

Agriculture, GATT, and Regional Trade Agreements

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Abstract

Concurrent with the development of the GATT/WTO multilateral trading system, there has been a significant increase in the number of regional trading blocs. Nearly all WTO members are parties to at least one RTA, which raises the question: Is the proliferation of RTA's an indication that countries are turning to regional initiatives to achieve trade liberalization, or do RTA's actually impede this process? Concerning agriculture, both the GATT and RTA's have only recently begun to more fully liberalize trade, and further progress in this area is needed. Instead of asking whether RTA's inhibit or facilitate world trade liberalization, it might be useful to consider other ways (such as strengthening WTO rules on RTA's and compliance mechanisms) to ensure that RTA's are trade creating, not diverting.

Introduction

Concurrent with the development of the GATT multilateral trading system, there has been a significant increase in the number of regional trading blocks. Over the period 1947-94, 109 regional trading agreements (RTA's) were reported to the GATT, nearly equal to the number of countries that are contracting parties (CP's) to the multilateral trade treaty.¹ 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 parties to at least one RTA—European RTA's account for the majority of these agreements, while Japan and Hong Kong are not members of any formal RTA's.²

Is the proliferation of RTA's, especially over the last 10-15 years, an indication that countries are turning to regional initiatives to achieve world trade liberalization? Or are RTA's actually an impediment to this process? To answer these questions, this article exam-

¹Since the GATT is technically a treaty, its signatories are referred to as contracting parties. The World Trade Organization, on the other hand, is an organization to which the contracting parties to the GATT became members in 1995. Therefore, in reference to the GATT, countries are referred to as Contracting Parties, while when discussing the WTO, they are designated as members.

²Both belong to the Asia-Pacific Economic Cooperation Forum (APEC). Since it is not a formal RTA, it has not been reported to the WTO. However, it is included in this study since its signatories have indicated their intent to liberalize trade within the region in the next century.

ines the coexistence of RTA's and the GATT—specifically, how the GATT treats RTA's under Article XXIV and how Article XXIV has been applied. GATT and RTA provisions on agriculture are compared to examine how (or if) either approach has liberalized agricultural trade. Finally, the larger question of whether RTA's are stumbling blocks or building blocks to trade liberalization is addressed.

What Does the GATT Say About Regional Trade Agreements?

When the GATT was being developed, the contracting parties envisioned the need for rules to regulate regional trade. Although such agreements are preferential in nature and represent an exception to the GATT cornerstone of most-favored nation (MFN) treatment, countries were tolerant (even supportive) of RTA's since they were viewed as leading to increased trade and therefore a more efficient allocation of resources.³ The political realities of post-war Europe and plans for greater European integration were also factors behind the general acceptance of RTA's. At the same time, there was an attempt to fashion the provisions for RTA's in very precise legal language in order to prevent complete circumvention of GATT rules. Despite this intent, the language contained in the GATT on the formation of customs unions (CU's) and free trade agreements (FTA's) turned out to be ambiguous, and most FTA's and CU's are not fully consistent with provisions of the GATT.

Article XXIV of the GATT contains the primary provisions covering CU's, FTA's, and interim trade agreements (ITA's)⁴, and is based on three primary criteria: (1) trade barriers must not increase from levels prior to the formation of a CU or FTA (XXIV:5), (2) all internal trade barriers (including

quantitative restrictions) must be eliminated (XXIV:8), and (3) all CU's, FTA's, and ITA's must be reported to the GATT to determine if conditions (1) and (2) are met, and to allow CP's to provide input (XXIV:7). The latter is achieved through the formation of a working party on regional trade, in which any interested country can participate.⁵

Although the provisions of Article XXIV seem obvious and clear cut, their ambiguity is revealed in their application. For example, XXIV:5 is unclear as to whether the concept of "trade barriers" applies to individual tariff lines (or to a specific trade measure) or to the tariff schedule as a whole (calculated, for example, on a trade-weighted average). Moreover, it is not clear if this provision refers to applied rates or to bound rates, both of which are contained in a country's schedule of commitments.

Second, XXIV:8 requires the elimination of all internal barriers⁶ on "substantially all trade." The purpose of this provision is to prevent countries from setting up preferential trade arrangements that exempt less import-competitive sectors, and to facilitate the trade-creation effect of the RTA. However, no consensus has been achieved as to what constitutes "substantially all trade"—is it qualitative (sectoral) or quantitative (share of intra-member trade covered) or both? Most RTA's have excluded, at least initially, some sensitive sectors.

Concerning ITA's, XXIV:5(c) requires a plan and schedule for the formation of a CU or FTA "within a reasonable amount of time." Again it is unclear what constitutes a reasonable amount of time for implementation. XXIV:7(b) contains language that enables the CP's to review this plan and schedule, to determine

³Viner's (1950) work on trade creation/diversion questioned this assumption.

⁴An interim trade agreement refers to an interim agreement that is necessary for the formation of a CU or FTA.

⁵Since 1996, the Committee on Regional Trade Agreements reviews all notifications relating to RTA's.

⁶Except where permitted under Article XI—general elimination of quantitative restrictions; Article XII—balance of payments; Article XIII—administration of quantitative restrictions; Article XIV—exceptions to non-discrimination; Article XV—exchange arrangements; and XX—general exceptions.

whether or not the formation of the CU/FTA is feasible, and to make recommendations on its implementation. The parties intending to create a CU/FTA cannot proceed without taking these recommendations into account. However, in many cases, the working parties were unable to complete their examination of the ITA before the CU or FTA was enacted, thereby reducing the efficacy of this provision.

Another factor contributing to the perceived weakness of Article XXIV is that most CU's and FTA's do not fully meet its criteria. Hoekman and Kostecki (1995) point out that a political decision was made early on not to examine the formation of the European Economic Community (EEC) in 1957 too closely, since the six countries making up the EEC had threatened to withdraw from the GATT if the EEC was found not to be in conformity with Article XXIV (some countries felt the formation of the EEC raised trade barriers). As the EEC did not fully meet the criteria of Article XXIV, a precedent was set for other RTA's. In fact, since the formation of the EEC in 1957, almost no GATT working party on regional trade agreements has resulted in unanimous agreement that Article XXIV criteria were met.⁷

With the proliferation of RTA's during the 1980's and 1990's and the problems with application of Article XXIV cited above, the GATT CP's recognized the need to clarify Article XXIV's criteria. The result was the "Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994" ("Understanding" for short), drafted during the Uruguay Round (UR) of negotiations. The Understanding reiterates that, to be consistent with Article XXIV, all CU's, FTA's, and ITA's must satisfy, among others, the provisions of paragraphs 5, 6 (compensation for tariff increases due to the formation of a CU), 7, and 8 of that Article.

⁷As of January 1995, only 6 RTA's have been found to be compliant with Article XXIV by unanimous agreement of the working party. Of these 6, only 2 are presumed to still be in operation (Czech-Slovak CU and the Caribbean Community and Common Market).

It also outlines how the evaluation of trade barriers before and after the creation of a CU (as contained in paragraph 5(a)) should be conducted. First, tariffs and related charges will be compared "based upon an overall assessment of weighted average tariff rates and of customs duties collected." The WTO Secretariat is instructed to compute trade-weighted average tariff rates, using data on *applied* (not bound) tariff rates provided by CU members for a "previous representative period." The definition of a "previous representative period" is left open for interpretation. Also concerning paragraph 5, the Understanding states that the "reasonable amount of time" mentioned in point (c) should "exceed 10 years only in exceptional cases."

One area that the Understanding does not address is the definition of "substantially all trade." In the preamble, members recognize that the gains from greater integration are reduced if "any major sector of trade is excluded" from the elimination of internal trade barriers, but there is no further clarification of how to determine if this requirement has been met.

Agriculture and RTA's

Although the GATT requires that CU's and FTA's remove trade barriers on internal trade, the "hole" (to use Hoekman and Leidy's terminology) opened by the phrase "substantially all trade" has allowed many RTA's to exclude agriculture from total liberalization (or use a staged reduction in trade barriers).⁸ The primary exceptions to this are the EU, the Australia-New Zealand Closer Economic Relations (CER) Agreement, and the Baltic FTA between Estonia, Latvia, and Lithuania, all of which currently have no internal agricultural trade barriers.

Although RTA's have taken different approaches to reducing barriers to agricultural trade, nearly all maintain some degree of protection, especially for sensitive

⁸It should be noted, of course, that the GATT itself contains many holes as far as agriculture is concerned.

products (table 1). The EU and EFTA FTA's with other countries (and each other) generally exclude trade in most agricultural products from complete liberalization, and market access opportunities in the EU and EFTA markets are limited through the use of tariff-rate quotas and other mechanisms. The CEE FTA's (CEFTA, Czech-Slovak CU) are moving in the direction of removing internal barriers on agricultural trade, although not as quickly as originally envisioned.

RTA's in the Western Hemisphere have made greater progress in removing internal agricultural trade barriers, although it should be noted that some of these barriers were removed only after implementation. The North American Free Trade Agreement (NAFTA) instantly removed tariffs on a number of agricultural products, and uses a staged reduction and eventual elimination of many of the remaining trade barriers. Most tariffs on agricultural trade between the United States and Canada expired on January 1, 1998 (as contained in the earlier Canada-U.S. FTA), while Mexico has a longer transition period (15 years maximum) to phase out most of its trade barriers with the United States and Canada. The Southern Common Market (MERCOSUR) has removed nearly all intra-regional tariffs, and the only agricultural product exempt from complete liberalization is sugar.

Road to World Agricultural Trade Liberalization Paved by RTA's or Multilateral Agreements?

Do RTA's in fact result in freer agricultural trade? In other words, have RTA's gone further than multilateral trade negotiations (MTN's) in liberalizing agricultural trade? A related and more general question can also be asked: Are RTA's a path or an impediment to multilateral trade liberalization?

To answer the first question, it is necessary to compare the path RTA's and MTN's have taken in liberalizing agricultural trade. The earliest RTA's, such as the EEC and EFTA (and the FTA's between them), did little to liberalize world agricultural trade. While it is true that

the EEC removed all internal barriers to agricultural trade, it also raised external barriers and is generally viewed as trade diverting for agricultural products (see studies by Vollrath; Liapis and Tsigas; and Leetmaa, Jones, and Seeley in this report). EFTA excludes most intra-trade in agricultural products from complete liberalization.

At the same time, the GATT from its inception has treated agriculture differently from most other sectors, by allowing the use of quantitative restrictions and trade-distorting subsidies. Moreover, the first three negotiating rounds (1949, 1951, 1956) after the GATT's creation did little to liberalize agricultural trade. On the other hand, the formation of the EEC in 1957 turned out to be a major setback for MTN's on agriculture, as the EEC proved to be a main impediment to greater liberalization in the Dillon (1961-62) and Kennedy (1964-67) rounds. While other CP's may have been less than enthusiastic about bringing agriculture fully under GATT disciplines, nevertheless, the EEC was a formidable opponent to agricultural trade liberalization.

Agricultural trade liberalization was relatively limited until recently, both in terms of regional and multilateral trade initiatives. The Uruguay Round of MTN's (1986-94) was the first multilateral breakthrough in bringing agricultural trade under the same GATT disciplines faced by other sectors. The Uruguay Round Agreement on Agriculture prohibits the use of nontariff barriers (with a few exceptions), reduces tariff levels, and disciplines trade-distorting domestic and export subsidies. New negotiations to continue the reform process are scheduled for 1999-2000.

Most RTA's formed in the last 10 years have included agriculture in the removal of internal trade barriers, or have made progress in reducing or prohibiting the introduction of new trade barriers. Agricultural trade between the United States and Canada reached a high degree of liberalization in 1998, with the removal of all tariffs. MERCOSUR has removed all internal agricultural barriers (with the exception of sugar), and its common external tariff results in a lower rate of protec-

tion for some products than was previously the case. APEC, an informal regional trade initiative, has set the year 2010 (2020 for developing countries) as a goal for complete trade liberalization. One reason for the greater degree of coverage of agricultural products in recent RTA's (compared with earlier ones) is that these agreements provided a way for like-minded countries to pursue more rapid agricultural trade liberalization at a time when multilateral trade talks (Uruguay Round) were foundering during the late 1980's.

Given the almost concurrent progress made at both the regional and multilateral level, it is difficult to say if RTA's have gone further than MTN's in agricultural trade liberalization. While recent RTA's have gone further than earlier ones in reducing trade barriers, it took MTN's to bring one of the largest RTA's, the EU, under stricter discipline. And, as Hoekman and Leidy point out, the same factors that block (or stimulate) trade liberalization in MTN's can also be strong in RTA's (see appendix on U.S.-Israel Free Trade Area Agreement). It is not coincidental that the agricultural and food products with the highest rates of protection in WTO members' schedules of commitments are the same products excluded from complete liberalization in most RTA's.

The second question, "are RTA's a path (building blocks) or an impediment (stumbling blocks) to multilateral trade liberalization," is best addressed by examining the relative merits of regional and multilateral trade approaches that have been debated in the literature. Although the issue of regionalism versus multilateralism is discussed in very general terms, it should be clear that the analysis pertains as much to agricultural trade as it does to trade in other sectors.

One perspective, put forth by Jagdish Bhagwati (1991), among others, is that RTA's are a dangerous development in the world trading system and a distraction from the goal of multilateral trade liberalization. Bhagwati sees RTA's as purely preferential agreements, which lower trade opportunities for third countries and are generally trade diverting. Moreover, he cites evidence from political economy studies that

suggests strong motives for producer groups to push for RTA's. Winters (1996) has echoed this concern, writing that multilateral trade liberalization could stall if producers get what they want from RTA's (trade diversion makes bad economics, but good politics).

On the other hand, Bergsten (1997) and others have argued that RTA's benefit multilateral trade liberalization. One reason for this, Bergsten believes, is that RTA's put pressure on other countries to liberalize. Blackhurst and Henderson (1993) have written that regional integration brings benefits through lower transaction costs, larger markets, and therefore more effective competition, which provides an incentive for greater integration/liberalization. The empirical work in this study appears to support this observation, as the U.S. agricultural sector benefits from inclusion in trade agreements but is less well off when remaining outside regional integration. Since countries have an incentive to join RTA's, the results increasingly become multilateral.

Others point out that RTA's and the GATT multilateral system can be mutually beneficial. For example, some RTA's are based on WTO/GATT mechanisms and provisions, which help to solidify GATT trade rules. On the other hand, RTA's have enabled countries to move more quickly to reform their trade regimes (for example, RTA's were out in front in liberalizing government procurement and trade in services), leading to multilateral liberalization in those areas. The challenge, as several observers have noted, is how to move from the regional level of liberalization to the multilateral forum ("switching to the multilateral horse once the race begins," as Winters put it), and at the same time, ensure that RTA's do not harm nonmembers through trade diversion.

While both sides of the "building/stumbling block" argument make valid points, a third approach, which takes a pragmatic look at the experience of RTA's and the GATT, is also helpful to consider. Blackhurst and Henderson have posited that RTA's are neither inherently good nor bad, but that the effect of RTA's on the world economy depends on the motive in forming it,

the way it is formed, and how it changes over time (are trade barriers removed?, are other countries able to join?). Most economists would probably agree that an RTA open to any interested country and that fully dismantles trade barriers (in the vein of the “open regionalism” of APEC) is a step forward in trade liberalization, and preferable to an RTA that makes membership to outside countries difficult, retains internal trade barriers, and is based primarily on political considerations, which would likely lead to a retaliatory response from nonmembers.

Following this line of thought, some observers of RTA's and trade liberalization have turned their attention to identifying ways to make RTA's less trade distorting, as well as factors that inhibit true liberalization in either the regional or multilateral context. One approach is to examine Article XXIV not only in terms of its provisions on RTA's, but to consider ways to make compliance with those provisions more likely.

While the UR Understanding provided some clarification of how XXIV:5 (tariff levels on the whole cannot increase after formation of an RTA) should be applied, some economists feel that looking at pre- and post-RTA tariff levels is the wrong indicator, since trade diversion is still possible even if tariffs are reduced. McMillan (1993) and others have proposed using trade levels as a better indicator of whether or not trade diversion occurs because of an RTA. However, Hoekman and Leidy point out that looking at trade data alone makes it difficult to determine causality, and have suggested that policy-based indicators should also be examined. Other proposals to strengthen Article XXIV criteria include requiring an open accession clause that would minimize the possibility of trade diversion and the “hub and spoke” effect of multiple RTA's (for example, the web of agreements between the EU, EFTA, and the Central and East European countries), and the use of the lowest pre-CU tariff rate as the common external tariff (a proposal of Bhagwati's).

Second, and equally as important (if not more so), is the issue of compliance with WTO/GATT rules (not

only Article XXIV, but more recent agreements such as on agriculture, technical barriers to trade, sanitary and phytosanitary measures, and rules of origin). While none of the RTA's reported to the GATT was unanimously accepted as fully compliant with Article XXIV, none was found to be in violation, and there have been very few disputes brought to the WTO/GATT based on Article XXIV noncompliance.⁹ As pointed out earlier, some have attributed this weakness in application to the political decision made not to hold the EEC too strongly to Article XXIV rules. However, without any credible threat of surveillance and possible sanction, an RTA has little incentive to comply with Article XXIV.

The Understanding addresses the need for greater emphasis on the notification and review process, which if implemented, could lead to greater pressure for RTA's to comply. So far, the WTO Committee on Regional Trade Agreements (CRTA), which was formed in 1996, has devoted much of its time to developing a systematic approach to RTA notification and reviews, as well as identifying areas where greater clarification is required.¹⁰ At the same time, the CRTA has also had to examine a backlog of new or existing RTA's reported since the formation of the WTO. It is too early to say if the CRTA will be able to play the kind of watchdog/surveillance role identified above, given the amount of work and the difficulty in addressing these issues (many of which are very contentious); however, it appears that the Committee is moving in the right direction.

⁹Only three cases have involved Article XXIV noncompliance, all involving the EU as the respondent and relating to preferential agricultural trade arrangements with developing countries. In all three cases, adoption of the panel results was blocked by the EU and its trading partners (the disputes took place before the WTO dispute resolution mechanism was developed).

¹⁰Issues identified in WT/REG/W/12 include: differences in WTO regulatory framework for CU's and FTA's, overlapping dispute settlement systems, legal implications of overlapping membership in RTA's, enlargement of CU's, notification under the Enabling Clause, definition of the term “substantially all trade,” and assessment of RTA's in which one or more members does not belong to the WTO.

As the empirical evidence presented by other studies in this report demonstrates, RTA's are not necessarily the trade-diverting "poxes" on the world trading system that Bhagwati has described, and can be building blocks to greater liberalization. However, these results also support Blackhurst and Henderson's contention that the terms of the RTA's formation and how it changes over time are important determinants of whether or not it will be trade creating or diverting. As a result, it may make sense to move beyond the "building/stumbling block" paradigm to look at ways in which GATT rules on RTA's and compliance with those rules can be strengthened to ensure that RTA's are more likely to create trade rather than to divert it.

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Table 1—Selected reciprocal RTA's and agricultural provisions

RTA	Created	Current Members	Agricultural provisions
Europe			
European Union (EU)	1957 (EEC-6)	Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom	No internal trade barriers. Common Agriculture Policy (unified trade policy and support)
European Free Trade Association (EFTA)	1960	Iceland, Norway, Switzerland, Liechtenstein	Agriculture is excluded from removal of internal trade barriers
Central European Free Trade Area (CEFTA)	1992	Hungary, Poland, Czech Republic, Slovakia, Slovenia, Romania	Scheduled to fully liberalize agricultural trade in 1998, postponed until 2000
Czech-Slovak Customs Union	1993	Czech Republic and Slovakia	Existing agricultural trade barriers not completely removed, but new barriers cannot be introduced
EU-EFTA FTA's	1973	Bilateral FTA's between EU and individual EFTA members	Trade concessions on agriculture were negotiated on product-by-product basis; EFTA adopted EU sanitary and phytosanitary regulations
EU-CEE Association ("Europe") Agreements	1992	EU and Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Bulgaria, Czech Republic, Slovakia	Separate protocol for agriculture: 5-year phase-in for most concessions, limited to tariff decreases and quota increases. Trade in some products, such as grains, is not liberalized
EFTA-CEE FTA's	1993	EFTA and Hungary, Poland, Romania, Bulgaria, Czech Republic, Slovakia	10-year transition period for elimination of tariffs and quantity restrictions (QRs) on products covered by the agreement (processed agricultural products)
Baltic FTA	1996	Estonia, Latvia, Lithuania	Internal agricultural trade was liberalized on January 1, 1997
Baltic FTA's with Norway, Switzerland	1992, 1993	Bilateral FTA's between Norway and Switzerland with Estonia, Latvia, and Lithuania	Processed agricultural products are included, unprocessed agricultural products are covered in a separated bilateral arrangement
EFTA FTAs with Israel and Turkey	1992 (Turkey) 1993 (Israel)		EFTA and Turkey: FTA by 2002 includes processed agricultural products and fish products; in both cases, bilateral arrangements for agricultural trade with EFTA members apply
Western Hemisphere			
Southern Common Market (MERCOSUR)	1991	Argentina, Brazil, Uruguay, Paraguay	Nearly all intra-regional tariffs removed, only agricultural product exempt from liberalization is sugar. Established common external tariff, ranging from 0-20 percent for agricultural products (avg. 10 percent)—generally lower than previous tariff levels

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Agriculture, GATT, and Regional Trade Agreements

Table 1—Selected reciprocal RTA's and agricultural provisions--continued

RTA	Created	Current Members	Agricultural provisions
Western Hemisphere			
U.S.-Israel FTA	1985	U.S., Israel	Agriculture is covered, but Israel was granted the right to protect infant industries, particularly in agriculture. 1996 Agreement designed to further liberalize ag. trade particularly U.S. products facing nontariff barriers
North American Free Trade Agreement (NAFTA)	1994 (CUSTA—1988)	Canada, Mexico, United States	<p>Agricultural trade treated bilaterally:</p> <p>Most agricultural tariffs between Canada and U.S. eliminated by Jan. 1, 1998 (as contained in the Canada-U.S. FTA); restrictions on sensitive products remain (grains, meat, eggs, sugar containing products, fruits and vegetables); agreement not to use export subsidies in bilateral trade and not to increase or introduce new tariffs</p> <p>15-year phase-out of all tariffs, quotas, and licenses that are barriers to U.S.-Mexican agricultural trade</p> <p>15-year phase out of tariffs, quotas, and licenses for most Canadian-Mexican agricultural trade</p> <p>All 3 countries agreed to use their WTO schedules to discipline domestic support and export subsidies</p>
Asia			
Closer Economic Relations (CER) Agreement	1983	Australia and New Zealand	Free trade in agricultural products
Association of Southeast Asian Nations Free Trade Area (AFTA)	1991	Indonesia, Malaysia, Philippines, Singapore, Thailand, Brunei, Vietnam, Laos, Myanmar	Transition to FTA with common external tariff planned by 2003. Since 1994, coverage includes agricultural products
Multi-Regional			
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, United States; Peru, Russia, and Vietnam became members in 1997	Goal of free trade in agricultural products by 2010 for developed economies and 2020 for developing economies