to the scenarios concerning market access – the version 6 database will include new and updated protection data, including preferential rates.

Multilateral trade-liberalisation scenarios

Based on the current multilateral trade talks and the most recent indications of negotiation positions from various WTO members, there are a number of interesting scenarios that may be analysed.

- Market access

As already discussed, market access (MA) is the main area of contention in the ongoing negotiations. Hence, it would be interesting to analyse a number of scenarios that illustrate what is at stake in relation to this aspect of trade liberalisation. One of the main discussion points at the moment concerns the method of tariff reduction. Yet assessing the impact of the various proposals lies beyond the bounds of this ENARPRI network project because of the substantial data work this would involve.

Nevertheless, we propose two other possible scenarios that reflect other aspects of the market-access discussion, namely whether or not the LDCs should ‘have the round for free’. It should be recalled that the EU has proposed more lenient treatment of the LDCs and other weak or vulnerable developing countries in a similar situation (essentially the G-90). The two alternative MA scenarios are:

> MA 1 – a ‘two-way street’ approach requiring all developing countries to increase access to their markets just as the developed countries must; and
>
> MA 2 – a ‘special and differential’ approach in which the LDCs and other weak and vulnerable developing countries are not required to increase access to their markets, but developed and more advanced developing countries are required to do so.

- Domestic support

Developing countries and the most liberal WTO members continue to express concerns about the trade-distorting effects of domestic-support policies, especially in the European Union and the US. For this reason, we propose the following scenarios related to domestic support (DS), where the focus could be on the consequences of such policies for third countries:

DS 1 – reform of the EU 2003 CAP (i.e. the Mid-Term Review);

DS 2 – hypothetical reform of the US agricultural policy; and

DS 3 – a combination of the two scenarios above (DS 1 + DS 2).

- Export subsidisation

Explicit and implicit forms of export subsidisation are also a hot topic in the current negotiations. Given the limited opportunities for doing more in-depth data and modelling work within the ENARPRI framework, however, it will not be possible to assess the magnitude, let alone the impact, of the more implicit forms of export subsidisation (credits, guarantees, food aid and state-trading enterprises). In order to avoid presenting an unbalanced picture (e.g. by analysing only the removal of the explicit EU export subsidies), we therefore suggest that we not embark on export subsidisation scenarios.

Regional trade agreement scenarios

Considering the regional approaches to trade liberalisation, we suggest the following scenarios based on the most recent developments and proposals:

1) the EU's EBA initiative;
2) the EBA initiative plus adoption of the EBA concept by other developed countries;
3) the approach immediately above (2) plus adoption of the EBA concept by more advanced developing countries;
4) EU enlargement, focusing on the impact on LDCs and other developing countries;
5) Mexico-Japan FTA, focusing on the impact on the agricultural and food sectors in the EU and US;
6) EU-Mercosur; and
7) the Free Trade Area of the Americas (FTAA) (NAFTA-Mercosur).

Appendix: Country Groupings

Cairns Group

Argentina, Australia, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Guatemala, Indonesia, Malaysia, New Zealand, Paraguay, Philippines, South Africa, Thailand and Uruguay

FIP (Five Interested Parties)

The EU, the US, Brazil, India and Australia

G-10

Bulgaria, Iceland, Israel, Japan, Liechtenstein, Mauritius, Norway, South Korea, Switzerland and Taiwan

G-20

Argentina, Bolivia, Brazil, China, Colombia,* Costa Rica, Cuba, Ecuador, Egypt, El Salvador, Guatemala, India, Indonesia, Mexico, Nigeria, Pakistan, Paraguay, Peru,* Philippines, South Africa, Thailand and Venezuela

G-33 (Net food-importing developing countries)

Barbados, Botswana, Congo, Cote D'Ivoire, Cuba, Dominican Republic, Haiti, Honduras, Indonesia, Jamaica, Kenya, Mauritius, Mongolia, Mozambique, Nicaragua, Nigeria, Pakistan, Panama, Peru, Philippines, Senegal, South Korea, Sri Lanka, Tanzania, Trinidad and Tobago, Turkey, Uganda, Venezuela, Zambia and Zimbabwe

G-90

African Union, least developed countries and African, Caribbean and Pacific (ACP) countries

*Columbia and Peru have left the G-20 since its formation.

ABOUT ENARPRI

ENARPRI is a network of European agricultural and rural policy research institutes formed for the purpose of assessing the impact of regional, bilateral and multilateral trade agreements concluded by the European Union or currently under negotiation, including agreements under the WTO, EU accession, Everything But Arms (EBA), EuroMed and Mercosur. It also addresses the wider issues of the multifunctional model of European agriculture and sustainable development of rural areas. Participants in the project include leading national institutes and research teams from 13 countries (11 EU member states and 2 accession countries).

AIMS

- Creation of an institutional structure linking key research institutes with major benefits for improved exchange of information and policy analysis both in the short and long run,
- Development of improved tools for impact assessment,
- More effective impact assessment of trade agreements on a variety of important social, economic, and environmental indicators and an assessment of multifunctionality, and
- Clearer analysis of the need for EU policy adjustments.

PARTNER INSTITUTES

- **AUA**, Agricultural University of Athens, Department of Agricultural Economics and Development (Greece)
- **CEPS**, Centre for European Policy Studies (Belgium)
- **FAL**, Federal Agricultural Research Centre (Germany)
- **FOI**, Danish Research Institute of Food Economics (Denmark)
- **IEEP**, Institute for European Environmental Policies (UK)
- **INEA**, Istituto Nazionale di Economia Agraria (Italy)
- **INRA**, Institut National de la Recherche Agronomique (France)
- **IRWIR PAN**, Institute of Rural and Agricultural Development/Polish Academy of Sciences (Poland)
- **LEI**, Landbouweconomisch Instituut (The Netherlands)
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