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Trade Conflicts and Prospects for Resolution in the GATT: Developed Country Issues

Background Paper

by

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Agricultural protectionism is not a new phenomenon, but international tensions over it wax and wane with the fluctuations of the world market. Substantial increases in production incentives in the European Community went almost unnoticed in the 1970s since there seemed to be an expanding market for all exporters. Tensions rose when the boom collapsed.

Recent trade disputes have centered on the massive use of export subsidies which enabled the EC to dispose of its surpluses at the same time that the U.S. resorted to costly measures to control supplies and farmers that were not insulated from the world market had to take lower prices. The U.S. has now entered the fray with its own export subsidies and an aggressive two-price policy.

Market access problems were high on the agenda of the agricultural exporting countries in the 1960s when the EC was still a major net importer of temperate zone agricultural products. The best remembered, though not the most important, dispute was the "chicken war." Rearguard actions are still being fought in this area. Examples are the U.S. complaint before the GATT regarding the EC's Mediterranean citrus import preferences that discriminate against the U.S.; and the current dispute over decisions in connection with the accession of Spain and Portugal to the EC.[1] Of potentially greater consequence are the recurrent EC attempts to restrict or impair the free access of American soybeans and protein feeds that is guaranteed by zero-duty bindings negotiated in GATT. All these disputes have given rise to threats of retaliation and counter-retaliation that could escalate on a massive scale.

These are the most urgent agricultural issues that need to be addressed in the forthcoming Multilateral Trade Negotiations if we are to avoid a trade war that could become extremely costly to taxpayers and consumers in the countries concerned, as well as to other countries that are innocent bystanders in these disputes.

Paradoxically, prospects for reaching an accommodation in these two areas may have improved precisely because of the aggressive stance adopted by the U.S. and because of the mounting budget costs of present policies. We should seize that chance to negotiate an interim solution that would be in the nature of an armistice or standstill until circumstances become more favorable for the liberalization of agricultural trade.

I make a distinction here between accommodation and liberalization. Accommodations are deals among governments designed to resolve conflicts pitting their producers against each other. They usually eschew significant reductions in producer protection. But we always need to remember that the ultimate purpose of the GATT is liberalization--that is, the reciprocal <u>reduction</u> of protection.

Unfortunately, the chances for liberalization of agricultural trade are not favorable for this upcoming round of trade negotiations. They looked a lot brighter a year-and-a-half ago when both the U.S. and the EC seemed to be moving toward greater market orientation. That was the time when the Reagan administration proposed to phase out all market-distorting government interventions over a period of five years. The administration's domestic proposals lent credibility to a trade policy stance that would rule out export subsidies of all kinds, convert import barriers into tariffs and negotiate them down as was done with industrial tariffs--all on a basis of reciprocity. That position is consistent with our general trade policy and with the principles of the GATT. It also is in keeping with the long-term interests of American agriculture. Needless to say, the new farm legislation has compromised this position. Across the Atlantic, the European Commission's "green paper," which proposed a shift from price supports to more selective and less market-distorting forms of assistance to farmers, likewise was successfully sandbagged by the European farm lobbies.

Clearly, any significant liberalization of agricultural trade will have to await a resumption of the drive for domestic policy reform, here and abroad. I believe that time will come--perhaps sooner than we think. But in the meantime, I am afraid all we can hope for is a reaffirmation of agricultural trade liberalization as the ultimate goal, and perhaps a timetable for a modest, gradual reduction of protection, expressed in terms of budget outlays or subsidy equivalents, that would still leave ample room for trade-distorting policy changes.

Since my time is limited, let me review a few areas in which agreements should be within reach. I'll then mention some other ideas--old and new--that could surface in the negotiations, which may look intriguing but, for the most part, have serious drawbacks.

Our first order of business should be to preserve and build upon those GATT rules applying to agriculture that have been, or could be, valuable to the United States in fending off harmful action by a trading partner. Once a trading partner has entered into a commitment to admit a product free of duty--as the EC did in the case of soybeans--it cannot renege on it without offering acceptable compensation or face retaliation (Article XXVIII). This concept also applies if a trading partner adopts measures that impair the value of a tariff binding or other trade concession (such as a tax on soybeans or a soybean product, or a preferential arrangement with a foreign supplier (Article XXIII)). It should also apply to subsidies stimulating domestic production at the expense of imports. The underlying principle is that compensation is due whenever the balance of rights and obligations is disturbed.

In the absence of formal bindings concerning specific products, import restrictions are permitted to protect domestic agricultural programs but the Agreement provides that domestic production must also be restricted and that imports not be restricted more severely than domestic production (Article XI 2c). "Primary products" are exempted from the ban on export subsidies provided that export subsidies not be used to acquire more than an "equitable share" of world export trade in the product in question. "Equitable share" is somewhat vaguely defined in terms of shares in a previous representative period and further qualified by reference to possible "special factors," but the intention is fairly clear, that export subsidies not be used aggressively (Article XVI, B3).[2] The underlying principle concerning both import restrictions and export subsidies is to maintain proportionality in the treatment of domestic and foreign interests. At the time--and even now--the idea seemed to be an acceptable compromise between "domestic policy imperatives" and the need to preserve a tolerable international modus vivendi--pending progress on the related problems of agricultural policy reform and trade liberalization.

Export Subsidies

Article XVI defines the limits within which export subsidies are allowed for agricultural and other "primary" products.[3] Its essence is a standstill: a commitment by the subsidizing country not to exceed its "equitable share," defined as its recent share in the world market. But the article is replete with qualifying terminology that has given rise to divergent interpretations. What "previous representative period" is to be taken as a base? What "special factors" are to be taken into account in determining the "equitable share"? Is improved comparative efficiency a "special factor" justifying an increased market share? The Subsidy Code negotiated in the Tokyo Round did little to clarify these issues except that it defined the "previous representative period" as the "three most recent calendar years in which normal market conditions existed." But what are normal market conditions? Is this merely meant to exclude years in which the exporting country experienced unfavorable weather? Or does it refer to the situation that would exist in the absence of all distortions? What would a country's exports be in that situation? What econometric model is to be used to answer that question?

The best, and probably the only, practical solution would be to strip away most of these qualifications. Most important, we "should relieve the equitable share rule of the burden to prove the causality of export subsidization."[4] We should also rule out attempts to roll the base back to some hypothetical golden era that was free of market distortions. This would remove the principal ambiguity that has prevented an acceptable international modus vivendi.

It does not resolve another major problem: what constitutes an export subsidy. Should this include domestic subsidies that have the effect of increasing exports? There is some support for this in the language of Article XVI and of the Code. Would this make American grain and cotton subject to the article? Or could the U.S. argue that its payments to producers are incentive payments for reducing production and that, in any event, acreage reductions required as a condition of the payments offset--and in some years more than offset--any production-stimulating effects of the payments? The econometricians would have to be called in to try to resolve that question. In any event, outright export subsidies such as those provided under the Export Enhancement Program clearly fall under Article XVI.

There are other questions. Should the equitable share rule apply only globally or also to specific markets? It would seem for both theoretical and practical reasons that an effectively enforced global limit should suffice. The destination of shipments within the limit could safely be left to transportation costs and other market factors. It does not seem reasonable to force the EC to divert shipments of wheat from nearby markets in North Africa and the Middle East to Latin America or China.

Should producer-financed subsidies be exempted from the subsidy rule? Several arguments have been put forward in favor of exemption. For example, a co-responsibility levy on producers to help finance export subsidies would reduce the average return to growers and thus reduce the incentive to produce. More effective in this regard are two-price systems which limit price supports to specified quantities, so that the marginal price received by producers would be the world price. But there are more persuasive arguments against exemption. (1) Co-responsibility levies can be shifted to domestic consumers, with adverse effects on consumption and a further increase in the export surplus.[5] Moreover, shifting the costs of export subsidization from the budget to domestic consumers would ease the budgetary constraint. (2) Experience has shown that, for a number of reasons, surplus production continues despite the price disincentives implied in various forms of two-price systems. (3) Exemption of producer-financed subsidies would legitimize dumping, prohibited by GATT.

Should export subsidies be permitted for "primary" ingredients of processed agricultural products? A case could be made for this, analogous to the "drawback" principle invoked by exporters of, say, refined sugar when rebating the tariff on imported raw sugar. The EC has sought to extend this principle to justify export subsidies for wheat flour, pasta, and poultry to the extent that they are necessary to offset the higher price of EC grain. (The difference is that the grain may be domestic rather than imported.) These "ingredient" subsidies would, in any case, be subject to the limit on exports of the primary product in question. There are several problems with this approach, however. For example, where do we draw the line? Who determines that the "ingredient subsidy" is not excessive and in effect also subsidizes the processing industry?

Obviously, there will have to be some give-and-take here if we are to settle this issue. Budget constraints may lead the EC to agree to a cap on its wheat, flour, and/or total grain export shares based on a recent representative three-year period. What could the U.S. offer in return? We'd probably wish to avoid becoming subject to a cap on our export share (although one based on 1980-82 would not seem to be overly restrictive). However, we could offer to terminate our Export Enhancement Program (which in any case has proven to be of little value to us). We could offer to have a panel of independent experts examine whether our domestic deficiency payments/acreage reduction programs provide a net stimulus to production and exports, compared to what would happen without government intervention. We could offer to negotiate an agreement on export credit terms. I don't think we should trade our zero-duty bindings on soybeans and protein feeds, which have proved to be extremely valuable to us.

Market Access

Governments have been restricting agricultural imports by a variety of nontariff barriers (including variable levies, minimum import prices, state trading, voluntary export restraint agreements, and quantitative import restrictions) wherever such restrictions are deemed to be necessary to implement domestic support programs. However, only quantitative import restrictions (quotas) are mentioned in Article XI(c). The article provides, in effect, that domestic programs and the accompanying import restrictions must be operated in such a manner as to preserve foreign suppliers' historical market share. The intent is, therefore, similar to that of the subsidy rule.

The U.S. has respected foreign suppliers' historical shares in administering its dairy import restrictions. Conveniently, the historical shares, dating back to the immediate postwar period, are very small. Historical foreign shares were also reserved in the beef import legislation enacted in 1964. In the case of sugar, where about half of the U.S. market was once set aside for imports, the U.S. began to violate the proportionality principle when domestic production came under pressure from corn sweeteners. For all three products, it failed to observe the condition that domestic production must also be subject to quantitative restraints; but it is not clear that this condition is necessary provided foreign access is assured by other means.

Article XI does not specifically address nontariff import barriers, other than quantitative restrictions, which have proliferated since the GATT was negotiated. The variable levies introduced by the EC in the 1960s escaped any discipline.

Logic suggests that the minimum access rule in Article XI should be extended to all new government interventions, including increases in domestic support prices and subsidies, that threaten to reduce imports. All programs would have to be administered in such a way as to safeguard traditional import shares. A base period would have to be agreed upon, as in the case of export subsidies. Minimum access could be provided by means of country quotas or a global quota. There would be no obligation to pay more than the world price for imports; foreign suppliers could be asked to submit competitive bids.[6] Compensation would be due for any failure to honor the minimum access commitment, whatever the reason.

With amendments along these lines, Article XI would be less biased against the U.S. than it is now. It may become useful in negotiating minimum access guarantees for high protein wheat and for feed grains in the EC. As part of the bargain, the U.S. should be prepared to give up the waiver, granted to it in 1955, which exempts it from the limited obligations contained in Article XI. The commodities that would give us the most trouble are sugar and dairy products. In the case of sugar, foreign policy and general economic considerations suggest that in any event the U.S. should not allow its sugar imports to drop to zero--as they will under present legislation. For dairy products, the U.S. might consider improving access for specialty cheese imports.

Conversion of quotas to tariffs should appeal to governments of importing countries because it would make import restrictions more cost-effective. The tariff revenue could be used to support and stabilize domestic producer incomes; it could also be used to compensate exporting nations that would lose their quota rents. Consumers would benefit from increased competition. Efficient foreign suppliers would be given a chance to increase their sales. Tariff rates should be scheduled to decline over time as domestic producers adjust to a more competitive environment.[7]

The conversion of import quotas to a combination of tariffs and deficiency payments is particularly interesting where the price elasticity of demand is high. In such cases, the replacement of import quotas by duty-financed deficiency payments can increase demand sufficiently to result in a substantial increase in trade without adverse effects on producers in the importing country and at small or no cost to that country's treasury.[8]

In the case of the U.S., this approach may commend itself for cheese. The tariff would be determined initially by auctioning off the import quotas. For beef, the import restraints are largely redundant: U.S. domestic prices are not significantly higher than world prices. For sugar, the equivalent tariff would have to be reduced drastically if we are to prevent imports from vanishing in the near future.

Improved Procedures for Settling Disputes

Disputes will inevitably arise concerning the interpretation and application of specific GATT provisions. When a member country considers that action taken by another member violates the Agreement, or nullifies or impairs its rights under the Agreement, it can bring a complaint. Article XXIII provides that the GATT Council shall investigate the matter and make appropriate recommendations to the parties concerned, or give a ruling on the matter, as appropriate. If this does not resolve the dispute, the Council may authorize the injured party to suspend such concessions or other obligations granted to the other party as the Council deems appropriate. Similar procedures are provided in the Subsidy Code, except that in this case the matter is referred to the Committee of Signatories of the Code.

In practice, the investigation of disputes is referred to a panel of experts. The panel tries to conciliate the dispute, but if no settlement is obtained, it reports its conclusions to the Council. The Council, acting by consensus that includes the disputing parties, decides on whether to adopt the panel's report and recommendations. It may also make recommendations of its own.

An assessment of the effectiveness of the process, by the U.S. International Trade Commission, concludes that it has been "adequate for managing all but the most contentious GATT disputes." Almost all of the "most contentious" disputes concerned agricultural trade issues, including five complaints brought by the United States against the EC for which adoption by the Council proved impossible. Cases involving agricultural subsidies proved to be the most intractable.[9]

There are no easy answers to the problem. The consensus rule in the Council probably cannot be changed. A formal rule that would require the disputants to abstain is not likely to be passed and probably would not help a great deal where large and influential trading partners such as the U.S. and the EC are either involved in, or affected by, the dispute. What is required is a political commitment to the arbitration process: panel findings should be presumed to settle the dispute, except in very unusual circumstances.

In any event there will be cases where action in the Council will be stalled indefinitely by the offending party. In at least one such case (Mediterranean citrus preferences), the U.S. retaliated unilaterally to offset the injury recognized by the panel. As matters stand, retaliation without authorization by the GATT Council is a violation of the dispute settlement process. This provision is untenable and should be repealed. Whenever an independent GATT panel finds that a country has been denied GATT rights by the action of another party, that country should have the right to retaliate if a panel report has not been adopted within a specified period. This should deter violations and impairments of GATT rights and encourage offenders to offer adequate compensation to avoid retaliation by the injured party.

This change would place increased responsibilities on the panels. Can they be relied upon to carry out their responsibilities impartially and decisively?

The past performance of the panels has been uneven. The panel that settled the "chicken war" in 1963 set an example of successful arbitration. Charged with determining "the value to be ascribed as of September 1, 1960, in the context of unbindings concerning this product [i.e., poultry] to the United States exports of poultry to the Federal Republic of Germany," the panel estimated the trade damage at $26 million (as compared with a U.S. claim of $46 million and an EC estimate of $19 million). The panel's decision was accepted by both disputants.[10]

Among more recent cases, the citrus panel stands out as a model for recommending sensible, constructive remedial action. Without attempting to judge the legality of the EC's Mediterranean preferences under GATT, the panel concluded that the arrangements had upset the balance of rights and obligations to the disadvantage of third parties and that the U.S. was therefore entitled to offsetting or compensatory adjustment. In contrast to the poultry panel, the citrus panel did not provide an estimate of the extent of the trade damage but recommended, as a remedy, the reduction by October 15, 1985 of the EC's MFN tariffs on citrus products, which would reduce the degree of discrimination against third parties.

The wheat flour panel, on the other hand, is an example of extreme timidity in interpreting and resolving ambiguities. Its recommendations (February 1983) acknowledged that the EC export share had increased considerably; that these exports would not be possible without export subsidies; and that the subsidies may well have resulted in reduced sales opportunities for the U.S. It refused to conclude, however, that the EC had used its subsidies to gain more than an equitable market share, on the ground that the pertinent provisions of the Subsidy Code were not sufficiently "operational, stringent, and effective." A bolder panel might have found negotiating history that would have supported the selection of a three-year period immediately preceding the adoption of the code as a basis for defining the EC's "equitable share" and the extent of the trade damage.

One step that could be taken to strengthen the panel procedure is to provide panels with more clearly defined terms of reference. These should include a request for determining whether the trade practices being considered were inconsistent with GATT or had nullified or impaired the benefits the complainant could reasonably expect from the Agreement. The panel also should be asked to estimate the extent of the injury. (The citrus panel, which was given rather vague terms of reference, proceeded to elaborate them.)

In general, the panels have been competent and have not been responsible for undue delays. Efforts have been made to ensure their impartiality by selecting chairmen from countries that could be expected to be neutral in the dispute, and by applying a rough geographic balance among the members. There has been some concern about the independence of panel members because they are generally drawn from the resident national delegations to GATT, who might be reluctant to let the chips fall where they may because of a desire to maintain good working relations with their colleagues. For this reason, it may be preferable to place greater reliance on nongovernmental experts. It has also been suggested that in important cases the Director General of GATT might serve as the chairman (as in the poultry panel).

This pretty much exhausts the areas of negotiation that I consider promising and worthwhile. Let me now turn to some other ideas that are questionable on either or both grounds.

Multilaterally Agreed Reductions in Crop Acreage

This idea, when broached by the U.S. during the Kennedy Round, was received without enthusiasm by the other major grain exporters. It is a natural for the U.S., which is already relying heavily on acreage restraints, and it is possible that mounting grain surpluses would now cause the EC to be more favorably disposed toward it. However, the EC as well as other major grain exporters are more concerned about the aggressive price and export policies recently adopted by the U.S. They would probably insist on a full-fledged commodity agreement, complete with floor prices and export shares, that would seem to be ruled out by the Reagan administration. Past experience with international commodity agreements indicates that they are impossible to enforce in a situation of chronic market glut. In any case, it is questionable whether the enshrinement of production controls in an international agreement would be in the long-term interest of U.S. grain producers, not to mention the public interest in ultimate progress toward a market-oriented world trading system.

Experience with the international dairy agreement, first negotiated in the Kennedy Round, which provided for minimum trading prices, has been discouraging for some of the same reasons. With effective production controls now in place, the EC might be inclined to promote a stronger international agreement that would not only set floor prices but also limit production and exports in order to protect its now-dominant share in the world dairy market. Efficient exporters like New Zealand and Australia would probably object to limits on their production; the U.S. would oppose them in principle and perhaps also because it has only begun to enter the subsidized competition in the world dairy market.

EC Restraints on Grain Production in Exchange for U.S. Restraints on Exports of "Grain Substitutes"

"Completing the CAP" is a high priority for the EC. What is meant by this is plugging the last remaining gap in the protective wall around European agriculture: the free entry granted to protein feeds by virtue of the zero-duty bindings the EC conceded in the Dillon round. The EC argues, rightly, that these bindings impair the effectiveness of its grain support programs: over the past fifteen years, imports of duty-free "grain substitutes" (mainly protein feeds and cassava) have risen from 3 million tons to about 15 million tons. If these imports were limited, the EC would limit its export subsidies for grains, or reduce its grain support prices, or increase its co-responsibility levy on grain, or limit the quantity of grain eligible for price support, or introduce incentives for acreage reduction. One EC trial balloon called for a voluntary limit on U.S. exports of gluten feed at the current level of about 3 to 4 million tons.

There are a number of reasons for taking a skeptical view of the EC proposal. Even though limited at present to gluten feed, it could be the entering wedge for impairments of the valuable zero-duty binding on soybeans. U.S. exports of soybeans and gluten feed together amount to $4 billion annually. To the extent that these exports have been stimulated by high EC grain support prices, they can be seen as partial compensation for EC restrictions on grain imports. The EC has refrained from taking unilateral action against protein feeds because of the fear of U.S. retaliation. Any concession the EC could make on its grain policy in return for U.S. concessions on protein feeds would be at best uncertain in their economic effects and legal standing. Why trade the bird in hand for the bird in the bush? Furthermore, it is not clear why the U.S. should assist the EC in removing one of the few sources of pressure that might induce it to reduce its grain support prices.

The Exchange of EC Restraints on Grain Production for Increased U.S. Dairy Import Quotas

This idea dates back to the 1960s but never got off the ground because of opposition by EC grain producers and U.S. dairymen. Now there is the additional problem that any relaxation of U.S. dairy import quotas would add to the surpluses that have to be bought up by the government and disposed of at a loss. That problem would probably also preclude any increase of American dairy import quotas in return for EC concessions on high-quality beef imports from the U.S. However, it is, of course, possible that minor concessions--for example, on European and Japanese beef imports--can be secured in return for American concessions on processed foods or other manufactured products.

International Commodity Agreements

International commodity agreements to support prices, share markets, stabilize supplies and prices is an approach that has surfaced with some regularity in the past. The experience has been discouraging. The agreement negotiated in the Kennedy Round which provided rather modest floor prices for wheat, differentiated to take account of quality differences, broke down when the market turned soft, shortly after it was signed. Negotiations in the Tokyo Round that were intended to stabilize the wheat market through a system of coordinated national buffer stocks failed because of the inadequate contributions offered by U.S. trading partners and extraneous demands pressed by developing countries. The international sugar, coffee, and cocoa agreements never had sufficiently strong buffer stock provisions to stabilize prices within the intended range. In any case, the tendency to set floor prices above long-term market-clearing levels virtually assured the breakdown of the agreements as stocks soon exceeded the levels members were committed to hold. The success of the international oil cartel in raising prices for more than a decade was made possible by exceptionally favorable circumstances--an initial world-wide oil shortage and low short-run elasticities of supply and demand in the rest of the world. In the end, the cartel foundered over its inability to enforce tighter production quotas as demand and supply in the rest of the world finally responded to higher prices.

An OPEC for grains could be expected to be more vulnerable since grain can be produced almost anywhere and response lags are shorter. As the "Saudi Arabia" of the world grain market, the United States would have to bear most of the burden of adjusting production to a shrinking demand. Even in the relatively short run, the American farmer is, therefore, probably better off by relying on his basic comparative advantage, even though the competition for world markets may be distorted by foreign government interventions. This may explain why successive American administrations have been unenthusiastic about international agreements to share markets and raise prices, and have shied away from market-stabilizing agreements that might drift off in that direction.

"Privatizing" Export Subsidies

Budget constraints account for the increasing popularity of this idea, particularly in the EC which has experimented with several different versions of it. One example is the imposition of a co-responsibility levy on each unit (ton of grain or hectoliter of milk) produced or marketed to help finance surplus disposal. This discourages production but, from the budget point of view, has an advantage over a similar cut in support prices in that all of the savings go to the budget; there are no benefits to consumers. In fact, part or all of the levy will be passed on to the consumer. Furthermore, producers may press successfully for an increase in support prices to compensate them for the levy. To the extent that the burden is shifted to the consumer, it may result in reduced consumption and increased surpluses.

The concept can be made more effective in discouraging production if a sharp cut is applied at the margin. For example, eligibility for price support may be limited to a quantity equal to 120 percent of domestic consumption; any additional quantities must be marketed at the world price (as in the EC sugar regime) or is penalized by a stiff tax (as in the EC milk marketing order).

The EC sugar regime--which is often commended as a possible basis for an international agreement aimed at restraining surplus production--has carried price differentiation one step further. Here an "A quota" (approximately equal to domestic consumption) is eligible for a support price of about 24 U.S. cents a pound of refined sugar. An additional ("B") quota (equal to about 22 percent of domestic consumption) is eligible for price support less a 30 percent levy on producers and processors to finance the disposal of this surplus. (The levy can be increased to 37.5 percent.) All quota sugar is also subject to a basic 2 percent co-responsibility levy. Any additional sugar is, in principle, not eligible for support and must be marketed at the world price. According to its advocates, the system is effective in (1) providing a guaranteed income to producers; (2) restraining excess production; (3) avoiding budget costs; (4) exposing incremental output to competition in the world market.[11]

If this model were to be adopted internationally, not only for sugar but for other price-supported commodities,[12] negotiations could focus on reductions in the quantities eligible for support--first, to eliminate subsidized exports, and then to open up part of the market to imports.

On further analysis, however, many problems become apparent with this approach. First, it would promote and entrench a uniform pattern of national commodity cartels that shelter the inefficient and limit or penalize efficient producers. The quota system, even more than support prices, impedes the transfer of resources to other lines of production in response to shifts in demand or comparative advantage.

Second, while the quota system is restrictive, it does not prevent productivity growth. Yields will increase and generate increased surpluses for the export market. Producers will seek to maintain average returns by pressing for higher support prices on the quantities eligible for support. This would depress domestic demand and result in increased surpluses.

Third, the way the system is administered affects production and exports. For example, where growers' returns are pooled, production will respond to the blend price rather than the marginal price. Where production quotas are not freely negotiable (the purpose being to keep high-cost producers in business), many low-cost producers whose marginal costs are less than the world price will divert a large part of their production into the export market. Less efficient producers will tend to exceed their quota in order to protect themselves against the risk of seeing their quota reduced in the event they fail to fill their quota because of a poor harvest.

Finally, adopting this approach internationally would legitimize export dumping which has long been recognized as a form of unfair competition. In the absence of offsetting restraints on production, any regime in which only exports are exposed to the world market will result in greater production and exports than one in which all production is required to meet international competition.

"Harmonizing" Agricultural Policies

This rather amorphous idea, favored by the EC, has cropped up in several different forms. One version aims at adjustments of national policies with a view to (1) maintaining the desired level of protection of agricultural producers; (2) reducing the budget costs; (3) reducing or limiting the areas of friction among trading partners. A tall order--even though consumer interests do not figure prominently among the objectives. Increased export subsidies and sharply reduced American market price supports under the American Food Security Act of 1985 are cited as evidence of increased disharmony. Restraints on production are considered to be factors for greater harmony. The general idea seems to be "accommodation" among producers and governments--with the emphasis on U.S.-EC relations.

A more specific version calls for the equalization of levels of protection (including domestic and export subsidies) among different agricultural products, within each country and, apparently, also among countries. The theoretical rationale is that this would result in a better use of each country's agricultural resources. The idea has some economic merit but the difficulties of measuring effective protection (in relation to hypothetical prices that would obtain in the absence of government intervention) and of assessing the effects of harmonization are considerable. Nor is it clear that moving toward a "harmonized" level of protection would meet significantly less resistance than liberalization from producers who need, or who have become accustomed to, an above-average level of protection. However, as in the case of liberalization, the adjustment problems would be mitigated if two or more major trading partners (e.g. the U.S. and the EC) were to move simultaneously toward harmonization.

One reason for floating this idea may be that it suits the EC's agricultural trade policy. First, the use of the "subsidy equivalent" (or support margin) to measure levels of protection would treat all subsidies equally and would thus legitimize export subsidies. Second, the concept would be severely biased against the U.S. unless adjustments are made for the radically different trade effects of government payments--depending on whether they are subsidies directly stimulating production and/or exports, or income supplements not related to production or exports, or payments to induce farmers to idle part of their crop acreage or reduce their dairy herds. Third, "harmonization" would serve the long-standing EC desire to restrain the imports of protein feeds now admitted freely as a result of GATT bindings.

The U.S. response to a rearrangement of protection levels among EC agricultural products would have to depend on the specifics. The U.S. would probably be disadvantaged by a reduction of EC protection on beef and dairy products. It could benefit from lower protection on feed grains (including feed wheat) but if all that is offered is an increased co-responsibility levy on producers, or a two-price system, or incentive payments for land retirement, the effects would probably be too uncertain to justify giving up in return the valuable zero-duty bindings on oilseeds and gluten feed.

Harmonization of U.S. levels of protection would favor efficient foreign suppliers of dairy products and sugar, and efficient competing exporters of wheat, rice, and cotton. On the other hand, it would entail increased support for feed grains and soybeans which now receive little or no protection because they are competitive. The underlying thought is that encouragement of these products would make for a better use of American agricultural resources. However, "harmonization" is decidedly second-best to liberalization--both from the point of view of resource use and from that of reducing costs to consumers and taxpayers.

International Consultations on Domestic Policies

When everything else fails, it is usually possible to agree on a procedure for continuing "high level consultations" on changes in domestic agricultural policies. Thus an International Agriculture Consultation Council (the "Cathedral") was established in the Kennedy Round. Multilateral consultations have also taken place in the OECD and the U.S. has held regular bilateral consultations with the EC and Japan. Ideally, consultations should take place before changes in national policies are considered and certainly before they take effect. In practice, this has been difficult to accomplish, partly because governments are reluctant to show their hand and also because of the chaotic and unpredictable way in which national and EC policies are formulated and adopted. Nevertheless, institutionalized consultations have proven their worth if only because they force national policymakers to keep the international consequences of their actions in mind. In many instances, they have also helped to contain the escalation of trade conflicts.

Notes

[1]The dispute is over the compensation due the U.S. for agricultural trade likely to be lost; whether compensation must take the form of EC concessions on agricultural products; and the nature and timing of transitional arrangements adversely affecting U.S. agricultural exports to Spain and Portugal.

[2]An attempt to define the provisions on agricultural export subsidies more precisely, in the Subsidies Code negotiated in the Kennedy Round, did not succeed--although the Code did reaffirm the thrust of Article XVI.

[3]Includes fishery and forestry products as well as minerals.

[4]Tangermann, Stefan, "Putting Agriculture in GATT," American Enterprise Institute, May 1986.

[5]Tangermann, Stefan, "Guarantee Thresholds: A Device for Solving the CAP Surplus Problem?" European Review of Agricultural Economics, vol. II, 1984, pp. 159-168.

[6]Global quotas would give new suppliers a chance to bid.

[7]See Robert Z. Lawrence and Robert E. Litan, Saving Free Trade, Brookings, 1986.

[8]It can be shown, for example, that the replacement of beef import quotas by a duty-financed deficiency payments scheme in Japan would increase demand sufficiently to permit more than a doubling of imports without displacing domestic supplies or reducing returns to domestic producers. See Fred H. Sanderson, "Irritants in U.S.-Japanese Agricultural Relations," talk before the Japan Society, New York City, April 2, 1982. Based on an earlier analysis by Yujiro Hayami, "Trade Benefits to All: A Design of the Beef Import Liberalization in Japan," American Journal of Agricultural Economics, 61 (1979), pp. 342-47.

[9]U.S. International Trade Commission, Review of the Effectiveness of Trade Dispute Settlement under the GATT and the Tokyo Round Agreements, Washington, D.C., December 1985.

[10]Talbot, Ross B., The Chicken War, Iowa State University Press, Ames, Iowa, 1978.

[11]In practice, the system has received a subsidy from the EC budget in recent years. See Jasper Womach and Donna U. Vogt, An Explanation of the European Community's Sugar Regime and Comparison to the U.S. Sugar Program, Congressional Research Service, Washington, D.C., June 1, 1985.

[12]See, for example, the Economist's proposal, May 11, 1985.