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## **THE URUGUAY ROUND NEGOTIATIONS AND AGRICULTURAL TRADE**

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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). Seven previous rounds have resulted in widespread tariff reductions (and, more recently, in codes of conduct with respect to nontariff measures) for many nonagricultural commodities, but up to now agriculture escaped significant scrutiny.

### **GATT Principles and GATT Practices**

The GATT is essentially a set of rules for international trade, formulated by consensus and enforced through voluntary compliance. When formed in 1947, it was 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 the American Congress, all that remained were the GATT rules themselves.

While GATT's impact on trade has not been equal to the World Bank's on development aid or the IMF's on monetary policies, GATT has served well as a forum for the resolution of trade problems and for periodic multilateral negotiations to liberalize trade rules. Its goal is a more liberalized trade, not "free trade." The basic premise is equal treatment for domestic and imported goods and nondiscriminatory treatment for the goods of other GATT members. Those countries that subscribe to GATT seem to do so not because they hold much credence in gains-from-trade economic models, but because they observe that economic prosperity often accompanies more liberal trading. Their reasoning is practical, not theoretic.

Today, GATT has ninety-six members (several of whom have only recently joined), and its rules are applied on a *de facto* basis by an additional thirty-one countries, including nearly all the developing nations. As its membership has grown, consensus has become harder and harder to achieve.

To foster a more open system, GATT rules generally prohibit the use of quantitative trade restrictions such as quotas, although stable or "bound" tariffs are permitted. Export subsidies are also largely prohibited. In addition, the rules prescribe valid actions that can be taken against dumped or harmful imports.

Despite GATT success 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 and the use of export restrictions in cases of critical domestic shortages. Both the United States and Switzerland are specifically exempted in large measure from the import access rules that bind other countries. There are virtually no rules disciplining the use of measures that purport to protect human, animal or plant health, or to conserve natural resources, even though they clearly can be used as barriers to trade. Finally, many commonly used nontariff 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 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 sector under more operationally effective GATT rules and disciplines. 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 a meeting in Punta del Este, Uruguay, in 1986. The resulting declaration set forth the objectives for the present multilateral trade negotiations in agriculture, scheduled to conclude in 1990.

At the talks in Geneva, a Negotiating Group on Agriculture has primary responsibility for the sector, although the fourteen other groups (such as those on Subsidies, on Tariffs, on Non-Tariff Measures, on Natural Resource-Based Products, on Tropical Products, on 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.

Through August 1988, the Negotiating Group on Agriculture had held nine formal (and a few informal) meetings. A technical working group has been established to work out aggregate measurements of support, and another working group on sanitary and phytosanitary restrictions on trade may be created. Specific negotiating positions have been put forth by several groups of the major agricultural trading countries, but no agreement has been reached. Progress in the

agricultural negotiations will be a major focus of a Ministerial Mid-Term Review scheduled for early December 1988 in Montreal.

### **Unresolved Issues**

Five key issues will dominate the discussions in Montreal and 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?

### **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. All proposals except that of the United States contain short-term elements. Most propose a reduction in export subsidies as well as action on domestic subsidies and import access.

The European Community (EC) insists that emergency action be a precondition for agreement on the long-term framework. The United States, in direct contrast, insists that agreement on a long-term framework should precede any emergency action. The EC proposes an emergency one-year commitment on cereal prices, a reduction in sugar exports, maintenance of present access to traditional import markets for sugar, and compliance with International Dairy Arrangement minimum export prices. These would be followed by short-term measures to reduce price supports and to control production in principal agricultural sectors. The Cairns Group has called for short-term action as a "downpayment" 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.

### **Permitted and Forbidden Government Actions**

In line with the Punta del Este mandate, all of the proposals on the table would eliminate or reduce domestic support measures, export

subsidies and import barriers. But the proposals differ dramatically when it comes to specifying *which* measures should be addressed. The United States wants a complete ban on all supports except those that are “decoupled” or are used for bona fide food aid. The EC proposes limitations on the quantities eligible for government support, largely through production quotas. Japan argues that GATT should minimize only the trade-distorting effects of domestic policies, while emphasizing that these policies have broader social welfare objectives than mere trade.

The complex relationship between domestic supports and trade intervention can be usefully examined in a framework that disentangles the two dimensions of policy effects. The first is the degree of trade distortion resulting from a given policy, or *trade effect*. The second, which emphasizes the production or supply-response distortion resulting from a given policy, is the *output effect*. Trade distortions often stem from output distortions, so the effects, while different, are related. Indeed, it is hard to think of any domestic production distortion that does not alter trade positions in some way, shape or form.

A policy has a trade effect if participants in the internal market face different conditions from those in the cross-border market. Such a definition encompasses not only policies that affect the difference between domestic and external prices, but also barriers such as protective sanitary regulations that systematically alter internal and external market conditions. The output effect arises when a policy influences 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 United States, EC, and many other countries currently engage in both policies simultaneously.

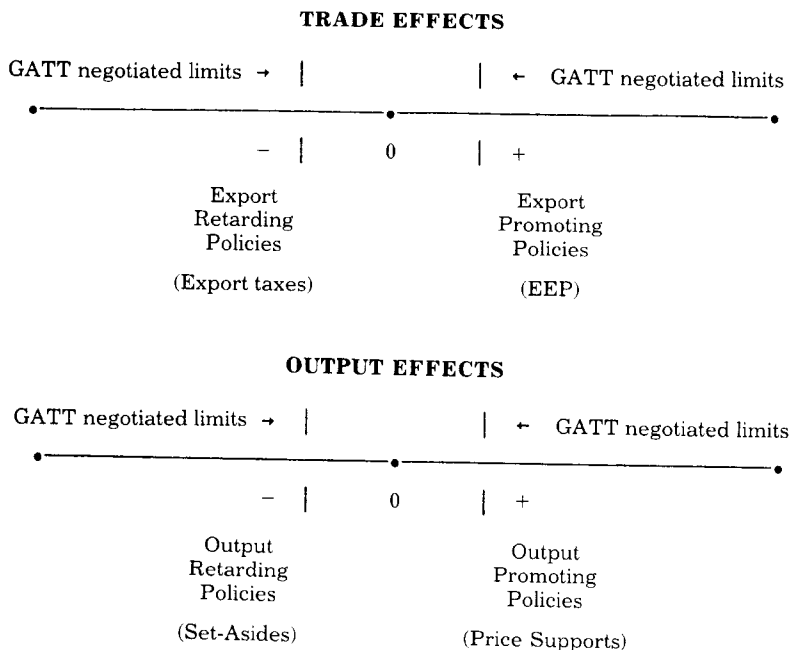
“Decoupled” agricultural policies are touted by the United States as measures that have both zero output and zero trade effects. Any income support—a feature independent of decoupling itself—could be provided through direct payments, a positive/negative tax scheme, a minimum income insurance program, 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. Still, it cannot be said that any direct payments would really have zero effects on production since any income supplements could be invested in additional production factors.

Attention by GATT to domestic agricultural policies would be consistent with the Punta del Este declaration’s resolve to confront the domestic sources of agricultural trade protection. Progress in the negotiations can be defined as an agreement to move, in each country, toward policies that are liberalizing overall, in the sense that both output and trade distortions are reduced, or alternatively, by move-

ment toward a package of policies with net liberalizing effects. Each country could choose a different mix of such policies, but all would be bound by a common framework agreement.

By arranging policies along a continuum of distortion, 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. The purpose of the bounds would be to constrain movement toward more trade and output neutrality. 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.

Figure 1



Any scheme proposing to reduce government intervention in production or trade decisions requires some measurement device that assesses the total level of diverse government support measures. The choice of technique should be consistent with the underlying philosophy of the agreements; in particular, is it to measure production distortions or trade distortions? Most frequently proposed is some form of the Producer Subsidy Equivalent (PSE) recently calculated for a relative handful of crops by the Organization for Economic Cooperation and Development (OECD). (The job is not yet done. There are more than 3,000 agricultural tariff line items on record.)

The PSE, which is supposed to measure the amount of income required to compensate producers for a change in policy, is not a direct measure of either the output or trade effects of a policy. Rather, it could be used as an independent check on the overall level of subsidy flowing to agricultural producers. It might also prove useful in monitoring changes in support levels if reductions can be agreed upon. Variations include the Trade Distortion Equivalent (TDE) proposed by Canada and the Support Measurement Unit (SMU) proposed by the EC. The TDE adjusts the PSE calculation in an attempt 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.

Some countries, particularly Japan and some LDCs, oppose the use of any such measurement devices, arguing that they do not take explicit account of critical noneconomic objectives of many agricultural policies. Too, since no measure can be neutral, the PSE (or TDE or SMU) will inevitably itself provide incentives for distortions as countries figure out ways to accomplish their purposes within the framework of whatever measuring device is implemented.

### **Nontrade Social Welfare Objectives**

The European Community, the Nordics (Finland, Norway, Iceland, Sweden) and Japan have repeatedly emphasized that many agricultural policies have extra-market social objectives, perhaps the most important of which are food security, environmental quality and rural employment. This source of resistance is often treated as a minor irritant by advocates of liberalization, but these objectives may be critical for governments trying to "sell" policy reforms in their own countries.

Some of these concerns might be diminished by agreement to move toward direct payments to farmers, as proposed in several decoupling schemes. A principal drawback is that such payments are often deemed "welfare for farmers" and are opposed as such by major farm interest groups in both the United States and the EC. Direct payments might be more palatable for producers if certain non-production obligations accompany 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. Such improvement projects as river and stream improvements, erosion reduction and forest plantings could additionally generate employment in the rural sector.

Food security adds an important psychological dimension to agricultural policy in countries where the memory of privations is only a generation old, as well as in those with very limited foreign reserves. 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 levels are sufficiently high. Greater assurance against supply interruptions can be approached through binding GATT obligations, but financial constraints must be addressed elsewhere.

### **Special Treatment for Developing Countries**

Special and differential treatment (S&D) for developing countries is now an integral aspect of the rights and obligations defined in the GATT. Such treatment in past negotiations usually took the form of nonreciprocity in the value of concessions exchanged between developed and developing nations, as well as longer periods for LDCs to implement trade reforms. The most recent negotiating round (1979) created a "tiered" system of rights and obligations (Aho and Aronson). These agreements, which essentially allow LDCs the rights of GATT membership without all the corresponding obligations, have attracted considerable criticism over the years, but their legitimacy was stressed again in the Punta del Este declaration.

In the current round, a group of developing countries (particularly the net food importers) have insisted that S&D treatment be an integral part of any agreed upon long-term framework of rules. They offer few specific suggestions on how this could best be accomplished, but they list their major goals as a reduction or elimination of export subsidies by developed countries without increasing costs for importing LDCs; the maintenance of LDC support measures related to the noneconomic objectives of agricultural policies including employment, structural adjustment, development and food security; and the protection of LDC domestic markets for development purposes.

Ironically, internal agricultural price policies in many LDCs discriminate against producers and artificially depress output, so removal of these policies through GATT agreements would be a move in the direction of a more output-neutral policy. Furthermore, reductions in LDC export taxes would constitute a move away from negative trade incentives. Therefore, even if GATT allows present LDC domestic subsidies to be left unchanged, the removal of present trade distortions would constitute a net improvement in GATT terms.

### **Health and Sanitary Regulations**

Each 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 ac-

cepted standards" such as the FAO's *Codex Alimentarius*. 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 (Runge). One important consideration is the capacity and the interest of a new U.S. administration (regardless of party) to maintain the momentum of the first two years and to push as adamantly for reform, especially in the context of drought-caused short supplies and rising prices. Also at issue is the capacity of the EC to make substantial reforms in light of its recent bitter political battle over budget stabilizer 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 (Paarlberg). As the December meeting in Montreal approaches, the European and U.S. positions seem to be on a collision course. The EC's new stabilizer package reinforces the two-price system of the CAP and augments the EC budget for greater export subsidization should a subsidy 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 nonagricultural interests are solidly behind the U.S. position.

Incentives exist for either the advocates of "liberalization" (lead by the United States) or the advocates of "realism" (lead by the EC) to walk out of 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 could encourage compromise fairly soon.

As negotiators move from high principles to specific policies, it seems prudent that the U.S. 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.

The Uruguay Round negotiations are certain to affect the 1990 U.S. farm bill debate. Proposals to establish marketing loans across the board, for example, together with a relaxation of present U.S. supply control measures, have been suggested as a way to punish intractable European interests. Removing acreage from set-asides could improve the U.S. competitive position considerably (especially if a targeting scheme were adopted bringing low-cost and nonerosion-prone acres back into production first), but an increase in marketing loans would be tantamount to protectionist export restitution, placing the United States 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 appears possible for marketing loans.

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 interstate banking experience. 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. Second, it appears that movement toward less trade- and output-distorting policies will remain a core concept. Policies should be measured and ranked according to their relative distorting effects, both for production and trade, allowing acceptable bounds to be established as a basis for further negotiation.

Third, the social welfare objectives of agricultural policies 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” in GATT. If, for example, the ultimate agreement involves some form of decoupling, then decoupling must be acceptable to farm and nonfarm 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 GATT.

Fourth, offers of access and, if necessary, special and differential treatment for LDCs will likely be made. There are risks in this approach. If developing countries are exempted from too many GATT disciplines, the major players like the United States and the EC might decide to move outside GATT to conduct their own agricultural negotiations, closing off LDC market access in the process. GATT must also remain sensitive to IMF and World Bank attempts

to have LDCs discipline their own pricing policies, but GATT-imposed reductions in LDC trade distortions may eventually be even more important to developing country growth than are domestic pricing reforms.

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 (not unlike the PSE), stalling progress on other issues. Beyond general agreements to pursue more uniform regulatory standards and to improve notification and consultation procedures, it will be exceedingly difficult to achieve major health and sanitary accords in this round. 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. Its outcome will affect domestic agricultural policies in much of the world. Liberalizing agricultural trade will require political courage and practical diplomacy, but failure to make progress will result in enormous costs to importers, exporters, producers and consumers in the North and South alike.

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