Special Article

Regional Trade Agreements & U.S. Agriculture

Regional trade agreements (RTA's) have become a fixture in the global trade arena, and their role in world trade is increasing. Defined as arrangements among separate economies to reduce trade barriers among members, RTA's have been established in every region of the world. Over the period 1947-1994, 109 regional trade agreements were reported to the General Agreement on Tariffs and Trade (GATT), the multilateral body charged with oversight of global rules governing trade. Since 1995, at least 16 new RTA's have been reported to the World Trade Organization (WTO), the successor body to the GATT.

Nearly all WTO members are party to at least one RTA. In the Western Hemisphere, about 40 regional trade pacts are currently in force, and at least a dozen others are under negotiation. Moreover, RTA's formed over the last decade are more comprehensive in their treatment of agriculture compared with earlier RTA's, many of which excluded agriculture.

Another relatively new development is the effort to negotiate trade pacts that include existing RTA's as well as individual countries. While not technically RTA's, which are reported to the WTO, these free trade networks are likely to become a key force in reconciling and building on the proliferation of RTA's.

An example of such a network is the Asia Pacific Economic Cooperation (APEC) forum, a free trade initiative encompassing 21 economies, including the U.S., Japan, and China. Members of APEC include economies in the North American Free Trade Agreement (NAFTA), the ASEAN Free Trade Area (AFTA) of Southeast Asia, and the Australia-New Zealand Closer Economic Relations (CER). APEC is committed to achieving free regional trade in all sectors, including agriculture, by 2020. Among the challenges will be to reconcile the AFTA agreement, which excludes bulk agricultural products (e.g., grains, oilseeds), with NAFTA and CER, both of which free almost all internal agricultural trade.

The U.S. is an active participant in regional trade pacts and networks. In 1989, the U.S. and Canada formed the U.S.-Canada Free Trade Agreement (FTA), which specified a 10-year phase-out of bilateral tariffs on most products, including most agricultural commodities. In 1994, the framework was extended to include Mexico in NAFTA. Since 1989 the U.S. has participated in APEC and has trade initiatives in the Caribbean Basin and with Israel.

Most of the major RTA's formed in recent years have internally liberalized most agricultural trade. In the Western Hemisphere, NAFTA and MERCOSUR (Common Market of the South), have removed nearly all agricultural trade barriers to their members, or, like APEC, have a specified timeframe for their elimination. Notable exceptions among commodities are sugar, dairy, poultry, and eggs in the bilateral pacts within NAFTA, and sugar in

MERCOSUR. The European Union (EU) has gone furthest in economic integration among its members—fully liberalizing internal agricultural trade and adopting a common farm support program, the Common Agricultural Policy (CAP).

A potential major regional trade agreement is the proposed Free Trade Area of the Americas (FTAA). The goal is to encompass most countries of the Western Hemisphere and to fold the hemisphere's many trade agreements into one comprehensive trade bloc.

Pros & Cons of RTA's

Regional trade agreements have generated intense debate. Advocates emphasize their *trade-creating* effects. By providing for freer trade among members, RTA's can improve resource allocation within a region. With regional free trade, production shifts toward the most efficient producers of specific commodities within the RTA, and consumers are better off because they can purchase goods at lower prices.

But opponents of RTA's argue that most agreements generate a degree of trade discrimination by lowering barriers on internal trade while retaining barriers to trade with nonmembers. A likely result is that the RTA's will be *trade-diverting*, increasing trade among member countries while diverting it from more efficient, lower-cost producers in the rest of the world. Even if an RTA results in internal trade creation, such gains, some critics maintain, are likely to be outweighed by their trade-diverting effects.

Special Article

A second issue raised by RTA's is their effect on the global trading system, and especially on multilateral trade negotiations. The current proliferation of RTA's has occurred simultaneously with successful global trade negotiations, which were concluded in 1993 under the GATT, and have continued in a series of "mini-rounds" addressing specific sectors, including telecommunications and services. A WTO mini-round of trade liberalization talks on agriculture is scheduled to begin in 1999.

Advocates of RTA's argue that recent regional trade agreements are likely to serve as building blocks for further multilateral trade liberalization in the WTO. This is because many recent RTA's, including NAFTA and MERCOSUR, have moved at a faster pace than the multilateral negotiations in liberalizing trade rules, particularly for agriculture. These smaller, regional negotiating groups may also be more effective than a large, global body in tackling difficult or complex issues such as sanitary and phytosanitary trade restraints.

Critics of RTA's contend that the agreements are more likely to act as stumbling blocks to multilateral trade liberalization. According to this line of reasoning, RTA's are more likely to create and entrench protectionist interests that benefit from trade diversion, and such RTA's may become "fortresses" with an interest in slowing or derailing multilateral trade negotiations. Furthermore, the current proliferation of RTA's has resulted in a bewildering "spaghetti bowl" of crisscrossing bilateral tariff rates and complicated rules of origin governing the transshipment of nonmembers' products through member countries. This leads to substantial administrative inefficiencies, and perhaps to disguised import protection resulting from complex provisions on domestic content of products.

RTA's & U.S. Agriculture

How are RTA's likely to affect U.S. agricultural production, trade, and support programs?

First, *U.S. agriculture can gain from U.S. participation in RTA's.* By lowering trade barriers among members, the major RTA's in which the U.S. participates—NAFTA, APEC, and potentially the FTAA—are expected to benefit U.S. agriculture. Increased agricultural trade and specialization among RTA partners will increase the efficiency of U.S. farm producers and lower prices for consumers, although this will lead to some adjustment and change in U.S. agriculture as some sectors gain through increased foreign sales and some lose domestic market share to imports. RTA membership is expected to improve U.S. international terms of trade in agriculture, with an increase in U.S. farm export prices relative to import prices as relatively high tariff barriers of some U.S. trade partners are reduced or eliminated.

This article draws from a forthcoming ERS report

Regional Trade Agreements and U.S. Agriculture

U.S. agriculture can lose when RTA's do not include the U.S. RTA's generally divert trade by lowering imports from the rest of the world as trade with partners increases. Expansion of the European Union (EU) is likely to divert agricultural trade and reduce U.S. agricultural exports to the EU and to third markets. But the farm subsidies under the current CAP program are probably unsustainable with EU expansion, and potential EU farm program reforms to limit subsidies would limit these negative impacts on the U.S.

In the case of the FTAA, the U.S. has the option of joining; a U.S. decision to remain outside the FTAA would divert trade from U.S. agriculture. However, many expect RTA's to induce economic growth in the developing countries of the Western Hemisphere, and if this trade-linked growth occurs as a result of the FTAA, then the U.S. is expected to benefit, even as a nonmember. Economic growth in the region would stimulate Latin American agricultural trade with the U.S., although this trade effect would be larger if the U.S. were party to the FTAA.

Agriculture is the source of most U.S. gains from RTA's. Gains from trade liberalization are roughly proportionate to the size of the trade barriers being reduced or dismantled in a trade agreement. Because agriculture still faces relatively high trade barriers in world markets, it stands to gain relatively more than many other sectors from U.S. inclusion in trade agreements. Agriculture accounts for 75 percent of the total expected U.S. benefits from APEC participation. With or without U.S. participation in the hemisphere-wide FTAA, U.S. agricultural trade will increase more than for other sectors. In the case of EU expansion, U.S. agriculture will be affected more than other sectors, but the effects will be negative, while effects on U.S. manufacturing will be positive as EU farm subsidies provide an incentive to Central and Eastern Europe to shift resources toward agriculture.

RTA's and domestic farm programs have mutual impacts. RTA's limit the ability of member countries to maintain independent farm programs. Market arbitrage within a free trade area will tend to unify prices, making members' efforts to use farm support programs to maintain different price levels either ineffective or costly. But the conversion of most U.S. farm support into decoupled contract payments, with the market determining the prices farmers receive, is compatible with free trade pacts. At the same time, the reduction in farm support and the increase in farm-sector market orientation in many countries over the past decade have diminished the inherent conflict between free trade and farm programs, making RTA's more likely to include agriculture, and increasing the gains from RTA's.

RTA's & Multilateralism: Peaceful Coexistence?

Are RTA's building blocks, stumbling blocks, or complements to multilateralism?

Economywide, trade-creating effects dominate in major RTA's, enhancing world welfare. Concern over the size of the trade-diverting impacts of RTA's has been a frequent argument against regionalism. USDA analysis of the longrun impacts of four major RTA's (NAFTA, APEC, FTAA, and an expanded EU)

Major RTA's and Summary of Agricultural Provisions

RTA	Year created	Current members	Agricultural provisions
European Union (EU)	1958 (EEC-6)	Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom	No internal trade barriers. Common Agricultural Policy (unified trade policy and support)
U.S.-Israel Free Trade Agreement (FTA)	1985	U.S., Israel	Agriculture covered, but Israel has the right to protect infant industries, particularly in agriculture; 1996 agreement designed to further liberalize agricultural trade, particularly U.S. products facing nontariff barriers
Asia-Pacific Economic Cooperation Forum (APEC)	1989	Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, Malaysia, Mexico, New Zealand, Papua New Guinea, Philippines, Singapore, South Korea, Taiwan, Thailand. The U.S. Peru, Russia, and Vietnam became members in 1998.	A network of individual countries and several regional trade agreements that include NAFTA, AFTA, and the Australia and New Zealand Closer Economic Relations (CER). Goal of free trade in agricultural products by 2010 for developed economies and 2020 for developing economies
Southern Common Market (MERCOSUR)	1991	Argentina, Brazil, Uruguay, Paraguay	Nearly all intraregional tariffs removed; the only exempt agricultural product is sugar. Common external tariff, ranging from 0 to 20 percent for agricultural products (average 10 percent), generally lower than previous tariff levels
Association of Southeast Asian Nations Free Trade Area (AFTA)	1991	Indonesia, Malaysia, Philippines, Singapore, Thailand, Brunei, Vietnam, Laos, Myanmar	Transition to free trade area with common external tariff planned by 2003. Coverage excludes unprocessed agricultural product
North American Free Trade Agreement (NAFTA)	1994 (U.S.-Canada FTA--1988)	Canada, Mexico, U.S.	*Between Canada and U.S.:* • most agricultural tariffs eliminated by January 1, 1998, but restrictions on certain products remain (poultry, eggs, dairy, sugar-containing products) • agreement not to use export subsidies in bilateral trade and not to increase or introduce new tariffs *Between U.S. and Mexico:* • 15-year phase-out of all tariffs, quotas, and licenses that are barriers to agricultural trade *Between Canada and Mexico:* • 15-year phase-out of tariffs, quotas, and licenses for most Canadian-Mexican agricultural trade
Free Trade Area of the Americas (FTAA)	Negotiations to begin in 1999	Expected to encompass most Latin American countries, Mexico, and Canada; U.S. has not committed to participating	To be negotiated

indicate that their economywide trade diversion effects are likely to be smaller than trade creation effects. Because they are expected to be net trade-creating, these RTA's will improve global welfare. These findings suggest that the RTA's will fulfill the intent of the GATT/WTO rules that permit RTA's: their gains from liberalizing internal trade at a pace faster than committed to in the Uruguay Round will outweigh the negative impacts of their discrimination against nonmembers. The WTO specifies that the purpose of a regional trade agreement be to facilitate trade among the signatory countries—not to raise barriers to trade with WTO members that are not parties to the regional agreement.

In agriculture, RTA's have both trade-creating and trade-diverting effects, but trade creation dominates in most RTA's. To date, empirical evidence shows that the U.S.-Canada FTA, MERCOSUR, and the Australia-New Zealand CER have led to increased agricultural trade both with partners and with nonmembers, supporting the view that RTA's can unleash growth in trade that benefits members and nonmembers alike. When fully implemented, NAFTA, APEC, and the FTAA are expected to be net trade-creating for agriculture. Only the EU, with its generous agricultural subsidies, has so far resulted in net agricultural trade diversion. Its expansion to include Central and East European countries is also expected to be trade-diverting. While trade-creating RTA's are likely to pursue more open markets at multilateral talks, trade-diverting RTA's are less likely to do so.

Special Article

Regionalism and multilateralism are likely to be mutually reinforcing. An effective multilateral process has already proved to be an important influence on the agricultural trade liberalization achieved in some regional agreements. In the future, multilateral commitments to reduce protection and support in agriculture could be pivotal in influencing the pace of regional agricultural trade liberalization as well as the directions to be taken by APEC, FTAA and an expanded EU on farm policy reforms. In turn, the freer agricultural trade already achieved in the Western Hemisphere and committed to in APEC is likely to strengthen efforts to achieve freer trade at the upcoming mini-round.

Should the U.S. pursue regionalism, multilateralism, or both?

Progress in the multilateral talks on reducing barriers to agricultural trade could reinforce RTA commitments to liberalize agricultural trade. While some newer RTA's have defined a timeframe for liberalizing substantially all agricultural trade (NAFTA, MERCOSUR), specific reduction commitments have not been fully defined in APEC, and the treatment of agriculture in the FTAA is still to be negotiated. Another shortcoming of some RTA's is selective trade liberalization, singling out certain sectors for exclusion, which makes the trade-diverting effects of RTA's more likely to dominate.

A strong multilateral process can help minimize the negative aspects of RTA's. USDA analyses find that most RTA's have trade-diverting impacts in agriculture, although they are smaller than the trade-creating effects. Among the examples of RTA protectionist practices are the EU's closed membership and the adoption by members of common, trade-distorting internal policies; AFTA's exclusion of bulk agricultural commodities; and the adoption by the Andean Pact and Central America Common Market (CACM) of common external tariffs that "escalate" or increase with the level of processing. A strong multilateral process that effectively disciplines the practices that lead to trade diversion can help minimize the negative aspects of RTA's. Such a process can also make it more likely that RTA's will evolve as trade-creating agreements.

The U.S., as a global trader with diverse trade partners, can gain potentially more from global free trade than from RTA's. But so far, multilateral talks have fallen far short of achieving free trade, and the gains to the U.S. from the deeper commitments made by RTA's are expected to exceed those from the Uruguay Round. The influence of RTA's on the multilateral process is still uncertain, and they have the potential to harm nonmembers. But *because RTA's and multilateralism can provide significant, mutually reinforcing influences, their joint pursuit can benefit U.S. agriculture.*

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