AGRICULTURE IN THE GATT TRADE NEGOTIATIONS: IMPLICATIONS FOR U.S. AGRICULTURE

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AGRICULTURE IN THE GATT TRADE NEGOTIATIONS:
IMPLICATIONS FOR U.S. AGRICULTURE

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This paper will address 4 points:

1. The original U.S. proposal for complete liberalization of agricultural trade among industrialized countries and how it might affect U.S. agriculture.*

2. The mid-term agreement of April 1989 and the issues that remain to be resolved.*

3. The evolving positions of the EC, the U.S. and the Cairns group, and the inferences one might draw from these developments as to the outcome of the agricultural negotiations.

4. The constraint on U.S. farm legislation stemming from the GATT negotiations.

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*The first two sections of this paper are based on the analyses and conclusions contained in a forthcoming volume on Agricultural Protectionism in the Industrialized World, to be published by Resources for the Future. The relevant chapters are "The Costs of Agricultural Protection and the Difference Free Trade Would Make", by David Blandord; "The Future of International Agricultural Relations: Issues in the GATT Negotiations", by Tim Josling, Fred H. Sanderson and T.K. Warley; and the "Overview", by Fred H. Sanderson, editor of the volume.
1. The Effects of Complete Liberalization of Agricultural Trade.

The U.S. was the first to unveil a proposal for the conduct of the negotiations on agriculture. It called for the elimination of "all policies which distort [agricultural] trade." All such measures would be phased out in ten years. The U.S. proposal would exempt certain programs that have only small effects on production and trade, such as domestic and international food aid and income supplements not linked to a farm's production. It would grant credits for measures introduced since the start of the negotiations that have contributed to reducing the imbalance between production and demand. The proposal would be implemented by measuring the various types of support programs in terms of an aggregate measure of support (AMS) such as the Producer Subsidy Equivalent (PSE) developed in the OECD. The schedule of reductions of the PSE would be supplemented by a "second tier" of disciplines, in the form of ten-year implementation plans that would specify schedules of policy changes for each country. These implementation plans would be bound in GATT and enforced by a special dispute settlement procedure.

The U.S. proposal did not offer short-term remedies to stop and reverse the build-up of surpluses and the escalation of direct and indirect export subsidies. It was not explicit about strengthening the GATT rules except for a brief reference to "changes necessary...to reflect the trading environment that will exist at the end of the transition period." This seemed to defer the revision of GATT articles XI and XVI until all domestic trade distorting policies had been phased out--when there would no longer be any need for special exemptions for agriculture. The apparent lack of interest of the U.S. in limited and short-term measures may reflect a belief that any effort to "patch things up" would slow down the momentum toward liberalizing agricultural policy reforms.

I think it is fair to say that this radical U.S. proposal was never accepted at face value by the EC or even by Canada, Australia, Argentina and other countries organized in the Cairns group of traditional agricultural exporters. It was seen as a statement of principles intended to signal the U.S. determination to use this round of trade negotiations to achieve meaningful progress toward the liberalization of an economic sector which had remained practically untouched by past rounds of GATT negotiations. And there were grounds for optimism in that the industrialized countries organized in the OECD had agreed, in May 1987, on principles of agricultural policy reform, with the objectives of reducing price supports and allowing market signals to influence production. Social problems in the farm sector would be treated by decoupled and targeted income and employment programs.

The U.S. proposal stirred interest in this country and elsewhere in what would happen if the industrialized countries were actually to do away with all market-distorting government interventions. We were suddenly blessed with a host of econometric studies which threw new light on the extent and structure of agricultural protection, the cost to consumers and taxpayers as well as the net costs to our economies, the effects of liberalization on the production, consumption and trade of agricultural products, the income or welfare effects, and the budget and balance-of-payments effects. Some of these studies predate the trade negotiations (IIASA, Tyers-Anderson, OECD); others were prepared in the last few years (IATRC Roningen-Dixit). Most are static equilibrium analyses modelling the effects of liberalization on specific agricultural commodities. A few attempted to incorporate dynamic features, including likely policy reactions to price changes, in their base-line projections (IIASA, Tyers and Anderson). Some take account of the effects on the rest of the economy, via. factor movements (IIASA), savings, investments and productivity (Robinson).

Although the results of these studies differ somewhat, depending on the base period, the policy coverage and the structure and parameters of the models, they all point in the same general directions. The United States would save about $25-30 billion in taxpayer and consumer costs. Producers would lose about $10-15 billion. They could be fully compensated for this loss and still leave American taxpayers and consumers...
better off by about $15 billion. The net gain to the economy would be greater if the favorable effects of agricultural liberalization on the rest of the economy were taken into account. Our agricultural trade balance would benefit from increase export values of beef and feedgrains that would benefit from increased export values of beef and feedgrains that would more than make up for increased imports of dairy products and sugar. Producers' loss of price protection would be partly offset by higher and more stable world prices, particularly for the most heavily protected commodities such as dairy products, sugar, beef and wheat. Land prices would fall, at least initially. In the longer run, the more competitive environment may be expected to accelerate technological advances (e.g., in the dairy industry).

Agricultural producers in Europe and Japan would sustain greater adjustment costs than American farmers, but consumers' and taxpayers' savings would also be greater, and the per capita gains to their economies would exceed those of the U.S.

2. The Mid-Term Agreement of April 1989 and the Issues that Remain to be Resolved.

If it was not evident all along, the slow and tortuous course of the Geneva talks has made it clear that the brave new world of free trade in agriculture will not be achieved in this round of trade negotiations. Indeed, there was reason to doubt that the U.S. Congress was ready for it. In any event, the U.S. bid for total liberalization ran into adamant opposition by the EC and Japan. The EC indicated its willingness to consider a substantial reduction in protection, without defining "substantial." The mid-term agreement reached in Geneva in April, 1989 resolved this issue in favor of the EC. It left open the depth of the cut and the time period over which it was to be accomplished. It also left open the method by which cuts are to be achieved: "through negotiations of specific measures an policies, or commitments on an aggregate measure of support, or a combination of these approaches." There was "a broad measure of consensus" that "agricultural policies should be more responsive to international market signals, and that support and protection should be provided in a less market-distorting manner." Finally it was agreed that "strengthened and more operationally effective GATT rules and disciplines" should be negotiated and that any new rules should be applied to all countries. Thus the negotiators laid out four basic approaches: (1) the across-the-board approach, involving a progressive reduction in terms of an aggregate measure of support; (2) agreements on specific policies and commodities; (3) policy reinstrumentation; and (4) rules reform. These approaches can be viewed as mutually reinforced, although the degree of reliance placed on one or the other varies from country to country and undoubtedly depends on judgments as to their relative effectiveness in accomplishing a country's negotiating goals and on their compatibility with its existing policies and practices.

Participants were invited to put forward by December 1989 detailed proposals for the achievement of the long-term objective, including "the terms and use of an aggregate measurement of support," and ways to "adapt" measures of support and protection to make them less trade-distorting and more market-oriented. Agreement on a long-term reform program was to be reached by the end of 1990.

The work program left major questions yet to be resolved. For example, if the AMS was to be adopted as the basic approach, agreements had to be reached on:

- the quantitative indicator to be used as a proxy measure of the trade-distorting effects of domestic subsidies, export aids and import barriers;
- the types of government interventions that could be excluded from the AMS as not significantly trade-distorting;
- the depth of cuts in support and protection;
the base period from which the cuts were to be measured;

the external reference price: fixed in terms of a country's own currency so as to insulate it from fluctuations;

the role of the AMS: binding commitment, target, or monitoring device;

whether agreements in terms of the AMS should be supplemented by commitments on specific policies and commodities;

whether cuts should be "linear" (the same percentage cuts for all commodities), and whether "rebalancing" of support amongst commodities should be permitted;

how to allow for supply controls.

Adaptation of the instruments of support could involve shifting from output-stimulating producer price supports to production-neutral income payments or to some form of income insurance. The problem here is that any subsidy, even though it may not be based on a farm's current production, or specifically linked to any product, cause more resources to be retained in agriculture than are justified by comparative advantage. If farm programs are listed according to their degree of trade distortion, one will find a continuous spectrum; but any line drawn between "admissible" and "nonadmissible" programs will be difficult to negotiate, because governments tend to be biased in favor of programs that are already in place.

"Strengthened and operationally more effective GATT rules and disciplines" on agricultural trade is a longstanding objective on which little progress has been made in past negotiations. The problem arises mainly around the special provisions for agriculture in GATT articles XI and XVI. Article XI bans quantitative import restrictions but exempts agricultural trade provided a minimum quantity (based on a recent representative period) is imported and domestic production is also restricted. Article XVI prohibits export subsidies but exempts agricultural exports provided the subsidies do not result in the subsidizing country gaining more than an "equitable share" of the world market (again based on a recent representative period). In both cases, the provisos have been largely disregarded because of loopholes or ambiguities in their working.

The cleanest solution would be to do away with the exemptions. This would mean the elimination of all non-tariff barriers to imports (including variable levies, voluntary export restraint agreements, etc.), and the inclusion of agriculture in the ban on export subsidies. A second-best solution would be to redefine the exemptions so as to make them "operationally effective". For example, Article XI could be converted into a straight minimum access commitment, guaranteed against any policy measure. It would be left to the importing country to implement the guarantee in any way it chooses (not necessarily by supply controls). In Article XVI, the equitable market share could be defined clearly as the average market share in (say) the preceding years, without qualifying references to "normal market conditions", "special factors" and "price undercutting", and unnecessary conditions such as the preservation of shares in individual markets. Here again, it would be left to the exporting country to choose the means of implementing its obligation.

Increased regulatory activity by national authorities has lent urgency to agreements to minimize the trade effects of sanitary and phytosanitary regulations. There is agreement on the principle of non-discrimination between domestic and imported products, laid down in GATT Articles III and XX. There also seems to be agreement on harmonization as an ultimate goal. So long as different standards persist, however, they will be subject to challenges by a country's trading partners - as evidenced by the dispute over hormone treatment of meat animals.
The US call for "tarification" (US discussion paper) is the most radical proposal for rules reform. Under this proposal, all non-tariff barriers to trade (including variable levies, minimum import prices, voluntary export restraint agreements and state trading) would be converted to tariffs, which would be first bound and then progressively reduced. This proposal - an old idea in the GATT that was given new impetus by the US success in negotiating the conversion into tariffs of Japan's import quotas for beef and citrus fruit - would address import access directly. Extensions of the concept could constrain domestic subsidies by specifying the maximum size of the "wedge" between domestic support and international market prices and placing upper limits on export subsidies.

Conceptually, these various approaches could be alternatives or used in combination in a mutually supportive manner.

3. The Evolving Positions of the EC, the US and the Cairns Group

It is difficult to predict, at this stage, the shape and contents of the agreement that may emerge by the end of 1990. Informed guesses can be made, however on the basis of the April agreement and the current positions of the major participants, particularly the EC which, much as one may regret it, holds a strong bargaining position.

Producer Support Prices. An EC paper of July 10, 1989 (EC) provides some indications of what its negotiators have in mind on the subject of internal supports. Their version of the AMS, called the "Subsidy Measurement Unit" (SMU), starts from a 1984-86 base period - the 3 years preceding the Declaration of Punta del Este that launched the Uruguay Round. The definition of the producer price includes U.S. deficiency payments; for the EC, co-responsibility levies are deducted from the buying-in price. Disaster payments and acreage diversion payments are excluded. Producer prices are compared to a fixed external reference price, expressed in the currency of each country, for the same base period; the difference is the SMU. Any reduction in a country's SMU since 1984-86 will be credited to it.

EC calculations of the SMU for wheat show that by 1988 EC support per ton was 16% below that of the base period. The "budget stabilizer" mechanism introduced in 1988 should reduce the EC producer price by 3% each year so that by 1992 it would be 152 ECU/ton. This would put the EC's SMU for wheat at only 29 ECU/ton, or 50% below its SMU for the base period (which was 58.4 ECU/ton). It follows that the EC could propose a 50% reduction in the aggregate measure of support without putting any new policies in place.

The EC paper illustrates some alternative approaches such as the use of a measure of total support (which takes account of changes in the volume of production for which support is provided) and the use of the Producer Subsidy Equivalent (PSE) developed in the OECD instead of the SMU - suggesting that these alternatives would probably not be ruled out. There also is reason to believe that the EC might accept the use of a moving average of world prices of (say) 5 years instead of a fixed external reference price, which would make the external reference price responsive to trends in world prices and exchange rates.

The US and the Cairns group support the AMS approach but unlike the EC, do not want to rely on it as the principal (or only) means of tackling high levels of protection. They see the AMS cut as an overall target that needs to be implemented by commitments on specific policies and commodities. Specific policy areas proposed for priority consideration are market access (via tariffication where possible); domestic subsidies (focusing on decoupling and identifying programs that fit the definition); and export subsidies. The EC would rely on surveillance under the GATT to ensure adherence to any agreed cut in the AMS. It considers that commitments on specific policy instruments are difficult to negotiate and afford too many opportunities for protection. They see the AMS cut as an overall target that needs to be implemented by commitments.
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**Decoupling.** The lines have not yet been drawn on this "sleeper" issue which may well make or break the negotiations. There appears to be a consensus that the AMS reductions should be "comprehensive" across countries and commodities and that the list of programs excluded from the AMS should be short. The US has promised a paper on this subject. The general idea is to encourage forms of assistance to farmers that are less trade-distorting, more precisely targeted and less costly than price supports implemented by production and/or export subsidies or import barriers. Because of the budget cost, the EC is unlikely to go very far in shifting from price supports to decoupled income payments.

**Supply Controls.** The EC wants credit for its milk marketing quotas and its new modest acreage set-aside program. It would give the US credit for any increase in yield acreage since the base period. The EC paper suggests that use of the total SMU (rather than the unit SMU) would reflect cuts in production due to supply controls and would thus automatically provide a credit for the introduction or tightening of controls (and a penalty for abandoning them).

"Tariffication." The US favors the conversion of non-tariff barriers (including variable levies) into tariffs. Tariffication would make protection more transparent and more readily negotiable. It would make production, consumption and trade more responsive to changes in world prices and would reduce world market instability. The EC sees tariffication as an attack on the variable levy system (which stabilized its internal market) but would probably be glad to convert its oilseed subsidies into tariffs (see below). The Cairns group sees tariffication as an option to be explored but not one that will prove appropriate to replace all other forms of support and protection. (Canada, for example, is reluctant to convert its import quotas on dairy products, poultry and eggs into tariffs). While the EC almost certainly will not give up its system of variable levies and export subsidies in favor of fixed ad valorem tariffs, it may agree to a ceiling on import levies and export subsidies. This could be of some value to the U.S. and other exporting countries in that it would lead the EC to accumulate stocks when world prices are abnormally low and thus to participate in the international adjustment process when such participation is most needed.

"Rebalancing." The EC has revived the concept of harmonization, now labeled "re-balancing". It would enable the EC to phase out its oilseed subsidies, which have become an increasing burden on its budget, by a variable levy or tariff, which would shift the burden to its consumers. This change would require releasing the EC from its zero-duty GATT bindings on oilseeds and is opposed by the US and other exporting countries who see it as a backward step. The EC wants the concept considered in the negotiations, although support for it among its member countries is not unanimous.

**Specific commitments on market access, export subsidies, decoupling.**

As already indicated, the EC views the reduction of internal price supports as the basic issue: a significant cut in support will lead to a reduction in uncompetitive production, and will therefore reduce the need for export subsidies and import barriers. The U.S. does not want to rely solely on commitments concerning the level of internal support; it is also pressing for specific commitments on market access, export subsidies, and a "reinstrumentation" of support policies to make them less market-distorting ("decoupling") and more responsive to world market conditions (conversion of quotas, "voluntary" export restraint agreements and variable levies into tariffs).
Rules Reform. This topic was discussed at great length in the GATT Committee on Trade in Agriculture (CTA) in the two years preceding the launching of the Uruguay Round but has not been taken up in the trade negotiations (except for the US proposal for tariffication which may be considered a radical rules reform). The Canadians are working on a paper on this subject.

4. Constraints on U.S. Farm Legislation
    Stemming from the GATT Negotiations

It is generally agreed that the 1990 farm legislation should be supportive of U.S. objectives in the agricultural trade negotiations: we cannot expect our trading partners to reduce their levels of support and protection and to shift toward less market-distorting forms of assistance to farmers if the U.S. shows no signs of wanting to move in the same direction. We cannot expect them to agree to reform and observe the GATT rules if the U.S. continues legislation that is incompatible with the spirit (and in some instances, the letter) of the General Agreement. At the same time, there are legitimate concerns that "unilateral disarmament" by the U.S., rather than setting an example for others, could weaken its bargaining power in the negotiations. The best course for resolving this dilemma would be for legislators to try to avoid introducing or extending measures that are clearly inconsistent with what may be realistically achievable in the Uruguay Round and to leave enough flexibility to modify or abandon programs that are likely to stand in the way of a successful conclusion of the negotiations.

A proposal by the EC to reduce producer support prices by 50% from the 1984-86 base would put the U.S. on the spot. As mentioned earlier, the EC already has policies in place that will reduce its grain SMU by 50% by 1992.

For the U.S. to achieve a 50% reduction in its wheat SMU per ton, the adjusted producer price would have to be reduced from $147.3 per ton (4.00 per bushel) in the base period to $126.2 per ton ($3.43 per bushel) -- 14% cut.

The EC figures will undoubtedly be subjected to close scrutiny. There may be alternative base periods and AMS concepts that produce results more favorable to the U.S. But having proposed this type of approach initially, the U.S. will find it difficult to opt out of it.

An agreement to reduce price supports across-the-board (even though not necessarily by identical amounts or percentages) would probably preclude increases in protection for any commodity -- for example, the introduction of target prices for U.S. soybeans. Any realignment of protection rates among commodities would have to be effected by more than proportional reductions in price supports that are considered to be relatively high (e.g. U.S. corn?). Because of its concern increased protection for EC oilseeds, the U.S. will be reluctant to request an exception for its own soybean growers.

A possible deal on export subsidies could involve an offer by the U.S. to give up the EEP in exchange for a cap on EC export subsidies or on the EC share in the world market. The EC offered several years ago to limit its share in the world wheat market to 14%; in 1988/89 it was 20%. It may also be possible to negotiate an agreement on export credit terms for agriculture similar to the OECD agreements on industrial products.

Agreements that would compel the U.S. or its trade partners to adopt specific "decoupled" forms of assistance to farmers in lieu of price supports can be ruled out. However, the definition of the SMU (or any other aggregate measure of support) could provide incentives to shift from producer price supports to "non-trade distorting" forms of assistance that may be excluded from it. The EC has already conceded that acreage diversion payments and disaster payments can be excluded. Exclusion of that part of U.S. deficiency payments that may be considered to be compensation for compliance with ARP requirements
would be more controversial. A U.S. claim that deficiency payments limited to a fixed base quantity (PEG) should be considered non-trade distorting is even less likely to gain acceptance.

Consistent with its own logic, the U.S. might be expected to offer the conversion of its import quotas on sugar, dairy products, peanuts and its beef import law provisions into tariffs. Although consistency is not likely to be put to a strenuous test in this round of negotiations, foreign request for increased U.S. dairy quotas will be difficult to ignore if we want improved access to foreign markets.

Something will have to be done, in any event, about U.S. sugar quotas which have been found to be in violation of existing GATT rules. Possibilities include (1) unrestricted imports; (2) tariffication; (3) bringing sugar quotas under Section 22; (4) establishment of import quotas in conformity with GATT Article XI.

Simply to dismantle the sugar quota system would result in increased imports, much lower domestic prices and massive forfeitures to the CCC. (However, it would not technically violate the no-cast provisions because the President would have used "all available authorities" to prevent costs to the Treasury). Tariffication would bring in revenue but would hurt our non-Caribbean suppliers. Extension to sugar of Section 22 is likely to be challenged in GATT. Establishment of quotas in conformity with Article XI would require domestic production controls and minimum access equal to the proportion of imports during a representative unrestricted period. That proportion was 40% in 1975-76 when there was no sugar program. To maintain that proportion at the present consumption level of 8.5 million short tons, U.S. production would need to be controlled at 5.2 million short tons, down from 7.2 million short tons, and imports would rise to 3.3 million short tons, up from 1.5 million tons. We may rule out a fifth option, the introduction of deficiency payments, because of the budget costs and because the move would not earn U.S. credits in the GATT negotiations as production subsidies are considered indirect export subsidies and, in any case, are charged against a country's AMS. Whatever the techniques of protection, there will be strong pressures for improved market access for the developing countries.

If it is decided to abandon the Section 22 waiver, the U.S. dairy quotas will also have to be brought into conformity with Article XI or converted into tariffs.

To sum up, the major points of pressure emanating from the GATT negotiations will be on U.S. target prices, the EEP, and sugar and dairy import quotas. Relaxations of supply controls will be viewed with suspicion, but the U.S., pointing to the conservation reserve, should be able to preserve its freedom of action in this area. A big fight could ensue if the U.S. should try to represent its present price support system -- or minor modifications of it -- as being "decoupled," and thus not subject to international discipline, on the ground that quantities eligible for support are limited and additional production is therefore, at world market prices. Insistence on this approach would open the door to new forms of protectionism, along the lines of the EC sugar regime, but would not resolve international frictions over subsidized competition.

Some of you may question whether the U.S. will be called upon to deliver even on such limited moves toward agricultural policy reform as outlined above. Admittedly, the current favorable market situation is not conducive to meaningful agricultural policy reforms. There is a tendency to view the crisis of 1982-1986 as the result of temporary macro-economic developments. Now that markets seem to be coming back into balance, they lend support to the prevalent view in the U.S. that the 1985 Food Security Act is working and will require only minor modifications in 1990. The European response to this is that maybe the Common Agricultural Policy will also require only minor adjustments in the near term. Clearly, a major effort will be required to overcome the inertia and complacency that have set in.
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