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The Political Economy of the Uruguay Round Negotiations:

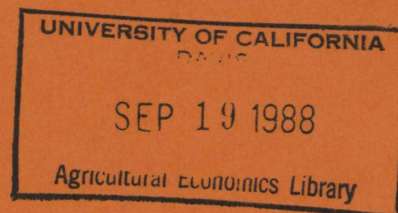
A View from Geneva

by

C. Ford Runge

and

Gretchen Heimpel Stanton



Department of Agricultural and Applied Economics

University of Minnesota
Institute of Agriculture, Forestry and Home Economics
St. Paul, Minnesota 55108

THE POLITICAL ECONOMY OF THE URUGUAY ROUND NEGOTIATIONS:

A VIEW FROM GENEVA*

C. Ford Runge

Gretchen Heimpel Stanton

In September 1986, at a meeting in Punta del Este, Uruguay, a new round of multilateral trade negotiations began. Agriculture was identified as one of the key sectors of concern in these negotiations under the General Agreement on Tariffs and Trade (GATT). This paper seeks to explain the need for negotiations in the agricultural sector, and identifies the key issues and positions before the negotiators. Prospects for the outcome of the negotiation are also examined.

Agriculture in the GATT

The GATT was established in 1947 by 23 countries agreeing to subscribe to a set of rules for international trade. At the same time, it established a forum for the discussion and resolution of trade problems, and for periodic multilateral negotiations to liberalize trade. Today, the GATT has 96 members (several of whom have only recently joined) and its rules are applied on a de facto basis by an additional 31 countries.

GATT rules are supposed to apply to trade in all goods, agricultural and industrial. Its basic premise is equal treatment for national and imported goods, and non-discriminatory treatment among

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the goods of other GATT members. To foster a more open trading system, the use of quantitative restrictions (such as quotas) on imports or exports is generally prohibited in favour of stable or "bound" tariffs. Subsidies on exports are also largely prohibited, and rules are provided for the application of duties to countervail subsidized or dumped imports, as well as for emergency actions against harmful imports. Seven previous rounds of multilateral trade negotiations have been held, successfully resulting in widespread tariff reductions, and more recently in codes of conduct for non-tariff measures.

In the agricultural sector, a number of exceptions to the general GATT rules exist, largely reflecting the interests of the United States at the time the GATT was established. Difficulties in the interpretation or enforcement of these rules have allowed agricultural trade to remain largely outside the disciplines of GATT. With regard to import access, for example, the GATT permits the use of quotas and other quantitative restrictions on agricultural imports in some cases when there are government programs seeking to reduce domestic production of the product. Export restrictions are permitted in case of critical domestic shortages. The rules governing these exceptions are relatively clear and strict, but have been largely ignored by countries maintaining quotas once justified for other reasons. Furthermore, some nations (notably the United States and Switzerland) have waivers excepting them in large measure from the rules on import access. Many of the non-tariff import measures now in common usage,

such as variable levies, minimum import prices and "voluntary" export restraint agreements, did not exist at the time the GATT was drafted. Whether these "grey area" measures are consistent with the requirements of the GATT has never been fully resolved. Exceptions to GATT rules are also allowed for actions to protect human, animal or plant health, or to conserve natural resources. There are virtually no rules disciplining the use of such measures, which can operate as barriers to trade.

In addition, in contrast to industrial products, GATT permits the use of export subsidies on primary products, including semi-processed agricultural products. The vaguely defined limitation on agricultural subsidies allowing respect for "equitable market shares" has made any disciplines difficult to apply. The situation is now exacerbated by structural surpluses, third world debt problems and new production technologies.

The resulting trade distortions are well known. Tariffs have been replaced by non-tariff barriers to agricultural imports. Domestic support levels are increasingly out of line with market signals. World markets have been depressed by subsidized exports (often from high cost producers). 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.

In 1982, a deteriorating world agricultural trade situation led the GATT contracting parties to establish a Committee on Trade in Agriculture. Its mandate was to examine how to bring the sector under more "operationally effective" GATT rules and disciplines. Its work made clear the need to address all measures which directly or indirectly affect agricultural trade including restrictions maintained through waivers, variable levies, direct export subsidies and other subsidies which affect agricultural trade. This focus was largely reflected in the Punta del Este declaration setting forth the objectives for the multilateral trade negotiations (MTN) in agriculture.

The Negotiating Group on Agriculture has primary responsibility for the sector in the Uruguay Round. The work of some of the other negotiating groups, including the Negotiating Groups on Subsidies, Tariffs, Non-Tariff Measures, Natural Resource-Based Products, Tropical Products, Dispute Settlement and on the Functioning of the GATT, may also be of relevance. Agreements reached in these other areas may apply to the agricultural sector and possible trade-offs may be made between sectors. Countries that have limited bargaining power in the agricultural sector may seek to exert leverage from other sectors.

As of August 1988, the Negotiating Group on Agriculture has held nine formal meetings, and a few informal ones. Specific negotiating proposals were made before the end of 1987 by all the major agricultural trading countries¹, and have been subsequently discussed. A

technical working group has been established with regard to aggregate measurements of support. Another working group on sanitary and phytosanitary restrictions on trade may be created later this year. Progress in the agricultural negotiations will be a major focus of the Ministerial Mid-Term Review scheduled for early December 1988 in Montreal.

Key Issues

Five key issues will dominate the discussions in Montreal and beyond: (1) short-term or emergency actions and their link, if any, to a long-term agreement; (2) identifying existing policies to be reduced or eliminated; (3) the linkages between agricultural policy and broader social welfare objectives, notably food security, environmental quality and employment policy; (4) the appropriate role of LDCs in agricultural negotiations, with specific reference their special and differential treatment; and (5) the role of health and sanitary regulations as non-tariff trade barriers.

1. Short-term action

The most difficult immediate obstacle facing the negotiators is whether and how to implement some form of short-term or emergency action to alleviate current subsidy and supply pressures. All proposals except that of the United States contain some short-term element. Most propose an immediate freeze and reduction in export subsidies. As a first installment on agreed long-term actions they propose 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 emergency action.

The EC proposes an emergency one-year commitment on cereal prices, the reduction of sugar exports and the maintenance of present access to traditional import markets for sugar, and compliance of all GATT members with the International Dairy Arrangement minimum export prices. These are differentiated from EC proposed short-term measures in the form of commitments to reduce support (compared to a specified reference period) and to bring production under control in principal agricultural sectors. The EC insists that such action, not necessarily directly related to any eventual long-term framework, should be accomplished before negotiation over new rules is begun. 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 US and EC positions. All participants agree that the final objective of the negotiations is a new set of effective GATT rules disciplining agricultural trade.

2. A framework for policies to be reduced or eliminated

In line with the Punta del Este mandate, all of the major proposals address the need to eliminate or reduce domestic support measures, export subsidies and import barriers. There is a wide difference of opinion as to what type of agricultural support should be reduced or eliminated. The US proposes complete elimination of all except "decoupled" income support and bona fide food aid. The EC

proposes limitations on the quantities eligible for government support, largely through production quotas. The Japanese propose to minimize only the trade-distorting effects of domestic policies, emphasizing their broader social welfare objectives.

How might a framework for domestic support policies to be reduced or eliminated be characterized? The complex relationship between domestic supports and trade distortion suggests two essentially different criteria. The first is the degree of trade distortion resulting from a given policy, or trade effect. The second, with its emphasis on the output or supply-response distortion resulting from a given policy, is the "decoupling" concept, or output effect. Trade distortion often stems from output distortion, so the effects, while different, are related. (See Figure 1.)

National policies might be said to have zero trade effects if they impose no distortions affecting the internal market for a commodity. In the absence of such distortion, the participants in the internal market face the same basic conditions as if the country had no border. This definition encompasses not only policies that affect the difference between domestic and external prices, but other barriers, such as protective health or sanitary regulations, that do not affect prices but systematically alter the conditions affecting the internal and external market. National policies may create incentives that either encourage or discourage exports or imports of particular commodities.

In the context of the objective of eliminating distortions to trade arising from government policies, a goal should be to reduce government measures that operate to provide major positive or negative trade incentives, moving towards more trade-neutral policies.

In contrast to the trade effect, the output effect arises when national policies create incentives encouraging or discouraging production. Output distorting policies may have negative effects, such as United States and European "set-asides", that pay producers to reduce their output, or positive effects, such as price guarantees for specific grains, that pay producers to increase their output. The US, EC and many other countries currently engage in both policies simultaneously, pushing on the price support accelerator at the same time as the set-aside brake, and paying for both. Movements in the direction of decoupling are movements toward more output neutral policies.

"Decoupled" agricultural policies are defined as measures that, in principle, provide neither positive nor negative incentives to produce a given crop. Decoupled payments could be provided through direct income payments, a positive/negative tax scheme, a minimum income insurance program or some other variation. So long as freedom exists for farmers to grow whatever crops are most marketable, the program would be more decoupled from planting decisions than currently. In the absence of artificial stimulation to produce or not to produce, farmers make more planting and marketing decisions on the basis of market prices. Decoupling thus relates specifically to output effects of various agricultural policies, and the supply-response distortions

that result. Still, it cannot be held that these payments will have zero effects on production, since the income could be invested in additional output. Naturally, the lower the payment, the less the incentive. Decoupling is thus best described as a matter of degree, with some policies having fewer output effects than others.

In a GATT context, a series of limits on acceptable policy could be set with respect to both trade and output effects, with all agricultural policies constrained to fall within certain arbitrary bounds over a period of ten years. The purpose of the bounds would be to move away from both positive and negative trade and output distortions, toward more trade and output neutrality. These bounds may, of course, be biased toward either positive or negative production or trade incentives, depending on the negotiated agreements.

Trade and output distortions are two important, and separable, components of the negotiating framework in agriculture. Progress in the negotiations may be defined by 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 movement towards a package of policies with net liberalizing effects. Each country may choose a different mix of such policies, but all would be bound by a common framework agreement. Focusing attention on output distortions adds a domestic agricultural policy dimension to the traditional GATT objective of reducing distortions to trade, consistent with the Punta del Este Declaration's resolve to confront the domestic sources of agricultural trade protection.

Another related theme common to many of the negotiating proposals is the need for some measurement device to reflect the total level of diverse government support measures. Most frequently proposed is some form of the Producer Subsidy Equivalent (PSE) recently calculated by the OECD. Variations include the Trade Distortion Equivalent (TDE) proposed by Canada and the Support Measurement Unit (SMU) proposed by the EC. The PSE measures the amount of income that must be given or taken away so as to compensate producers for a change in policy. This subsidy equivalent is a measure of the level of domestic support provided to producers, but is not a direct measure of either the output or trade effects of policy. It is, rather, an independent "check" on the overall level of subsidy flowing to agricultural producers and may be useful in monitoring support levels. The TDE amends the PSE by attempting to isolate only those subsidies that have trade effects, then adjusts the PSE calculation in an attempt to capture the trade distorting component of the producer's subsidy. 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 such devices, primarily because they fail to take into account the non-economic objectives of many agricultural policies.

3. Non-trade Social Welfare Objectives

Various proposals have emphasized objectives of agricultural policy that are outside the realm of trade or output effects. The European Communities, the Nordics, and Japan, in particular, have

repeatedly emphasized that agricultural policies have extra-market social objectives. Perhaps the most important of these are food security, environmental quality and rural employment. These objectives underlie much of the resistance to policy reform and are often treated as minor issues by advocates of liberalization. However, these objectives relate directly to the capacity of governments to "sell" agricultural and trade policy reforms, and may be crucial to a final package of domestic and trade policy changes.

One manner of addressing some of these concerns is to move away from production-oriented support measures towards more output-neutral (decoupled) direct payments to farmers. A key problem is that direct payments are often seen as "welfare for farmers". However, it can be argued that current payment schemes, notably payments per acre in the United States and European Communities, are less equitable than welfare in the sense that the largest farmers receive the largest payments. Welfare objectives may be made more acceptable if obligations accompany the receipt of direct 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. By taking carefully targeted fragile lands out of production, the primary effect would not be supply control, but a shift in cultivation patterns onto those lands most able to support sustainable productivity gains over time. Retirement of fragile lands would also substantially reduce erosion and pollution, and offset the costs of direct income transfers.

It can be argued that direct income transfers, coupled with environmental projects (river and stream improvements, erosion reduction, forest plantings) could generate employment in the rural sector. In contrast, some economists believe the high price supports of the United States and European Communities have primarily benefited large producers using heavy concentrations of chemical inputs, contributing to soil and water pollution and the decline of small, diversified, labor-intensive producers.

Food security, perhaps the most difficult social concern, arises particularly in discussions with the Japanese and with net importing developing countries. Food security is an important psychological dimension of agricultural policy in countries where the memory of privations is only a generation old, and in those with very limited foreign reserves. Unfortunately, there has tended to be confusion between food security (which, assuming reliable suppliers and sufficient income, can be accomplished through trade) and the more autarchic idea of self-sufficiency, which can be used to justify a high level of protection. In the domain of food security, greater assurance against supply interruptions can be achieved through binding GATT obligations, but financial constraints must be addressed elsewhere.

4. LDCs: Special and Differential Treatment

Special and differential treatment (S&D) for LDCs is now an integral aspect of the rights and obligations defined in the GATT. Based on agreements made in 1964 to exempt LDCs from reciprocal

concessions under "Part IV" of the GATT Agreement, and subsequent waivers from Most-Favored-Nation treatment, the Tokyo Round legitimized S&D in 1979 through an "enabling clause" that created a "tiered" system of rights and obligations (Aho and Aronson, pp. 95-115). These agreements have allowed LDCs the rights of GATT membership, without corresponding obligations. While considerable criticism has been leveled within the trade policy establishment at S&D, their legitimacy was stressed again in the Punta del Este declaration. Efforts to provide S&D treatment in past negotiations have usually taken the form of non-reciprocity in the value of concessions exchanged between developed and developing nations, and longer implementation periods for the developing countries.

In the Negotiating Group on Agriculture, a group of developing countries (particularly the net food importers) insist that special and differential treatment be an integral part of any agreed long-term framework of rules. No specific suggestions on how this could best be accomplished have yet been presented, but major concerns include the reduction or elimination of export subsidies without increasing import costs for importing LDCs; the maintenance of LDC support measures related to the non-economic objectives of agricultural policies including employment, structural adjustment, development and food security; and the protection of LDC domestic markets for development purposes.

In the context of proposals to reduce the trade and output effects of government policies, there is some scope for S&D. In most

LDCs, internal agricultural price policies discriminate against producers and artificially depress output. The removal of these policies (without any additional subsidy) would be a move in the direction of more output-neutral (decoupled) policy. Furthermore, many LDCs impose border measures that are significant distortions to trade. Export taxes, for example, if removed, would constitute a move away from negative trade incentives. Even if domestic subsidies were left unchanged, removal of such trade distortions would constitute a net improvement and a concession in GATT terms.

5. Health and Sanitary Regulations

Following the mandate of the Punta del Este Declaration, each of the proposals makes reference to the need to improve disciplines on health and sanitary ("H&S") restrictions which act as barriers to trade. Previous efforts to address this thorny problem have been largely unsuccessful. Improvements in notification and consultation procedures, and perhaps in dispute settlement procedures, are possible, but past experience shows little benefit from such efforts. A number of the proposals refer to the use of universally accepted standards, and to the work done in other international bodies such as the FAO's Codex Alimentarius. Difficulty arises here because there do not exist agreed international standards regarding health and sanitary restrictions for more than a few items, and none are binding.

Direction of the Negotiations

Heading into the final two years of the Uruguay Round, negotiators confront both political and practical challenges in

agriculture. An important question is the capacity and interest of the new US administration (regardless of party) to maintain the momentum of the first two years and to push as adamantly for reform, especially if drought leads to short supplies and rising prices. Also at issue is the capacity of the EC to make substantial reforms following the bitter battle for its recent stabilizer programs, and of Japan to offer further liberalization in the wake of those recently forced upon it by dispute settlements, which have aroused intense domestic opposition.

The interaction of multilateral trade negotiations and domestic policies can 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). In the context of the December meeting in Montreal, the European and United States positions seem to be on a collision course. The European position stems from the recent budget stabilizers package which, while attempting to limit production, reinforces the two-price system of the CAP and augments the budget, allowing for greater export subsidization should a subsidy war erupt. As for the United States position, its strength - uncompromising support for liberalization - is also its weakness; it is considered completely unrealistic by many.

Incentives exist for either the advocates of liberalization (the United States) or the advocates of "realism" (the European Community) to walk out of the negotiation, each justifying their action as defending the true objectives of GATT.

In any event, the Uruguay Round appears sure to affect the 1990 US Farm Bill debate. Proposals to establish "marketing loans across the board", for example, together with re-entry of much of the land taken out of production under the 1985 Farm Bill, have been suggested as a way to "punish" intractable European interests. While removing acreage from set-asides could improve the United States competitive position considerably (especially if a targeting scheme were adopted allowing low cost and non-erosion-prone acres to be re-entered first), the marketing loan amounts to an export restitution, and would place the United States on a par with the EC as a subsidizer of exports. If the United States intends to stay with its current approach, re-entering competitive acres is consistent with greater output neutrality. However, marketing loans distort trade since they insulate the producer from the market and decrease the interaction between domestic and international prices.

In summary, there are certain areas of universal concern in which discussion and potential progress is likely. First, some resolution of short versus long-run reforms must be made. Second, it appears that movement towards less trade- and output-distorting policies will remain a core concept. The trade effects of policies must be ranked according to their relative distorting effects, allowing acceptable bounds to be established as a basis for further negotiation. In order to make output effects (and thus decoupling) operational from a negotiating perspective, they must be clarified and related to particular policies, so that a given policy is understood as more or

less "decoupled" than another. Similar bounds should then be established to limit policies with extremely negative or extremely positive output distorting effects.

Third, social welfare objectives of agricultural policies will inevitably be a part of the discussion. These issues may appear tangential to trade or output effects, but are crucial in selling policy reforms to domestic public interests. All negotiators must be able to justify to their constituents (commodity and consumer groups) that they have gotten a "fair deal" in GATT. If, for example, this deal involves decoupling, then decoupling must be acceptable to the farm and non-farm public alike. Linking it to environmental policy reforms may help its acceptance through the impact on rural development and employment objectives. Nor can the issue of food security be sidestepped; it will be important to guarantee supplies to major importers as part of a final agreement, consistent with the rules of GATT.

Fourth, the issue of LDC treatment is likely to remain. It is possible that offers of access and, if necessary, special and differential treatment will be made. But there are risks in this approach. If the LDCs are exempted from GATT disciplines agreed to by the United States, the European Communities and Japan, these major players could possibly move outside of GATT to conduct agricultural negotiations, closing off LDC market access. GATT must also remain sensitive to the IMF and World Bank attempts to have LDCs discipline their own pricing policies. A real opportunity exists to bring LDCs

into the same output and trade framework as the developed countries. The role of GATT in removing LDC market distortions that decrease output through subsidies to consumers, and reducing trade distortions arising from import substitution strategies, may eventually be even more important to growth in world trade than reforms in developed agricultural economies.

Finally, there is potential for long, drawn out and exceedingly complex negotiations over health and sanitary regulations. Because of their complexity, and different national attitudes toward health and sanitation, this area has the potential to become a negotiating bog (not unlike the PSE), stalling real progress on other issues. Beyond general agreements to pursue more uniform regulatory standards and improve notification and consultation procedures, it will be exceedingly difficult to achieve major "H&S" accords in this round, although the groundwork for such accords could perhaps be laid.

It must be remembered that the Uruguay Round involves fourteen other negotiating areas besides agriculture, and that important cross-cutting deals will ultimately be made. Nevertheless, this round is being regarded as a make-or-break event, the results of which will affect domestic agricultural policies in much of the world. For the nations meeting in GATT, liberalizing agricultural trade will require political courage and practical diplomacy. The failure to do so will result in enormous costs to importers, exporters, producers and consumers in the North and South alike.

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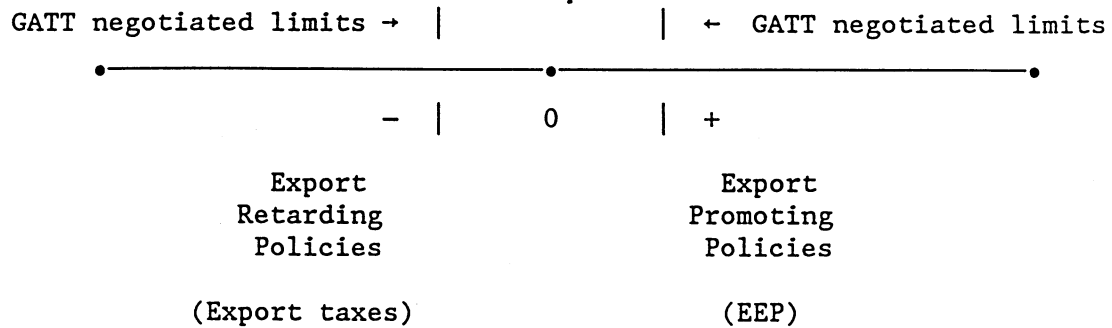
FOOTNOTES

The first author formerly served as Special Assistant to the United States Ambassador to GATT in the Geneva Office of the United States Trade Representative (USTR) during 1987-88. He is an associate professor in the Department of Agricultural and Applied Economics and the Hubert H. Humphrey Institute, University of Minnesota. The second author is an Economic Affairs Officer in the GATT Secretariat. No aspect of these remarks should be interpreted as reflecting the policy positions of either USTR or the GATT. Our thanks to Donald McClatchy and O. Ray Stanton for comments on an earlier version.

¹United States, the European Community, Canada, the Nordic countries (Finland, Norway, Sweden and Iceland), Japan and the Cairns Group. This latter group consists of 13 agricultural exporters who consider themselves to be "fair traders" not reliant on export subsidies: Australia, New Zealand, Canada, Argentina, Uruguay, Brazil, Thailand, Hungary, Chile, Colombia, Indonesia, Malaysia and the Philippines.

Figure 1.

TRADE DISTORTIONS



OUTPUT DISTORTIONS

