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Changing the Rules for Agricultural Trade

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Introduction

Agricultural trade has taken on unaccustomed prominence in the present multilateral trade negotiations, the so-called Uruguay Round of the General Agreement on Tariffs and Trade (GATT), headquartered in Geneva. Seven previous rounds have resulted in widespread tariff reductions for many non-agricultural commodities, but up to now farm products have escaped scrutiny. In this issue we lay out the key issues in the current negotiations and speculate on likely outcomes.

GATT Principles and GATT Practices

The GATT is essentially a set of rules for international trade, formulated by consensus and adhered to through voluntary compliance. When formulated in 1947, these rules were to have been part of a larger International Trade Organization (ITO), itself intended (along with the World Bank and the International Monetary Fund) to be the third pillar of the post-war financial order. When formation of the ITO was blocked by Congress, all that remained were the GATT rules themselves.

The underlying theme for all GATT discussions has been more liberalized trade, not "free trade." More "liberal" trade is traditionally defined as open trade, without overt manipulation by countries, companies, or individuals. The basic premise is equal treatment for both domestic and imported goods. Those countries that subscribe to the GATT seem to do so not because they think that liberalized trade can be shown to be theoretically better, but because they observe that economic prosperity often accompanies more liberal trading.

Today, the GATT has 96 members (several of whom have only recently joined), and its rules are informally adhered to by an additional 31 countries, including nearly all the developing nations. As its membership has grown, consensus has become harder and harder to achieve.

Under current GATT rules, quantitative trade restrictions such as quotas are generally prohibited, but certain tariffs are permitted. Non-agricultural export subsidies are also largely prohibited. In addition, the rules prescribe legal actions that can be taken against "dumped" or harmful imports.

Despite GATT successes over the years in reducing tariffs, in bringing order to trade in industrial products, and in providing a forum for the discussion and resolution of most trade issues, much of agricultural trade has effectively avoided its disciplines.

For example, the GATT permits the use of domestic quotas when a country is trying to reduce production. Export restrictions are allowed in cases of critical domestic shortages. In addition, historical reasons have exempted both the U.S. and Switzerland from many of the rules that bind other countries. There are virtually no rules regarding policies that purport to protect human, animal, or plant health even through such policies clearly have been used to influence trade patterns.

Finally, many commonly used non-tariff import measures such as variable levies, minimum import prices, and "voluntary" export restraint agreements were not in use at the time the GATT was drafted and have

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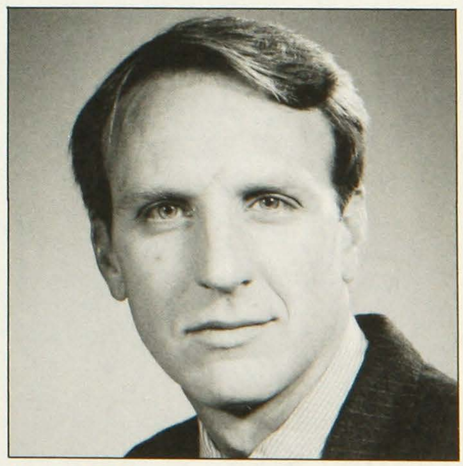

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not come under its oversight since that time.

The deteriorating world agricultural trade situation in the early 1980s led the GATT contracting parties to reconsider ways in which to bring the agricultural sector under control. The need to address all measures that directly or indirectly affect agricultural trade—whether quotas, waivers, variable levies, production restrictions, or export subsidies—was made clear at an initial meeting in Punta del Este, Uruguay, in 1986.

The resulting declaration set forth the objectives for the present round of multilateral trade negotiations—the "Uruguay Round"—scheduled to conclude in 1990. Significantly, the declaration made clear that both domestic and trade policies were to be addressed in the agricultural talks.

For day-to-day talks in Geneva, a Negotiating Group on Agriculture has primary responsibility for the agricultural sector, although the fourteen other groups (such as those on subsidies, tariffs, non-tariff measures, natural resource-based products, tropical products, dispute settlement, and on the functioning of the GATT), may also have a say, especially when the time comes for trade-offs among sectors.

At that point, probably not until close to the 1990 deadline, countries that have limited bargaining power in the agricultural sector may seek to exert leverage from other sectors in which they are more influential. For example, Brazil and India have argued that resolution of patent protection disputes should wait for agreement on agricultural issues.

Specific negotiating positions have been put forth by several groups of the major agricultural trading countries, but little agreement has been reached. The negotiating impasse was not overcome at the Ministerial Mid-Term Review in December 1988 in Montreal.

Unresolved Issues

Five key issues dominated the discussions in Montreal and will continue to be the focus of the continuing negotiations in Geneva: 1) Can or should short-term or emergency actions be linked to a long-term agreement? 2) Which government actions should be reduced or eliminated and how will progress be measured? 3) How will GATT link agricultural policy with broader social welfare objectives such as food security, environmental quality, and employment policy? 4) How much special treatment should be accorded developing countries? 5) To what extent should health and sanitary regulations be allowed to function as trade barriers?

1. SHORT-TERM ACTIONS AND LONG-TERM AGREEMENTS

The most difficult immediate obstacle facing negotiators is whether and how to implement some form of "emergency" action to alleviate current subsidy and production pressures. (It was on this point that the Montreal talks foundered.) The European Community (EC) insists that emergency action be a precondition for agreement on the long-term framework. The U.S., in direct contrast, continues to insist that agreement on a long-term framework should precede any emergency action.

The Cairns Group, a coalition of "low-subsidy" nations, has called for short-term action as a "down payment" on a longer-term framework and is seeking to mediate the diametrically opposed U.S. and EC positions. All participants at least agree that the final objective of the negotiations is a new set of effective GATT rules disciplining agricultural trade.

2. PERMITTED AND FORBIDDEN GOVERNMENT ACTIONS

All of the proposals currently on the negotiating table argue for elimination or reduction of domestic support measures, export subsidies, and import barriers. But the proposals differ dramatically when it comes to specifying *which* measures should be so curtailed.

The U.S. wants a complete ban on all supports except those that are "decoupled" (more on that later) or are used for food aid. The EC proposal deals mostly with limitations on the quantities eligible for government support, largely through production quotas. Japan argues that the GATT should focus on only those domestic policies that affect trade, all the while emphasizing that even these policies have broader social welfare objectives than mere trade.

The attention by GATT negotiators to domestic agricultural policies is consistent with the Punta del Este declaration's resolve to confront the domestic as well as the cross-border sources of agricultural trade protection. The complex relationship between domestic and trade policies can be usefully examined in a framework that disentangles the **trade effects** of a given policy from the production or **output effects** of that policy. The two effects, while different, are related. Indeed, it is hard to think of any domestic production policy that does not alter trade positions in some way, shape, or form. And the existence of many trade policies undoubtedly affects farmers' production decisions.

A policy has a trade effect if buyers and sellers in the domestic market face different conditions from those who participate in the cross-border market. Such a definition encompasses not only policies that affect the difference between domestic and external prices, but also protective barriers such as health, environmental, or sanitary regulations that systematically alter internal and external market conditions. A leading current example is the application of health restrictions to hormones in U.S. beef imported to Europe.

The output effect arises when a policy influences farm production decisions. Such policies may be negative, as are U.S. and European land retirement programs that pay producers not to produce, or positive, as are price guarantees that pay producers on the basis of output. The U.S., the EC, and many other countries currently engage in both policies simultaneously.

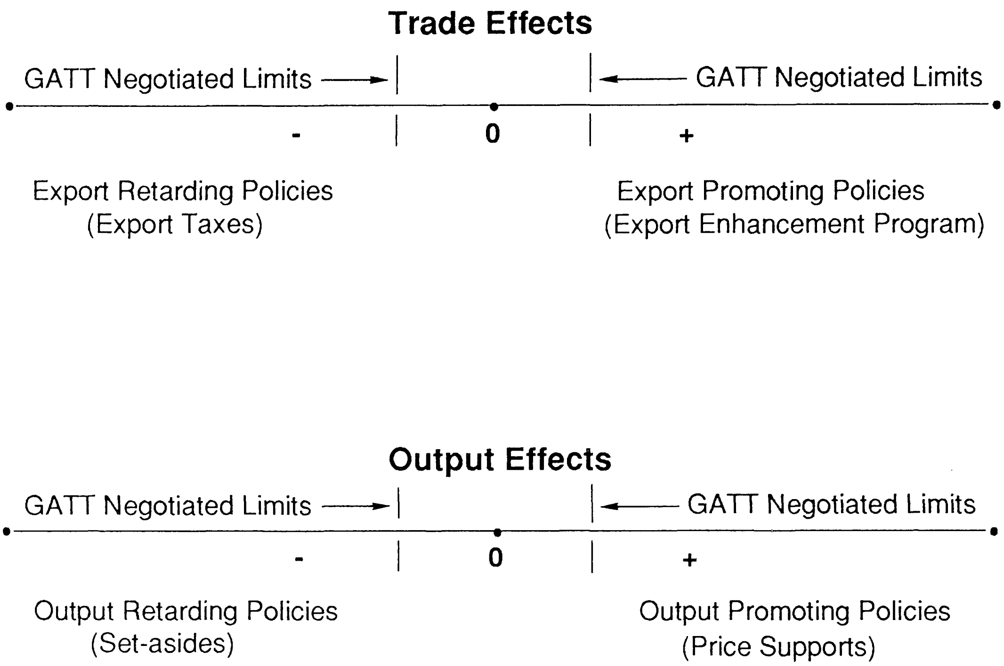
"Decoupled" agricultural policies are measures that have both zero output and zero trade effects. Any desired income support might then be provided through direct payments, a positive/negative tax scheme, a minimum income insurance program, or some combination. In the absence of government incentives to produce or not to produce, farmers would presumably make planting and marketing decisions solely on the basis of market prices.

Progress in the present negotiations might be defined as an agreement to move, in each country, toward policies that are individually more liberal overall, in the sense that output and trade distortions are reduced, or alternatively, by movement towards a package of policies whose net effects are more liberalized. A series of acceptable limits could be set with respect to both trade and output effects of any given policy (figure 1).

All agricultural policies could be required to fall within certain arbitrary but agreed-upon bounds over a stated period of time. These bounds could be biased toward either positive or negative production or trade incentives, depending on the negotiated agreement. A "zero-zero" outcome is unlikely.

Any scheme proposing to reduce government intervention in production or trade decisions requires that the level of diverse government supports be measured in some way. The choice of technique should be consistent with the underlying philosophy

Figure 1. Setting Acceptable Limits for Trade and Output Effects



of the agreements; in particular, is it to measure production effects or trade effects? Most frequently proposed is the Producer Subsidy Equivalent (PSE) recently calculated for a relative handful of crops. (The job is not yet done: there are over 3,000 different agricultural goods traded worldwide!)

The PSE, which is an estimate of the subsidy paid to farmers as a proportion of their total income, is not a direct measure of either the output or trade effects of a policy. Even so, it could be used as an independent check on the overall level of subsidy to agricultural producers. It might also prove useful in monitoring changes in support levels if reductions can be agreed upon.

Variations of the PSE include the Trade Distortion Equivalent (TDE) proposed by Canada and the Support Measurement Unit (SMU) proposed by the European Community. The former attempts to capture only the trade distorting components of producer subsidies, while the SMU uses a fixed reference price to minimize the effects of exchange rate fluctuations.

Many countries, particularly Japan and some less developed countries (LDCs), oppose the use of any such measurement devices, arguing that they do not take explicit account of critical non-economic objectives of agricultural policies. Too, any agreed upon measure will inevitably lead to attempts to manipulate measurements or measuring devices.

3. NON-TRADE SOCIAL WELFARE OBJECTIVES

The European Community, the Nordics (Finland, Norway, Iceland, Sweden), and Japan have repeatedly emphasized that many agricultural policies have non-trade social objectives. Most often cited are food security, environmental quality, and rural employment. These arguments seem to be treated as minor irritants by some advocates of liberalization, but they may be critical for governments trying to "sell" policy reforms in their own countries.

Some of these social concerns might be diminished by agreement to move toward direct payments to farmers, as proposed in several decoupling schemes. But direct payments are often deemed "welfare for farmers" and are opposed as such by major farm interest groups in both the U.S. and the European Community.

Direct payments might be more palatable for producers if certain non-production obligations accompanied the payments. One politically attractive option with sound economic justifications is to link direct income supports to a program of environmental improvements, including retirement of environmentally sensitive lands. Projects such as river and stream improvements, erosion reduction, and forest plantings could additionally generate employment in the rural sector.

Food security is another matter. It adds an important psychological dimension to agricultural policy in countries where the memory of privation is recent.

Security is also a concern in those countries with too little money to pay for imports. This is a tricky negotiating point. Proponents of trade reform argue that food security need not depend upon self-sufficiency, that it can in theory be accomplished through trade with reliable suppliers, as long as national income and hard currency reserves are sufficiently high.

Greater assurance against supply interruptions might be gained through the GATT, but financial constraints must be addressed elsewhere.

4. SPECIAL TREATMENT FOR DEVELOPING COUNTRIES

Special treatment for developing countries is now an integral part of the GATT. The rules permit imbalances in trade concessions between developed and developing nations as well as longer periods for LDCs to implement required trade reforms.

A 1979 agreement created a "tiered" system of rights and obligations, which essentially allow LDCs the rights of GATT membership without all the corresponding obligations. This arrangement has attracted considerable criticism over the years, and its legitimacy was questioned again in the Punta del Este declaration.

In the current round, several developing countries have insisted that these special arrangements be formalized. Although they have offered few specifics, they list as their major goals a reduction or elimination of export subsidies by developed countries without at the same time increasing costs for importing LDCs; the maintenance of LDC support measures related to the non-economic objectives of agricultural policies such as employment, structural adjustment, development, and food security; and the protection of LDC domestic markets for development purposes.

Ironically, many LDC policies have the effect of depressing production. Removal of these policies would be a move in the direction of a more output-neutral policy. Furthermore, reductions in present LDC export taxes would be a move away from negative trade incentives.

So even if new GATT rules allow LDC domestic subsidies to be left unchanged, removal of these trade disincentives would constitute a net improvement in GATT terms as well as boost LDC exports. Such GATT-imposed reductions in LDC trade distortions may eventually be even more important to developing countries than are IMF-imposed domestic pricing reforms.

5. HEALTH AND SANITARY REGULATIONS

Each GATT negotiating proposal makes reference to a reduction in those health and sanitary restrictions that act only as barriers to trade. Heretofore, efforts to address this thorny problem have been largely unsuccessful. Several proposals advocate the use of "universally accepted standards" and reference the work done by other international bodies.

Difficulty arises here because agreed-upon international standards for health and sanitary restrictions exist only for a few items, and none are binding. Improvements in notification and consultation procedures, and perhaps in dispute settlement procedures, are possible, but past experience shows little trade benefit from such efforts.

Direction of the Negotiations

Heading into the final two years of the Uruguay Round, negotiators confront both political and practical challenges in agriculture. One important consideration is the capacity and the interest of the new U.S. administration to maintain the momentum of the first two years and to push as adamantly for reform, especially in the context of drought-caused supply shortages and rising prices.

Also at issue is the capacity of the EC to make substantial reforms in light of recent bitter political battles over budget programs.

Finally, will Japan agree to further liberalization in the wake of those measures forced upon it by earlier dispute settlements in the face of intense domestic opposition?

The interaction of multilateral trade negotiations and domestic policy changes could lead to mutually reinforcing reforms, but a movement toward less liberal trade and greater protectionism is also possible if progress in Geneva appears stalled. As the Montreal talks indicated, neither the European Community nor the United States seems willing to budge.

The EC's new financial package reinforces present trade barriers and augments the EC budget for greater export subsidization should a trade war erupt. The strength of the U.S. position—uncompromising support for liberalization—is also its weakness; it is considered completely unrealistic by many other parties, and no negotiating fall-back position is apparent at this point.

The U.S. Administration has focused most of its GATT attention on events in Geneva and Washington. Despite assurances to the contrary by U.S. negotiators, there is little evidence that major agricultural and non-agricultural interests are solidly behind the U.S. position.

As negotiators move from high principles to specific policies, it seems prudent that the Administration open the trade liberalization debate to a broader spectrum of American public opinion. This would be a particularly apt role for policy educators in general and for the Extension Service in particular.

Unfortunately, incentives exist for either the advocates of "liberalization" (led by the United States) or the advocates of "realism" (led by the European Community) to stall the negotiations. Either side could justify its action as consistent with the true objectives of GATT. Deadlocks can be broken, of course, and the self-imposed 1990 negotiating deadline might encourage compromise fairly soon.

The Uruguay Round negotiations are certain to affect the 1990 U.S. farm bill debate. The announced reduction in required 1989 set-asides (triggered by drought-caused production shortfalls) could improve the United States competitive position considerably, but a proposed expansion of marketing loans to the major grain crops would place the U.S. on a par with the EC as a subsidizer of exports.

The United States can stay consistent with its current pro-liberalization approach and argue that reducing set-asides leads to greater output neutrality. No such rationalization is possible for marketing loans, which clearly distort markets.

Finally, the scheduled completion of the Uruguay Round coincides with the EC's own 1990 integration of capital markets, a process with some similarities to the recent American relaxation of interstate banking restrictions.

Capital integration is a scheduled milepost on the way to full European economic integration by 1992. Integration within the EC could lead to greater protectionism aimed at non-EC countries, to the detriment of the principles of the GATT negotiations.

Summary

Five areas of concern are sure to be discussed—and really have to be resolved—in upcoming GATT negotiations.

First, some resolution of short versus long-run reforms must be made. Either or both the U.S. and the EC will have to give ground before progress is made.

Second, it appears that movement towards policies that reduce both output and trade effects will remain a core concept. Acceptable bounds will have to be established as a basis for further negotiation.

Social welfare objectives of agricultural policies are the third area of concern and must be squarely addressed so that all negotiators can report to their constituents (both commodity and consumer groups) that they have gotten a "fair deal." If, for example, the ultimate agreement involves some form of decoupling, then decoupling must be acceptable to farm and non-farm publics alike. Nor can the issue of food security be sidestepped; it will be important to guarantee supplies to major importers, consistent with the rules of the GATT.

Fourth, special treatment for LDCs will likely be made part of the discussion. There are risks in this approach. If developing countries are exempted from too many GATT disciplines, the major players like the U.S. and the EC might decide to move outside the GATT to conduct their own agricultural negotiations, closing off LDC market access in the process.

Fifth and finally, there is potential for long, drawn-out and exceedingly complex talks over health and sanitary regulations. This area has the potential to become a real negotiating bog, stalling progress on other issues. Beyond general agreements to pursue more uniform regulatory standards and to improve notification and consultation procedures, it seems unlikely that major accords will be reached. At best, the groundwork for future negotiations might be laid.

The Uruguay Round involves fourteen other negotiating areas besides agriculture; important cross-cutting deals will ultimately be made. Negotiations involve the translation of principles into details, and it is detail upon which deals are made.

This round is being regarded as a make-or-break event. Liberalizing agricultural trade will require political courage and practical diplomacy. Failure to make progress could result in enormous costs to importers, exporters, producers, and consumers throughout the world.

Further Reading

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The next issue of the *Minnesota Agricultural Economist* will feature a discussion of the Minnesota Real Estate Market of 1988.

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