A Tale of Two Countries: An Assessment of the EU-US Trade Relationship in Agriculture

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ABSTRACT

UDOAKU CAMILLA IHENETU: A Tale of Two Countries: An Assessment of the EU-US Trade Relationship in Agriculture
(Under the direction of Donald Searing and Esteban Arribas)

Although it is recognized that agriculture is not the most financially lucrative sector of EU and US economies, it has tremendous importance politically for these nations. But, agriculture is by far one of the most important features of developing countries economies. The US and the EU are two of the most prominent members of the World Trade Organization, and the WTO often relies on them to lead the charge towards open trade. But the inability of the EU and the US to agree on policy in agriculture has made the Doha Round negotiations in agriculture very difficult. This paper aims to show that the EU-US trade relationship in agriculture is equally economic as well as political, and that the fate of these rounds of WTO negotiations and future legislative reform in the US and the EU rely heavily on the EU and US ability to cooperate with each other.

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Table of Contents

Chapter

Chapter 1

Introduction

There are political forces that shape the relationships between societies in the multilateral trading system that is the World Trade Organization. In an age when hard power, or perhaps better said, military power, is of less consequence, it is apparent that trade negotiations are ongoing exercises of political soft power. The growing interconnectedness of the multilateral system makes it so. The World Trade Organization is the only forum for multilateral trade negotiations, and two of its most important players are the United States and the European Community (Union). The EU has a common trade policy (Common Commercial Policy), whereas for WTO concerns, the EU acts as one single actor. The European Commission, perhaps the most powerful of all the Union institutions, negotiates trade agreements and represents European interests on behalf of all 27 member states. All 27 countries claim to represent a common goal, making it an entity that holds a tremendous amount of clout. The United States is recognized as the most powerful nation in the world. Its present economic power rivals that of the EU, and it is the largest financial contributor to the World Trade Organization.

Many have argued that the ongoing rounds of WTO negotiations (the Doha Development Rounds, 2001-present) have been the medium for a heated political and economic argument between the US and the EU. Both have taken the opportunity to flex their economic might and demand concessions while the other shouts foul play.

The suspension of WTO negotiations in 2006 is according to many, largely due to the inability of the United States and the European Union to cooperate.

The most contentious issue on the Doha Round Agenda of negotiations has been agriculture, although it can be argued that it is not the most important. For developed nations today, agriculture is not the most lucrative sector. The US and EU economies have evolved so that the production and the export of foodstuffs is no longer of the utmost importance. It is true however that at least 70 percent of the land in Europe can be classified as devoted to agriculture and forestry. And exporters form quite a formidable political lobby in both the US and the EU. Although agriculture is not the basis of financial stability for the US, the EU and other developed nations, it is still a major factor in politics, especially in nations where the route to power is through elections.

Because of the political consequences, the transatlantic trade relationship in agriculture is a controversial one. Also because of its political importance, agricultural policy has received continued support, although many believe the issue has become obsolete. The Common Agricultural Policy in the European Union and the US Farm Bill are the manifestations of that longstanding support. But as many countries of Europe and the United States have shifted their focus from simple survival (after suffering the devastation of two World Wars) to seeking economic prominence, a shift to liberal economic policy has also taken place.

The case for open trade has been made, and the benefits of open trade have shaped the rounds of WTO negotiation. The case for open trade reached the agricultural sector as agriculture was finally put on the WTO agenda during the

Uruguay Rounds (1986-1994). The widespread belief that open trade is advantageous has highlighted US and EU trade policy and has helped to discredit policies that may perhaps go against this maxim. Each accuses the other of the most striking offenses, complicating multilateral negotiations and the embittered transatlantic agricultural trading relationship.

This paper investigates that complicated relationship, and in the process, reviews the history and character of both EU and US agricultural policy. In addition, we will discuss the WTO's function in the argument, featuring the importance of the past round of negotiations (the Uruguay Rounds), and the role of the current Doha Rounds of negotiation. We hope to show that the relationship is not just economic but political as well.

Also, this paper explores possible outcomes concerning negotiations in the agricultural sector. I acknowledge that agricultural negotiations have a "spill over effect"; that is, in order for countries to cooperate and come to conclusions on agricultural matters, concessions must be made in other sectors on the Doha agenda; such as, Services, Intellectual Property, and Non-Agricultural Goods. To complete the analysis, I will make suggestions about desirable reforms for EU and US agricultural policy.

The Doha rounds were dubbed the "development rounds" for good reason. Their agenda seeks to ratify changes in the multilateral trade system so that developing countries can now benefit, rather than just developed countries, as has been the case in the past. This paper will touch briefly on the position of developing countries as it affects the agricultural relationship between the US and the EU. In the end, I will attempt to emphasize the power that each country has to shape the fortunes of the other and the fortune of the WTO.

Method of Research

With this work I hope to create a unifying framework that explores the nature of the transatlantic trade relationship and provides hypotheses for the future of transatlantic agricultural trade policy. Since this paper is primarily an analysis of the trade relationship in agriculture, I will first explain the concept of open trade, and the advantages it promises. I will focus on the work of classical economist David Ricardo. David Dollar and Aart Kraay will also be considered.

This paper also details the role of the World Trade Organization in the multilateral trade system. Hence, I will discuss as well the objectives of the World Trade Organization and its own efforts at reform in order to adhere to and promote open trade. As was mentioned earlier, the WTO is the only entity that deals with multilateral trade and, with its 150 members, is the only organization that can effectively force the ratification of negotiated decisions in national parliaments.

Falling in line with the belief that open trade is beneficial, and in efforts to fully illustrate the EU-US agricultural trade relationship, this paper will examine US and EU agricultural policy for its efforts to restrict the use of trade distorting policies. Also, the only two rounds of WTO negotiations that have featured agriculture have been the Uruguay rounds and the ongoing Doha rounds. Therefore the research examples used in this work are those that (a) correspond with that limited time period (1986-present) and, that (b) were influential in subsequent reforms of agricultural policy.

I will focus on a limited number of examples in order to make analysis more efficient. These research examples will be the 1996 and 2002 US Farm Bills and the 1992 MacSharry, 2000 Agenda, and 2003 Fischler Reform of the EU Common Agricultural Policy. The WTO rounds discussed will be the Uruguay Rounds (1986-1994) and the ongoing Doha rounds. We will use this analysis of policy to describe and assess the contentious character of the transatlantic relationship in agriculture and highlight major points of debate.

To conclude the project, I will reference my previous analysis of policy to draw conclusions concerning the nature of possible reforms to the US Farm Bill and the EU Common Agricultural Policy, and also to suggest possible outcomes for the agricultural section of WTO Doha negotiations. Conclusions of the Doha round are especially pertinent because this year (2007) the United States is set to reform and renew its Farm Bill. The US relies on WTO settlements to shape Farm Bill reform. It is widely understood that because of agriculture's importance to developing countries, the Doha negotiations are unlikely to end without agreements in that sector. So, one cannot stress enough the importance of agriculture for the welfare of the Doha rounds, and correspondingly, for the reputation of the World Trade Organization, the European Union and the United States.

Chapter 2

Trade and the WTO

The Debate for Open Trade

The US-EU trade relationship in agriculture has in recent years been based on a system of open trade. The shift to a liberal economic ideology has been its driving force. A liberal economic ideology seeks to maximize one's resources and benefits and, for this purpose, open trade is essential. Debates about open trade have been long and arduous. However, most economists agree that open trade is beneficial. Much data show that there is a consistent statistical link between open trade and economic growth.[1]

The classical economist, David Ricardo, demonstrated that everyone can benefit when goods and services are traded. His theory is founded on the principle of comparative advantage. The theory demonstrates that countries prosper when they take advantage of the assets they possess in order to concentrate on what they can produce best. Then trading those products for the products that other countries can produce best creates a relationship that is advantageous for both countries involved. It is irrelevant whether one country can produce all things better than other countries (that being absolute advantage).

Liberal trade policies, policies that allow the flow of goods and services, "sharpen competition, motivate innovation, and breed success," ensuring that consumers receive the best products, the best design, and the best price. The case for open or free trade is also supported by the example of the surge of economic growth after the Second World War. Tariffs restricting trade began to fall steeply after WWII came to an end. The result was world economic growth that grew by an average of 5 percent per year. For some 25 years after the wars, the world experienced such growth. The causal link is believed to be liberal trade policy. World trade grew at an average rate of 8 percent per year during the same period.

The evidence is clear: open trade is beneficial. The 150 countries that now comprise the World Trade Organization have taken that view as well. In addition, the WTO (2007:13) states that "all countries, even the poorest have assets-human, industrial, natural, financial-which they can employ to produce goods and services for their domestic markets or to compete overseas". The US and the EU are obvious examples of country commitments to open trade. The rules that govern the customs union[2] of the EU promote free trade in goods. The US is one of free trade's most vocal supporters and has taken significant steps in the past to lower tariffs, especially in agriculture. Liberal economic ideology reigns in the WTO, and those who do not abide by the rules it sets are liable to be investigated and, if appropriate, punished.

The WTO and Agriculture

The WTO supports open trade and trade liberalization. Its emphasis on open trade also helps to shape the agricultural trade relationship between the United States and the European Union. There are some exceptions to the rules however, which we will not discuss here.[3] At the core are the WTO agreements that are negotiated and signed by the majority of the world's trading countries. "These documents provide the legal ground rules for international commerce" (WTO 2007:9). And the US and the EU are obliged to follow them. The goal is to help trade flow as freely as possible. The WTO's job is to remove barriers that obstruct free trade.

The principles of the trading system that the WTO seeks to uphold are the following: (1) Trade without discrimination, meaning that all countries treat each other equally with regard to the exchange of goods and services. There is no discrimination between trading partners. This is known as Most Favored Nation (MFN) status. Second in the discrimination vein is "national treatment," which means that within a country all goods, imported and local, should be treated equally after foreign goods have entered the market. (2) Free trade, which means that barriers to trade are reduced through negotiation. (3) Predictability; through the binding of tariff levels, ensuring that tariff levels will not be raised arbitrarily. And in addition, there should be transparency or surveillance of national trade policies. (4) Promoting fair competition, so that trade is not distorted. (5) Encouraging development and economic reform. This objective is very important considering that three quarters of WTO members are developing countries. A sixth and less central principle of the WTO is its obligation to act as a dispute settling mechanism for member-nations. If there is a conflict regarding trade practices, members can appeal to the WTO to address it and seek a solution. All member countries must uphold these principles and, as economic leaders, the US and the EU must take the reigns and lead the charge for implementation of such policies. Their trade behavior is expected to reflect these principles.

Agriculture is one of the most contentious issues in all of trade. One reason for its importance is its relevance to developing nations. Two-thirds of the member states of the WTO are classified as developing nations. Agriculture is also important for the United States and the European Union. However, as of the year 2000, US agriculture only contributed 1.4 percent to the US Gross Domestic Product. The EU average (excluding Bulgaria and Romania) was less than four percent. These are small economic contributions. Therefore the strong focus on agriculture cannot be economically motivated as it is for developing nations, but rather politically motivated.

The temptation for richer countries to restrict challenges from competitive imports is always great, and not just for domestic economic gains. Protectionism can be used for short term political gains as well. Protectionism forces markets to contract, which reduces economic activity. Such restrictions distort trade and almost always have negative effects. The world has regularly experienced these effects. The years of autarky and protectionism after the First World War are a prime example: the results were nothing short of catastrophic.

Trade in agriculture is distorted "when prices are higher or lower than normal and if quantities produced, bought, and sold are also higher or lower than normal" (WTO 2007:26). "Normal" is the world price in the competitive market. Governments often have reasons for employing trade distorting policies: assurance of enough food for the country's needs; protection for farmers and rural societies, etc. However, such policies are expensive, and developing countries often suffer because they do not have sufficient resources to provide similar protection. Countries in general suffer because they cannot realize their economic potential and cannot provide their customers with the best products available. Competition is thereby diminished and money is lost ("dead weight" in economic terms).

The WTO Doha Round of negotiations seeks to address trade distorting policies. As the leading exporters and importers of agriculture, the US and the EU are very influential in the negotiations. Three pillars of discussion are addressed in current WTO agricultural negotiations: market access (trade restrictions on imports), domestic support (subsidies and other programs that raise or insure farm prices or incomes) and export subsidies (methods to make exports artificially more competitive). The WTO allows governments to pursue agricultural policies that support their rural economies, but only as long as those policies are not found to distort trade. But while tariffs can be used to deny access to markets, domestic subsidies can be used to encourage overproduction, and export subsidies can be used to dump[4] those overproduced products in other markets at prices well below the normal competitive prices. Under WTO regulations, policies that promote such actions are either not allowed or only minimally permitted.

The Uruguay round (1986-1994) agreed on regulations that espouse "tariffs only" (with regard to non-tariff boundaries) policies. Before the round, imports were restricted by quotas and by other non-tariff boundaries such as bureaucratic red tape. These policies have now been replaced by tariffs in a process dubbed "tariffication". When all policies had been replaced by tariffs, tariffs were then reduced and bound so that tariffs levels could never exceed a designated ceiling.

Domestic support that does have a direct effect on production was cut back during the Uruguay rounds and "boxes" were created that categorized these types of subsidies and direct payments. These boxes are based upon a sum called the AMS or Aggregate Measure of Support, which is a tally of how much trade distorting support a country or group of countries is allowed to employ. The level is set by the WTO and differs for developed and developing countries. According to WTO policy, the AMS ceiling should decline yearly until the agreed upon level is achieved. During the implementation period after the termination of the Uruguay rounds, developing countries were obligated to reduce their AMS by 13 percent and developed countries by 20 percent. The US cap is now 19.1 billion and the EU cap is 67 billion.

The three boxes that distinguish the principal types of domestic support are labeled Amber, Green, and Blue. The “Amber box” contains policies that have a direct effect on production and a distorting effect on trade. These policies contribute directly to the aggregate measure of support. Measures and policies that have a minimal effect on production and trade and can be used freely are categorized as “Green box” policies. They include payments to farmers that encourage environmental safety, and payments to restructure agriculture. The “Blue box” or “transition box” contains practices that minimally distort policy and that are subject to further reform.

There is a separate Amber box quantity that allows domestic support on a small scale (5 percent or less than the total value of products supported). It is called “non-product specific de minimis” support. The US has a limit of 10 billion dollars for de minimus support. There is much debate as to whether a Blue box should even exist, since it allows trade distorting policy, albeit on a small scale. The Uruguay round also cut the allowed amount of export subsidies. According to most countries however, (more specifically the least developed countries) these cuts were not enough. And ensuring the welfare of developing countries is an outstanding portion of the agenda of the on-going Doha rounds of negotiation (hence the name Doha Development Round).

The Doha rounds seek to reduce further the amount of trade distorting policies. Some even call for the complete abolition of export subsidies. One hundred percent of tariffs on agricultural goods are bound[5] but, for many concerned observers and participants, that is not enough. Although the tariffs are bound, the bound rates are still very high. The EU bound rate for agricultural products is 15.4 percent of the price (value). The US average is 5.2 percent which is quite a bit lower, but does not reflect tariff levels on specific goods. In the EU, some rates are as high as 52.9 percent for dairy products and 26.7 percent for animal products. In the US the rates are 25.0 and 2.5 percent respectively.[6]

Domestic support has been lowered, but not enough from the perspectives of the Cairns group, the African Group, and the G-20 group.[7] Therefore these countries have banded together within the WTO to promote the cause of the developing nations. Developed countries will not consent to reduce trade distorting measures unless concessions are made in their favor. The most prominent argument is the one between the United States and the EU. They have agreed in the past that the reduction of trade distorting policies is necessary for the benefit of all. But now, the issue is whether the US and the EU can fulfill the objectives that have been set for other nations, whether they can live up to the WTO standard of open trade. The proverbial question is: when it comes to agriculture, can the EU and the US put their money where their mouths are?

The tensions between the US and the EU are at the core of negotiations in agriculture and place a major strain on their trade relationship. They are at loggerheads over important details: By how much will tariffs, domestic support and subsidies be lowered?; When and how they will be lowered?; And what will they receive in return for their cooperation? The policies that each employs arouse suspicions in the other, and also in third party trading partners. Outsiders fear that the US and EU have each found ways to circumvent any new WTO conditions, as they have successfully done in the past; and that, instead of eliminating trade distorting policies, they will simply be repackaging them to fit their AMS commitments.

The strain in the US-EU trade relationship in agriculture not only reflects poorly on each of them, but also on the WTO and its inability to broker deals between two of its most important members. It is fair to assume that neither the EU nor the US will leave the table or let negotiations end without some kind of concession in return for any policy changes on their parts. They have to satisfy their political obligations, i.e. their consumers, farmers, and exporters alike. And, without pressure from the WTO and its members, neither is likely to enact such policy changes and risk the wrath of the farming elite and jeopardize political outcomes. But these political imperatives in the United States and the European Union are alienating their trade partners and each other, and are rendering the trade negotiations of the WTO ineffective and inefficient. Conclusions for the rounds seem more and more like shifting goal posts: they get further and further away as time goes on.

[1] See the work of David Dollar and Aart Kraay (2001)

[2] A customs union is an entity that has a common external tariff to all third parties and trade without barriers within the grouping

[3] See provisions for “Special and Deferential Treatment” in the Doha Development Round Declaration

[4] Dumping, in general, is a situation of international price discrimination, where the price of a product when sold in the importing country is less than the price of that product in the market of the exporting country

[5] Bound Tariffs rates are rates resulting from the World Trade Organization. It is the maximum levy a country can apply to a product. The applied tariff is the tariff actually levied on an imported good. According to the Article II of the GATT, the applied tariff should be less than the bound tariff or the affected country has the right to retaliate against an equivalent value of the offending country’s exports or they can receive direct compensation or compensation in the form reduced tariffs on other products.

[6] Data from the World Bank website

[7] The Cairns Group is a coalition of 19 agricultural exporting countries and has been influential in agricultural negotiations since its creation in 1986. The G-20 is a group of developing countries with special interest in agriculture and trade liberalization established in 2003. The African Group is 41 African countries with the main interest of lowering subsidies on cotton established in 2005.

Chapter 3

Agricultural Policy and the EU-US Relationship

Common Agricultural Policy

Unlike the United States, the EU successfully reformed its agricultural policy before significant decisions were made or before critical stages were reached in WTO negotiations. But, as WTO decisions are obligatory, previous WTO rulings are still influential in policy reform. The latest of these reforms came in 2003, with the so-called Fischler reform, named after Franz Fischler, former member of the European Commission responsible for Agriculture, Rural Development and Fisheries.

The CAP was created in the 1950's following the end of the Second World War. The countries of Western Europe had been devastated by this war, and the agricultural sector so weakened that food supplies were not secure. The CAP was therefore created as means to guarantee prices to farmers so that they could, in turn, guarantee supplies of food. The Treaty of Rome[1] states that the principles of the CAP are the following:

a. To increase agricultural productivity by promoting technical processes by ensuring the rational development of agricultural production and the optimum utilization of the factors of production, in particular labor;
b. To ensure a fair standard of living for the agricultural community, in particular by increasing the individual earning of persons engaged in agriculture;
c. To stabilize markets;

d. To assure the availability of supplies;

e. To ensure that supplies reach consumers at reasonable prices.

Price supports in the form of subsidies were relied upon to encourage production. This focus on price supports created strict production-oriented subsidy policies that distorted world markets. The US, as a leader in the export and import of agriculture, was outspoken in its complaints. The CAP has been very successful in promoting European self sufficiency; so much so, that during the 1980's, the EU transitioned from a net importer of agricultural goods to a net exporter.

At the time of this transition, subsidies supported the increase of production and maintained prices above world market prices. The EU had to introduce a means to rid itself of its surplus goods. The remedy was a system of export subsidies. The EU used subsidies to sell surpluses on the world market, thereby distorting competition and artificially lowering world prices. In addition to using these subsidies, the EU also employed high import tariffs to sustain its agricultural sector. The EU stuck to these policies until the WTO (beginning with the Uruguay rounds) forced it to reform. The first significant reforms started in 1992 with the MacSharry reforms and were followed by the 2000 agenda reforms, and then by the most recent 2003 Fischler reforms.

Market access, domestic support, and export subsidies are the focus for trade negotiations. The MacSharry reforms addressed market access. The WTO Uruguay rounds consolidated non-trade barriers (NTBs) into tariffs, and then bound tariffs were included in the MacSharry reform. Also featured in the MacSharry reform was the 30 percent decrease of the intervention price (price supports) in cereals.

The 2000 agenda reform was prompted by the need to prepare the CAP for the introduction of 10 new countries into the EU. Price supports were reduced again for cereal, beef and, for the first time, dairy products. The 2000 agenda also created a second rural development pillar of the CAP. The Fischler reforms have achieved the most thus far. Their notable development is the introduction of "decoupling," a process that severs the link between direct farm payments and production. The Fischler reforms decoupled the main supports for oilseeds, cereals, proteins, beef, dairy and, later on, olive oil, tobacco, cotton and sugar.

The amount of direct payments varied depending on the goods produced and previously, on the amounts produced. Such practices support over-production. For the products mentioned above, this practice has ceased. But, for other products, a high share of price support and coupling of direct payments to production still exists. The coupling of direct payments to the amount of land is still common practice. Price support is still the main source of farm support in the EU and is still one of the most inefficient and market distorting strategies. For some products, the subsidized part of gross farm receipts still exceeds 50 percent (European Commission Directorate General for Economic and Financial Affairs 2004:8).

Through pressure from the WTO, the EU has taken measures to curb production by using set-aside policies (setting aside a certain amount of arable land that is not to be farmed) and production quotas[2]. But, for political reasons, price supports have been much more difficult to tackle. The farming sector in the EU still has a significant amount of political influence. Historic ties between farmers and social democratic parties in Europe are too strong for the latter to safely neglect the former. This reluctance to touch the issue puts the EU at odds with its transatlantic partner.

To scale back intervention in the market, the Fischler reform created the Single Payment System which consolidates direct payments into one single payment. Then for some products, these single payments were decoupled (see above). This change was a major step in shifting EU domestic supports from the Amber box to the Green Box. These changes also reduced the need for production limitation instruments like quotas. It is however up to member states to determine how far they will decouple their direct payments, a fact that has also drawn attention from critics, especially the United States. This intergovernmental approach leaves much up to national interpretation. National parliaments can decide which products to decouple or to decouple at all. The policy does not fall in line with the spirit of "Common Agricultural Policy."

The direction of the 2003 reforms moved away from the Pillar 1 objectives of the CAP (commodity support focused) towards the newly created Pillar 2, which focuses on rural development and the environment. The reform also instituted a compulsory rule of cross-compliance, meaning that the amount of the direct payments that farmers receive will be with some respect linked to certain statutory environmental, food safety, animal and plant health, as well as animal welfare standards.

Even with the changes, there has been limited success in the shift from market support to rural support. The EU still refuses to go further with cuts in price support and tariff reduction unless others will act similarly. The US is not convinced that EU reform is truly focused on open trade. The US will not make what it contends are "unilateral" concessions unless it feels its behavior will be reciprocated.

US Agricultural Policy

US agricultural policy grew out the New Deal Keynesian belief that the US government had the responsibility for the economy's performance. Policy makers also shared the belief that agricultural markets were more risky, more volatile, and less efficient than other markets. The nature of the market required more government attention. In 1933 the Agricultural Adjustment Act of the FDR administration initiated the first federal price supports, enforced by supply controls for basic commodities like wheat and corn. By 1948, the body responsible for price supports in agriculture (the Commodity Credit Corporation) took the task of "stabilizing, supporting, and protecting farm incomes and prices, [and] of assisting the maintenance of balanced and adequate supplies of agricultural commodities" (Skogstad 1998:468).

The 1953 US government had the clear goal of granting the agricultural sector special protectionist treatment and obtained a waver that excluded the agricultural sector from conforming to any GATT trading rules. They shielded the sector almost completely from the threat of foreign imports. By the 1980s the US government was employing support for wheat and other crops by using three key policy instruments:

> "Loan rates, deficiency payments, and supply controls. Loan rates supported prices by establishing a minimum floor price for each crop. Deficiency payments covered the gap between a politically determined target price, on the one hand, and the higher of the market price or loan rate on the other. Farmers' eligibility for both loan rates and deficiency payments were conditional at various times on their practicing supply controls, that is taking a stipulated amount of their acreage out of production. In addition export subsidies were introduced at periodic intervals in the 1950's and 1960's. This battery of policy instruments maintained US domestic prices well above international market clearing levels over sustained periods" (Skogstad 1998:469).[3]

US Farm Bills do not address import levies (tariffs) but they were also employed as a means to protect the agricultural sector. These policy instruments behave similarly to those employed by the EU. The government was the “buyer of last resort”. They buy agricultural surpluses and then use export subsidies to sell them on the international market (See figure 1 in appendix).

The Uruguay rounds of negotiation were the first rounds of negotiation to fully address agriculture. They forced the US to make changes concerning trade distorting policies. Reforms like the 1996 FAIR act (1996 Farm Bill) and the 2002 Farm Bill were the result. The FAIR Act of 1996 decoupled direct farm payments and farm production on a small scale. The FAIR act created the AMTA payments or Agricultural Market Transition Act payments that fixed direct payments on traditional crops only, like soybeans, wheat and corn. In addition it based these payments on historical records of acreage and production so that current rates of production had no bearing on support. It was a policy shift from distorting “Amber box” to the non-distorting “Green box.” The AMTA payments also allowed the government to relinquish its role as the buyer of last resort.

Loan Deficiency Payments continued. The government also made loans available so that in the case of low world market prices, farmers could borrow money and stockpile their goods until prices for their commodities increased. These policies were only to be used in the case of a price emergency-a situation to be determined by the US government. The collapse in prices in 1997 and 1998 caused the distribution of large loan payments. The magnitude of those payments grew through most of 2002.

Although major farms bills are only created every 5-7 years, the government enacts new policy yearly as House Ways and Means discusses the budget. In 1998 a new payment rate was introduced by the name of Market Loss Assistance (MLA) payments. MLA payments were classified as decoupled as they were paid only in response to low commodity prices. They are also non-specified payments because they can be paid to farmers regardless of the crops they grow. In 2002 the US named MLA payments "Green box" legislation because they were decoupled from production. The MLA payments doubled each year to 2002. The FAIR act also authorized the use of export subsidies at Uruguay round maximums.

By the time the debate on the 2002 US Farm Bill began, three programs constituted the majority of US direct farm payments: AMTA payments, MLA payments (neither of which, the US claims, are tied to production) and marketing loan benefits that are tied directly to current production. The 2002 Bill renamed the yearly MLA provisions counter cyclical payments, or CCP, and were thus written into the Farm Bill. The 2002 Bill also authorized the voluntary updating of base acreage and yield. Updating changes the amount of AMTA and CCP (MLA) payments that can be made to farmers. The Bill also provided generous increases in support and extended the fixed AMTA payments for another six years. According to the 2002 Bill, farmers could also include historical soybean acreage to their base acreage if they could prove they had previously planted soybean crops. Soybean is one of the US historic program crops and entitles farmers to more support.

Such US support schemes have the European Union (and other nations as well) incensed over their ambiguity. These support schemes are also the EU bargaining chip when the EU refuses to address the subject of lowering their own tariffs and domestic support practices. The EU is not convinced that 2002 US Farm Bill policy deserves the title of Green Box legislation, nor are they convinced that the US is complying with Uruguay round decisions. The EU doubts that the US adheres to the spirit of open trade that each WTO member nation has to observe.

<u>A Tough Relationship</u>

The EU-US trade relationship is sensitive. Each party knows that the fortune of the one relies heavily on the other. They are one another's main trading partners and EU-US trade is the largest bilateral trade relationship in the world. The importance of the relationship is not limited to the EU and the US. The US or the EU is the largest trading partner for a variety of other nations. The EU-US transatlantic relationship can be said to define the shape of the global economy in general. The EU-US relationship is so interdependent that when the one is not complying with WTO sanctioned rules, the consequences for the other can be disastrous. When one considers what is at stake at home and abroad, it is perhaps inevitable that there will be disputes. Each recognizes that their policies not only affect their own joint relationship, but affect the multilateral trading system en masse.

The WTO is the only international body that deals directly with trade, and it is the medium through which the transatlantic feud takes places. Each combatant claims the other does not follow the WTO maxims of open trade and liberalization. The EU's major concern is that the 2002 US Farm Bill does not liberalize the agricultural sector, and that future Farm Bills will be equally inadequate. The EU is also worried about the welfare of developing countries. The US on the other hand feels that EU efforts at decoupling are insufficient. The US demands more market access in developing countries and so refuses to make more concessions in domestic support unless they can be assured of cooperation on that front. Both countries are concerned about how, when, and by what measure to decrease tariffs, domestic support and export subsidies. These and other issues fuel the EU-US agricultural fire.

Since the US signed the 2002 Farm Bill before significant decisions were made in the Doha round negotiations, the US was not forced to make substantial reforms. According to the EU, the Farm Bill of that year was a feeble attempt to comply with the objectives of the WTO and the Uruguay round regulations. The MLA/CCP payments were first tabbed as non-specific and so allowed under the “de minimis” rule (and its 10 billion dollar cap). But as of 2002 the US claimed the payments were not tied to current levels of production and so qualified for the “Green box” of allowed policies and practices. They therefore do not apply directly to the designated AMS maximum, nor to the de minimus allotment. The EU does not agree that such CCP payments are completely decoupled from production.

The CCP payments are tied to past levels of production and yield. But farmers are allowed to revise estimates of yield based on the probability of future upgrading. If farmers anticipate that more payments will be made in the future, they can plant more of the program crop now to build a base acreage and yield for the future (Sumner 2003:111). The value of future payments becomes more important. One should question whether these payments are truly decoupled from production and whether they should be added directly to AMS. The EU believes the payments could and should be. The EU views so-called “Green Box” CCP policies as attempts to manipulate the Uruguay maximums.

The EU also debates whether AMTA payments are Green Box legislation. The loopholes in the AMS policy allows for these payments to be classified as “de minimis,” but many in the EU see this as another attempt at manipulation of the Uruguay round rule of Aggregate Measure of Support. The EU fears that the US can argue that these domestic payments “are designed to stay within the URAA limits, even if it does not fit within the spirit of reducing subsidies and protection” (Sumner 2003:117). The EU fears the US will use similar tactics for the upcoming 2007 Bill.

According to EU officials, policies such as the CCP and AMTA schemes are likely to hurt developing countries. Jacques Chirac noted in 2002 that “massive increases to [USA] farm subsidies would hurt the poorest countries hardest-including those in Latin America” (Sumner 2003:109). The EU prides itself on its commitment to aiding developing countries in their quest to make themselves viable on the world market. The EU leads all other countries in this capacity. Poorer countries like the less developed countries of Africa and Latin America enjoy duty-free access to the EU market under the Everything But Arms Initiative. The Initiative enables these countries to sell their products at the higher EU internal prices (which are a product of price supports), but without incurring the levies that other countries face.[4]

The EU (and others) argues that the US has taken advantage of loopholes in WTO regulation. The US has shirked its responsibility to uphold WTO objectives with its 2002 Farm Bill. According to the EU, because of the US inattention to detail, the US has forfeited its ability to negotiate for more market access or lower subsidies in other countries. The US neglected its role in the promotion of trade liberalization and so therefore has no "right" to demand similar concessions of other WTO members, especially the EU. The Financial Times of London said it best: "with its new, grotesque farm subsidies, the US has let the European Union off the hook. Trade liberalization was supposed to be one of the disciplines that would push the EU to reform its absurd Common Agricultural Policy. But having surrendered to protectionism, Washington is in no position to fight" (Sumner 2003:120). The EU is not likely to heed the complaints from Washington when it feels the US has done the multilateral trading system as disservice.

The US has some complaints of its own. The EU has made it very clear to the world community that in the last Fischler reforms it has decoupled its direct payments and domestic support from production; in the press however, they never elaborate on how many products payments have been decoupled. For a great many of EU agricultural products, policies of price support still exist, as do domestic supports based on production **(data on how many products was not readily available)**. The US claims that the level of decoupling is lacking.

The EU has also claimed that it has made great strides in shifting its payments from the trade distorting Pillar One to the rural development and environmental protecting Pillar Two-in other words, a change from the Amber Box to the Green Box. The EU pays its producers to uphold standards of food production, animal treatment, and food quality. They have created a labeling system[5] so that their consumers are assured of the quality of their food. The US has labeled these attempts as a masked form of protectionism, and has charged that the EU uses these policies to deny US goods access to the EU market. Developing country markets are similarly closed to US products. Both the EU and developing countries have "special products" that are sheltered by high agricultural tariffs. These sensitive products are also exempt from full tariff cuts. According to the US these policies run afoul of the WTO commitment to increase market access in agriculture.

Both the United States and the European Union take issue with each other for inabilities to agree about the amount, the time, and in what fashion tariffs, subsidies, and domestic support will be decreased. By what amount to lower (or if at all) the maximum of the Aggregate Measure of Support is also a contentious issue. The classification of agricultural policy in ambiguous boxes is also a source of great contention between the US and the EU. These are just a few of the issues that cause tension in the EU-US trade relationship. There are of course more specific, commodity based and dispute settlement issues that we have not had time to discuss here. The tension directly affects the multilateral trading system because of the important role both the EU and the US play in global trade. The tension also reflects poorly on the WTO, for as the only international body that addresses global trade, the world looks to it to manage trade disputes. In the eyes of many the WTO has been less than successful at fostering better transatlantic trade relations and making progress in the Doha rounds of negotiation. As much as the WTO appears to be an entity dedicated to economy and trade, the WTO is a political body responsible for negotiating and bargaining on the global scale.

[1] Treaty signed by France, Germany, Italy and the Benelux nations on March 25, 1957 that established the European Economic Community (EEC), the precursor to the European Union of today.

[2] However quotas can in fact have a counter effect as they raise domestic prices and can often cause larger surpluses

[3] Loan deficiency payments are output subsidies, the rate of payment is the amount by which the applicable county's loan rate exceeds the marketing loan repayment rate.

[4] This duty –free access is allowed under the WTO Framework for Special and Differential Treatment for Least Developed Countries.

[5] Labels for Protected Designations of Origin, Protected Geographical Indications and Traditional Specialty Guaranteed. According to the European Commission these labels offer guarantees about origin and method of production, the value of the product, and protect against unfair imitation

Chapter 4

Conclusions

Possible Conclusions for the Doha Rounds

The conflict between two of the most influential members of the World Trade Organization makes negotiations quite difficult. The position of each directly affects the position of the other with respect to policy, and also directly affects the path of WTO negotiations. The reputation of the WTO as a mediator is at stake. The suspension of the Doha round in 2006 is an example of the power the US-EU relationship has to shape the course of negotiations. Here I will discuss issues and possible conclusions to the Doha Rounds of negotiations. I will keep in mind the "spill over" effect of negotiations. The Doha conclusions will also affect national policy, so I will discuss potential reforms for the US Farm Bill and the Common Agricultural Policy since the one will correspond with the other. The EU-US relationship is an exercise in give and take. One must give to get.

There are four keys to the Doha Agenda: (a) cuts in overall support; (b) cuts in the maximum AMS values; (c) reductions in de minimus levels; and (d) the Blue Box ceiling should be lowered to 5 (perhaps 2.5) percent of the value of agricultural production. In 2004, the then 147 members unanimously agreed on a framework for modalities on how to liberalize farm trade. Modalities are the rules (or amendments to existing rules) and numerical targets needed to meet the Doha Round Agenda. After countries agree to the modalities, work commences on creating schedules for the changes. Each member nation submits detailed offers that they must adhere to when WTO decisions have been made. But the modalities do not give explicit formulas to be used; they do not include the figures that will eventually be used; nor do they determine how much reform is to be achieved.

In 2005, the sixth Ministerial Conference proposed some resolutions. Export subsidies were to be phased out by the year 2013 with conditions on export credits and food aid (measures used primarily by the US). In regards to domestic support, the WTO wants to force reform of the US CCP policies, and create three bands for reduction in domestic support overall, with higher cuts in the highest subsidy bands. For market access, the system for tariff cuts is a four band scheme. The highest tariffs will suffer the highest cuts. Finally, for those countries in a position to do so, they should provide duty free access and quota free market access for products from Least Developed Countries.

According to the WTO website, the Doha mandate "underscores the 'level of ambition'…For example phrases such as 'substantial reductions' and 'substantial improvements' are used repeatedly; and throughout there are references to 'special and differential treatment' for developing countries being 'integral' " (WTO 2004:17). The three pillars (market access, domestic support and export subsidies) are always mentioned as being interconnected, and improvements concerning them must take place equitably. The Doha mandate does also include references to market access for other non-agricultural products, an issue which may be integral for agricultural negotiations to be laid to rest. Developed countries (especially the EU) are not willing to agree unless concessions are made with regard to Intellectual Property (TRIPS), Non-Agricultural Market Access (or NAMA which includes industrial products or manufactured goods), and Services.

The United States, aside from the faults in the 2002 Farm Bill, still proposes massive restructuring of the multilateral tariff and subsidy scheme. The US proposes the top tier of bound tariffs be cut by 90 percent, with the average cuts hovering at 75 percent. The EU is in agreement that tariff rates should be cut, but at a less ambitious rate-60 percent for the highest bound tariffs with an average cut of 46 percent. These proposals have put the EU and US at odds.

In a bid to support developing countries, the EU has proposed that developing countries be allowed to designate up to 8 percent of imports as "sensitive" and therefore not subject to the cuts. The US on the other hand proposes that exemptions should be limited to just 1 percent of imports. The US favors higher reductions because it fears that inadequate cuts in bound tariffs will not influence applied tariffs. The US has even gone so far as to suggest attacking applied tariffs directly. It does not favor giving more specialized treatment to developing countries, because the US feels it has already fulfilled that obligation under the Framework Agreement.[1] The US expects more concessions in tariffs from the EU (Japan and others for that matter) before it will agree to any further "special and differential" treatment.

The precise means to reduce the tariffs is under debate. There are several proposals: the Swiss Formula for reduction, which produces much steeper cuts on higher tariffs; the Uruguay Round approach, which uses the same percentage of reductions no matter the starting tariff rate; ad valorem uses a percentage of the price; or specific tariff rates for each product. The time period for implementation of reductions is in question. Lastly, whether all developed countries should allow duty-free access to developing countries is contested. The sixth ministerial conference proposed it, but it is still unknown who will accept such sweeping regulation.

Provisions will also be made for food safety. Member countries (especially the EU) are very much against the WTO forcing them to accept food imports they deem unsafe, or goods that harm animals in their production. There are new concerns about genetically modified organisms and disease outbreaks and the use of these concerns as a means of protection. Some like the US are already concerned that sanitary and photo sanitary regulations (SPS) are replacing tariffs in that capacity.

Also, there is the debate surrounding the "boxes" of domestic support. There are proposals that support the removal of the "de minimis" provision and the inclusion of all its policies in the Amber box. They would then contribute directly to the Aggregate Measure of Support. To add, the same is proposed for the Blue box: its destruction and those policies that directly distort trade added to the Amber box and those which do not, to the Green box.

With regard to possible conclusions, if we revisit all that is above, it is quite clear that fulfilling all of the objectives of the Doha Agenda will be quite difficult to execute. Concerning tariffs, the EU is also very easy with its declaration that the US does not enjoy a very strong bargaining position. Its 2002 Farm Bill has left much wanting and so allows the EU and the developing countries to take more liberties. The US proposal for sweeping tariff cuts does not seem plausible. The EU will not agree to such extensive cuts unless their "sensitive products" can be adequately sheltered. The US will not agree to their own proposals to lower their tariffs further unless developing nations agree to more market access for industrial products (NAMA) and services; nor will the US agree if the EU continues to shelter its products. No side is willing to budge on the point, especially now that developing countries have joined together in the matter. Marked tariffs reductions in these rounds of negotiation do not seem likely.

With regard to domestic subsidies, for political reason the US has shown how reluctant it is to decrease its domestic subsidies (however willing they are to restructure them). Before it will do so, the US must be assured of securing more market access in agriculture from the EU and developing countries. The fear of environmental policy as a form of protection has already incensed Washington. The US needs more in return if it is going to persuade its own farmers to give up their safeguards. The US is not prepared in any way to act unilaterally. There must be give and take.

I agree with Arvind Panagariya (2005:5-6) when he proposes that there are two possible conclusions. The first is an agreement on the complete destruction of export subsidies. Export subsidies have been the subject of much negative publicity over the last two decades. An agreement to terminate them would be a watershed decision for the WTO and is sure to be seen as acceptable to all countries. The US will have to eliminate (or a least come close to eliminating) export credits and food aid, as they are also considered a form of subsidy. The current world level of export subsidies is between 3 and 5 billion dollars a year. Their elimination would not be such a drastic change for the countries that employ them. Food aid is important for some developing nations, but provisions would be made to secure that those countries that need food aid the most would receive it.

The second of these possibilities regards the domestic subsidy boxes. Eliminating the Blue box and the de minimis provision could jar domestic policy, but it would also give the WTO a clean slate in the subsidy regime. The WTO could make the definition of the boxes more concrete and leave less room to interpretation. Clarity and transparency are also sure to be acceptable, especially in so-called liberal democratic nations. With regard to a schedule for tariff reductions, nothing is impossible. But I believe that the level of reductions will correspond closely to the amount the market in Services and other sectors opens. However, I do not believe that significant decisions will be made in tariffs during this round of negotiations.

These possible conclusions leave much wanting with regard to other sectors. In my opinion, not much headway will be made in other sectors like NAMA and Services. It is hard to leapfrog over agriculture, a sector of the economy that is specifically important to developing nations. But if the US and the EU can cooperate on the elimination of export subsidies and the clarification of the domestic subsidy boxes, perhaps the door to negotiation in other sectors will open further and more could be achieved in the next round of negotiations. It is true that rounds of negotiation take place only every 10-12 years, but the above concessions could help soften the transatlantic relationship and could help preserve the reputation of the WTO. All can benefit if they decide to cooperate.

Future for US Agricultural Policy and the CAP

Because it is very unlikely that WTO negotiations will end this year, or even that substantial decisions will be made, it is also very unlikely that substantial changes will be made to the 2007 US Farm Bill. The US does however rely on past and on-going negotiations to help shape new Farm Bill regulations. US regulations must comply with regulations or limitations set forth by the World Trade Organization. But without international guidelines to follow, the US isn't so much a body without a head but a body without a conscience. There is no external body to monitor reform. And tariff legislation is not a feature of Farm Bill policy.

Farm Bill policy is not a process determined solely by the White House executive. The US Trade Representative does report to the president, and she (Susan C. Schwab) did enjoy Fast Track Authority[2]. However, now that Fast Track Authority has expired, congressional proceedings will prolong negotiations. It has been argued that renewing Fast Track Authority in the US was essential for the Doha rounds to end. Policy creation is the product of compromise involving Congress, the Administration, and key interest and lobbying groups. Fast Track Authority was controversial but it "trimmed the fat" on legislative procedures. Without it, the US seems that much less likely to agree on any Doha proposal in a timely fashion. The 2007 US Farm Bill was to be shaped by the outcome of Doha negotiations, but that is now nearly impossible.

US policy in agriculture has been the subject of much internal criticism. Government assistance disproportionately aids larger farms. The largest 10 percent of farms receive more than half of the total payments (Blandford 2007:21). Farmers are very vocal about equity in payments and this may force Congress to back policies that benefit the smaller farmer. The focus on the environment and the protection of wildlife habitat could also impact Congress. Interest groups pressing for funding on environmental programs, a la Europe, could be rewarded in 2007. But pressure to reduce the deficit and curb government spending could make things more difficult. The fact is that the president owes his second term to farm state electors, and the 2002 Republican sweep of elections is still fresh in the minds of the farming sector. The 2006 Democratic sweep of Congressional elections shook things up, but the power of the farming elite is not far from their minds either.

Therefore for largely political reasons, it is unlikely that there will be a major shift from domestic support in the 2007 Farm Bill. The current focus on environmental issues is great but the need to curb government spending may be greater. It is even more unlikely that environmental issues will receive support at the expense of domestic support considering the Bush administration has continued to downplay the issue of global warming. The 2005 WTO rulings in the Brazil-US cotton case could prompt the US to make changes in domestic support. It is acknowledged that US trade-distorting domestic policy ranks near the top of world values (along with the EU and Japan). But, the farm lobby is just as strong as it has even been.

If a WTO decision could be made in 2007, it would force the 2007 Farm Bill to make restrictions accordingly. But as WTO conclusions this year are unlikely, so are significant changes in the US Farm Bill. If the US does not make changes to comply with WTO cotton case rulings, and/or decrease domestic support, the EU will not be compelled to do so either. US compliance is almost directly linked to more market access in agriculture, NAMA, and Services in developing countries. In addition, the WTO reputation as a dispute settlement mechanism is still in jeopardy.

CAP reform does happen to take place outside of WTO negotiations. The EU does make a large show of making progress towards liberalization "without WTO interference." The CAP reforms that took place in 2003 are set to be in place until 2013. With regard to reforms beyond 2013, it is a bit more difficult to predict. There will however be a 2009 EU budget debate which could make the policy scope more limited. The green movement in the European Union is very real. Continued efforts to shift from Pillar I to Pillar II will continue. According to Allan Buckwell "there is no doubt that in the case of Europe, with its high proportion of land under farming, forestry or nature management, with the extent of trans-boundary environmental spillovers, and EU-based environmental, animal welfare and food safety regulation within its single market, a significant case can be made for its rural land policies" (Buckwell 2007:17).

The EU will undoubtedly examine its policies in the future and decide whether coupled direct payments are such an important feature and whether policies of cross-compliance should not extend to all products. Until 2013 however, the Single Payment System will account for the major part of CAP expenditure. But member-states like the UK are proposing their total elimination by the year 2020. Nonetheless one can successfully conclude that the EU will not take steps in the future to reduce domestic support or increase market access for "special products" unless they have some assurance that other powerful nations like the United States will follow suit. And without pressure from the WTO, the EU is not likely to receive such assurances. The US has showed itself to be very difficult when it comes to protection of farmers. Negotiations are likely to stall again. The reputations of the US and the EU as leaders in the effort to liberalize are at stake, but it appears that the transatlantic trade relationship in agriculture will continue to be controversial and every bit as political as it has been.

[1] See WTO August 2004 Framework

[2] Fast Track Negotiating Authority or Trade Promotion Authority is the president's ability to negotiate trade agreements that the Congress can approve or disapprove but cannot amend or filibuster. It expired on July 1, 2007.

Appendix

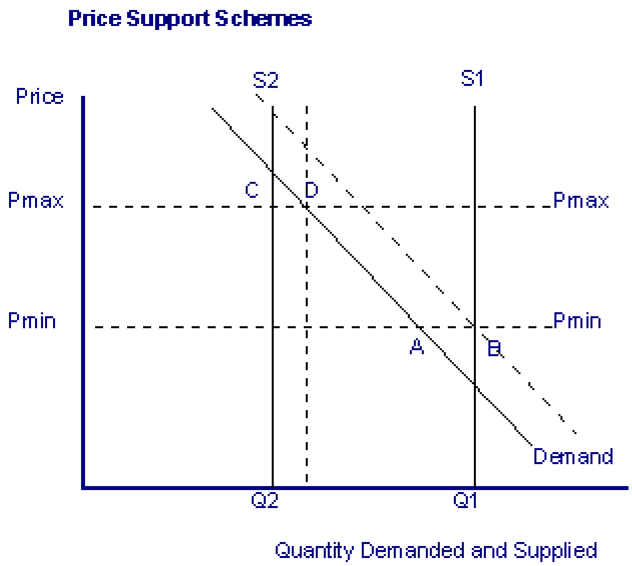

Figure 1. Price Support
Source. http://www.tutor2u.net/economics/content/diagrams/bufferstocks1.gif

The above figure describes how price supports work. The graph represents the market for a particular good. S1 and S2 are representations of supply of a good that is produced by a farmer. Both are completely elastic as the farmer cannot change the quantity of the good supplied to the market after he has harvested for the season. Pmin and Pmax are the minimum and maximum price that the government will allow for the good. Demand is represented by the two downward sloping lines.

If for a given year, the supply of the good is S1 and demand remains constant, then the price will fall below the minimum. To raise the domestic price of a good above the minimum, the government in this case will buy however much of the product necessary to raise the price. The demand shifts from the solid line to the dotted line and back within the designated price band. If for another given year, supply of the good is S2 and demand is constant, then the price goes above the maximum. The government will sell whatever goods it has in its reserves to lower the price back into the necessary price band. Demand again shifts from the solid line to the dotted line. The government also employs export subsidies to sell whatever surpluses it has purchased from the domestic market onto the world market at lower prices, therefore distorting not only prices in the domestic market, but in the world market.

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