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# The GATT Compromise Proposal on Agriculture

by Fred H. Sanderson

Following yet another impasse in the agricultural negotiations, the Secretary General of the General Agreement on Tariffs and Trade (GATT), acting as Chairman of the Agricultural Trade Negotiating Group, has submitted a draft agreement that is designed to meet the principal concerns of the major players. What has emerged is a complicated set of rules that provides for a significant change in methods of agricultural support—via tariffication of nontariff barriers such as quantitative import restrictions and variable levies—but leaves the contracting parties free to continue (or even increase) the level of total farm support, so long as it is done through certain government payments declared to be "non-trade distorting."

## Background

This is a sharp departure from the initial thrust of the negotiations, which centered on levels of support and protection and promised, for the first time, to include internal price supports and subsidies. In fact, it was the European Community that favored virtually exclusive reliance on the mutual reduction of internal supports as represented by an index called the "Aggregate Measure of Support" (AMS) so as to reduce the *need* for import protection and subsidized exports. The U.S. and its Cairns Group allies agreed that domestic policies should be addressed but insisted that commitments in this area should be accompanied by corresponding commitments on border measures. A compromise reached in April 1989 then settled on a four-pronged approach that called for specific commitments on internal support, import barriers and export subsidies, as well as rules covering sanitary and phytosanitary regulations.

The reductions suggested by the EC in subsequent negotiations were deemed insufficient by the traditional exporting countries. A breakdown of the negotiations was avoided early in 1991 when the U.S. government requested and received a two-year extension of its "fast-track" negotiating authority from the Congress.

Most of 1991 was spent on expert discussions which were helpful in clarifying issues and options. During the year, however, the EC Commission proposed a radical reform of its Common Agricultural Policy. Known as the MacSharry initiative, it would sharply reduce the European Community's agricultural support prices but would fully compensate its farmers for these cuts by deficiency payments. Except for small producers, these compensation payments would be contingent upon compliance with a land set-aside requirement, fixed initially at 15 percent. The proposal thus embraces some of the essential features of the U.S. support system. If implemented, it should facilitate a GATT agreement on direct export subsidies: with domestic market prices approximately at world market levels, the EC could dispense with them, as the U.S. did 20 years ago when it shifted from market price support to deficiency payments. It would not solve the underlying problem, however, for EC exporters would be subsidized indirectly (as they are in the U.S.), and imports would continue to be impeded by high levels of output supported by deficiency payments. This problem can only be addressed effectively by a mutual reduction of total internal supports (i.e., cuts in support prices and/or cuts in quantities eligible for support).

*Fred H. Sanderson is Senior Fellow, National Center for Food and Agricultural Policy, Resources For The Future.*

## Dunkel Proposal

Tariffication has replaced internal support as the centerpiece of Dunkel's package. Existing nontariff barriers would be converted to their tariff equivalents. These would be added to the existing tariffs. The total import protection would then be cut by an average of 36 percent from a 1986-88 base, with a minimum cut of 15 percent on any single tariff-line product. These cuts are to be made gradually over a six-year period beginning during 1993 and ending during 1999. Where products are now faced with virtually prohibitive barriers, minimum access equal initially to 3 percent of consumption (rising to 5 percent by 1999) must be facilitated by reduced, nonrestrictive tariff rates on these quantities. Where access opportunities exceed these minimum levels, they must be continued at least at those higher levels.

A safeguard mechanism may be used temporarily to limit imports by additional duties if (1) the volume of imports exceeds the average of the three preceding years (or the agreed access minimums) by more than 25 percent; or (2) the c.i.f. import price (in local currencies) falls by more than 10 percent below the average price during the 1986-88 base period. There are limits on both the level and duration of these additional duties.

Government spending on export subsidies is to be reduced by 36 percent, and the volume of subsidized exports by 24 percent from a 1986-1990 base. The list of export subsidies does not include subsidized export credits, or producer-financed export subsidies that do not involve a government role. No export subsidies are to be introduced on products that did not benefit from such subsidies in the base period.

In contrast to these modest but specific commitments on border measures, the commitments on internal support have been fatally weakened by the introduction of a broad range of exemptions. The proposed 20 percent cut in the AMS is itself a retreat from the 30 percent cut offered by the EC at an earlier stage of the negotiations. More important is the fact that direct payments to producers (which constitute the principal method of farm support in the U.S., and will be in the EC once its internal reform is implemented) are exempted from even this small cut—and, indeed, from any GATT discipline—so long as they meet certain conditions that are alleged to make them production-neutral (and hence, non-trade distorting).

Early on in the Uruguay Round, a consensus had been reached that only a very narrow range of internal subsidies could be excluded from the AMS (and thus exempted from the reduction requirement). This so-called green box included expenditures for research and extension, domestic and international food aid, resource retirement programs, and

assistance in the event of natural disasters. The Dunkel proposal adds some programs such as "structural" investment aids, and aids provided in the context of regional and environmental programs, that could involve large subsidies to agricultural producers. Furthermore, governments would be free to make any payments to their farmers, in any amount, so long as they are linked to their production or land use in some past base period and not to their current production or land use, or to current domestic or international prices. Another condition is that "no production shall be required in order to receive such payments." This seems to imply that a farmer receiving payments based on his wheat production in the base period would continue to be entitled to these payments even if he produces no wheat in the current year, or leaves farming altogether.

Canada receives a special dispensation for its new gross revenue insurance program (GRIP), which is heavily subsidized by the federal and provincial governments. The only limitations here concern the extent of the farmers' coverage for income losses, not the proportion subsidized by government.

## Implications

The proposed agreement would require significant changes in the methods of farm support in the U.S. and in the EC as well as in other Western European countries and in Japan and Korea. It would not require a reduction (or even prevent an increase) in total farm support so long as it is provided under one of the headings in the "green box." This opens up an enormous escape hatch that is limited only by the ability and willingness of governments (i.e., taxpayers) to finance such payments.

Exclusive reliance on tariffication, minimum import quotas and ceilings on subsidized exports is unlikely to achieve a significant reduction in uneconomic production. Relevant provisions already contained in the GATT (Articles XI, XVI, XXIII) have been widely disregarded or circumvented in the past and there is little reason to expect that somewhat more elaborate commitments in these areas will be more effective so long as governments are free to maintain (or even increase) their total support to the farm sector.

Experience has shown that whenever domestic policies stimulate production in excess of the limits set by commitments on market access and export subsidies, it is the GATT commitments that give way. The EC's record on oilseeds is a good example. Duty-free treatment negotiated in the Dillon Round became meaningless when the EC decided to encourage domestic production with subsidies that raised the prices received by European farmers to as much as three times the c.i.f. prices of imports. This led to a tenfold increase in oilseed production between 1977 and 1987; an increase from 10 percent to 46 percent in the self-sufficiency rate; and significant displacement of potential imports. Guarantees of minimum access to the British cereals market negotiated in the 1960s were equally ineffective when farmers' resistance to price cuts, together with increased productivity, made the agreement unenforceable.

## Internal Support

In its initial reaction to the Dunkel proposal, the EC indicated that it rejects any limitation or conditions on its proposed compensation payments. In fact, the EC Commission is trying to sell the MacSharry plan to EC farmers by promising that present farm receipts will be fully and permanently safeguarded by payments not subject to GATT reductions.

The U.S. is probably alone among the traditional agricultural exporters to have much faith in the negotiability and efficacy of the conditions that are intended to "decouple" such payments from current production. Farm organizations are interested in keeping their members on the land and are wary of entitlements that can be transferred to nonfarmers or kept by farmers after selling their farms.

Basing payments on production in past years is said to remove the incentive for additional uneconomic production because that part of the output would be faced with world prices. This argument, however, is valid only in the very long run. As a practical matter, investments in physical and human capital already made will keep farmers producing at or near capacity so long as they cover their variable costs. "Base-building" will also be a consideration: farmers will have an incentive to increase their production so long as there is any expectation that their payments base may be adjusted in the future. There is no way to ensure that farm payments bases will stay permanently fixed.

U.S. and EC officials have hinted at possible compromises on the green box issue. One would think that the EC could accede to payments to be based on past production since that is already a feature of its reform proposal. It should have little


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difficulty agreeing to a ceiling on compensation payments, so long as other subsidies such as "structural" investment aids and environmental aids not tied to resource retirement remain in the green box. Even so, a ceiling might well be more effective in preventing additional uneconomic production in the EC than the "decoupling" provisions that the U.S. succeeded in having inserted in the Dunkel text. Furthermore, a ceiling on nominal expenditures would, over time, be reduced in real terms as a result of inflation.

The U.S. would have no problem agreeing to a ceiling on deficiency payments based on 1986-88. In fact, except for milk, sugar and peanuts, it could easily comply with a 20 percent reduction of its AMS because of cuts already made in the 1985 and 1990 farm bills.

If EC compensation payments are allowed to go into the green box, it would seriously undermine the U.S. claim in GATT for compensation on soybeans. That claim is based on the impairment of the zero-duty binding by the EC's internal subsidies. The subsidies would now be legitimized. Furthermore, the Dunkel draft contains an explicit provision that green box subsidies are not subject to countervailing action.

### Export Subsidies

The proposed 25 percent cut in the volume of subsidized exports, although far short of the original objectives of the U.S. and other exporters, would impose a 12.7 million-ton limit on EC wheat exports by 1999. The U.S., in turn, would have to reduce its Export Enhancement Program by about $200 million.

EC sugar exports would be covered unless (as is likely) the responsibility for administering the export subsidies is formally transferred from the EC Commission to the producer associations. This particular escape hatch may also be used elsewhere and for other commodities.

Transportation subsidies for exports (Canada) are subject to reduction but cuts can be avoided so long as such subsidies are extended to domestic shipments. The commitment not to introduce new export subsidies affects the U.S. more then the EC since almost all EC exports are already subsidized.

### Market Access

The minimum import access provisions would maintain a limited market for U.S. corn in the EC and open up 5 percent of the rice market in Japan and Korea. The U.S. would have to allow limited imports of butter, skim milk powder, peanuts and cotton to compete in its domestic market. Canada would have to allow increased imports of poultry and dairy products.

Additional effects stemming from tariffication will probably be rather modest for two reasons: (1) cuts in border protection can be as small as 15 percent on "sensitive" products; (2) tariff protection would still be high enough to rule out significant imports over and above the minimum access quotas.

### Conclusion

The Dunkel proposal reflects the recent retreat from the original central theme of the negotiations which was to achieve a "substantial reduction" in agricultural support and protection. Instead, the Uruguay Round negotiators ended up tinkering, once more, with the methods of protection. It remains to be seen whether the results will turn out to be significantly less trade-distorting than the status quo, absent meaningful commitments on the levels of domestic support.

Dunkel's draft provides the basis for a compromise that seeks to minimize loses to inefficient producers. By the same token, it offers only very limited gains to efficient producers. The principal losers are likely to be the European and North American taxpayers who will be saddled with large farm support payments that remain exempt from any GATT disciplines.

At the time of writing, it appears that the remaining differences between the U.S. and the EC have been reduced to essentially two issues: limits on the volume of export subsidies and limiting conditions or ceilings on deficiency payments. A substantial reduction in the volume of export subsidies would seem to be essential to gaining acceptance of the agreement in the U.S. and other traditional exporting countries. At least equally important is to prevent escalation of domestic subsidies that would be costly for taxpayers and could also stimulate production to the point where even the modest commitments on market access and export subsidies become unenforceable. To prevent this from happening, a ceiling on total farm support payments is likely to be more effective than elaborate "decoupling" conditions which are difficult to negotiate and enforce and whose efficacy is questionable. C

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