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International Agricultural Trade
Research Consortium

Trade Update Notes

**Report of the Task Force on
The Comprehensive Proposals for
Negotiations in Agriculture***

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Executive Summary

The Uruguay Round of GATT negotiations has among its objectives the "greater liberalization of trade in agriculture" and the inclusion of domestic agricultural policies "under strengthened and more operationally effective GATT Rules and Disciplines." Negotiators have until December 1990 to fulfill this ambitious aim. The major participants have tabled their "comprehensive proposals" on the content of the negotiations. This report compares these proposals to see if common ground exists which would allow for a satisfactory outcome of the negotiations.

All the current proposals from the Cairns Group, the European Community, Japan, the Nordic Countries and the United States emphasize the need for an integrated package of measures. Such a package would address the issues of import access, export subsidies and restrictions, domestic subsidies that distort trade, and the differences in sanitary and phytosanitary regulations that act as trade impediments. To the US and the Cairns Group, such integration can best be achieved by ensuring that action is taken on each of these fronts. To the EC, balance is better left to domestic policy decisions, with international negotiations focussing on the overall level of support given by border and domestic measures. A reasonable compromise would suggest that specific policy instruments be disciplined within an overall objective of support reduction.

On import access, the main issues involve the proposal by the US, also favored by the Cairns Group, for conversion to tariffs of import barriers such as variable levies and quotas. The European Community has proposed a modified form of tariffication which would fix a part of the variable levy. Canada has suggested that quantitative import controls be kept if domestic production is also controlled. The EC wants to be allowed to increase some import barriers as a way of rebalancing its domestic markets, and Japan would like to exempt some import restrictions on food security grounds. Though agreement will be difficult in this area, a move toward tariffication could be an important step toward more market orientation in domestic policies.

The issue of export subsidies needs to be tackled if the Uruguay Round is to succeed. The US proposal is to phase all such subsidies out over a five-year period, while the Cairns Group would allow somewhat more time to remove such subsidies. The EC proposal does not mention explicit negotiations on export subsidy levels, preferring them to be reduced as support levels fall and as tariffs are cut. But they agree that the "same arrangements" as hold for import access barriers could be applied to exports. This opens up the possibility of a parallel move to limit both import levies and export subsidies if it proves impossible to remove such subsidies altogether.

The problem of domestic subsidies shows up the same differences in approach between the main protagonists. The US wishes to ban price-related ("red light") subsidies altogether while allowing trade-neutral ("green light") programs to continue. The Cairns Group would favor the same process of domestic policy reform which this would entail, but the EC argues for less restraints on domestic policy choice. The solution to this dilemma may be to agree on a list of policies that are less disruptive to trade and to encourage their use, at the same time negotiating down the level of support given by other policies--whether or not those policies could eventually be banned.

On the question of Sanitary and Phytosanitary Regulations considerable agreement has been reached on the need to strengthen GATT rules and procedures, to encourage the use of international standards, and to agree that "sound scientific evidence" should be used to avoid protectionist use of health regulations. Differences still exist on the best method of accomplishing this.

Countries are also broadly in accord on the need to allow developing countries more time to adopt such new obligations, and the EC proposes further assistance to countries that may be adversely effected by world price increases arising from liberalization. Though the details remain to be worked out, the issue of "special and differential treatment" for developing countries should not be a stumbling block.

More likely to remain an issue to the end is the "special" treatment that Japan seeks, to be allowed to preserve its range of policies on sensitive products on grounds that these involve "non-trade concerns." Along with the EC's desire to see "rebalancing" in its own oilseed and cereals market, this issue could best be handled by treating it as "sui generis", rather than building such exceptional treatment into the rules of the GATT.

The common ground is substantial, including the agreement by all major players to remove current waivers and exemptions; to reduce substantially the level of trade-distorting support; to move toward a form of tariffication on imports; to reduce if not remove export subsidies; to classify domestic subsidies so as to encourage the use of some and discourage others; to firm up rules dealing with health and safety standards; and to allow developing countries more time to meet these obligations.

A satisfactory outcome, built on this common ground, could include a reduction in support of at least the same level as that agreed for the tariff negotiations, achieved by a lowering of import barriers by that amount and a comparable reduction in export subsidies and in trade-distorting domestic subsidies. In addition to the reduction in support, a start would be made on the reinstrumentation of domestic and trade policies. This would include a move toward tariffication and the ultimate elimination of export subsidies, together with the shift of domestic policies toward the use of more decoupled instruments of support. Together with improvements in dispute settlement mechanisms and the clarification of GATT rules, such an agreement would contribute significantly to the success of the Uruguay Round and represent a major achievement in improving the conditions for agricultural trade.

The Comprehensive Proposals for Negotiations in Agriculture

I. Introduction

The Uruguay Round of GATT negotiations was launched in September 1986 with ambitious aims. Among these aims was the achievement of "greater liberalization of trade in agriculture" and the inclusion of domestic agricultural policies that directly or indirectly affect trade in agriculture "under strengthened and more operationally effective GATT rules and disciplines".¹ The negotiators were given four years to complete this and other tasks. By the end of 1987 initial proposals on the conduct of negotiations on agriculture had been tabled by the United States (US), the Cairns Group (CG), the European Community (EC), Japan, and the Nordic Countries.² These proposals were the subject of discussion and elaboration throughout 1988, leading up the Mid-Term Meeting in Montreal in December of that year. Agreement on the conduct of the negotiations for agriculture proved elusive at Montreal, but a compromise was found in April 1989, allowing negotiators to proceed.³ The remainder of 1989 was devoted to the preparation of "comprehensive proposals" by the major participants, in accordance with the timetable agreed in April. These comprehensive proposals will form the basis for the final phase of the negotiations during 1990. The Uruguay Round is scheduled for completion by December 1990, when the final package will be considered at a Ministerial meeting in Brussels.

The International Agricultural Trade Research Consortium (IATRC) has established study groups to report on and contribute to progress in the Uruguay Round talks on agricultural trade. Earlier IATRC reports covered the initial phases of the negotiations. This report considers the comprehensive proposals of the US, the EC, the Cairns Group, the Nordic Countries, and Japan, as they were presented at the end of 1989.⁴ The objective is to compare the proposals to see what common ground exists; to suggest, in the light of that comparison, compromise positions which might lead to an acceptable result; and to illustrate the scope for compromise by describing the major elements of a package of particular measures which might constitute a feasible and successful outcome to the agricultural component of the Uruguay Round negotiations.

A substantial amount of common ground exists among the major proposals. This common ground should be enough for a substantial outcome to the negotiations. However, the different presentational

¹ GATT Ministerial Declaration on the Uruguay Round, Sept. 1986.

² The initial proposals are to be found in: GATT, *United States Proposal for Negotiations on Agriculture*, July 1987; GATT, *Cairns Group Proposal to the Uruguay Round Negotiating Group on Agriculture*, October 1987; GATT, *European Communities Proposal for Multilateral Trade Negotiations on Agriculture*, October 1987; GATT, *Japanese Proposal for Negotiations on Agriculture*, December 1987; and GATT, *Proposal of the Nordic Countries to the Negotiating Group on Agriculture*, November 1987. In addition, Canada, though a member of the Cairns Group, tabled a paper "Canadian Views on the Negotiating Approach for Agriculture" in October 1987.

The Cairns Group includes Argentina, Australia, Brazil, Canada, Chile, Colombia, Hungary, Indonesia, Malaysia, New Zealand, the Philippines, Thailand, and Uruguay. The Nordic Countries comprise Finland, Iceland, Norway and Sweden.

³ GATT, *Mid-Term GATT Review*, April 1989.

⁴ The proposals are contained in the following papers: GATT, *Submission of the United States on Comprehensive Long-Term Agricultural Reform*, October 1989; GATT, *Global Proposal of the European Community on the Long-Term Objectives for the Multilateral Negotiation on Agricultural Questions*, December 1989; GATT, *Comprehensive Proposal for Long-Term Reform of Agricultural Trade*, Submission by the Cairns Group, November 1989; GATT, *Submission of the Nordic Countries on Some Elements in a Comprehensive Long-Term Agricultural Reform Program*, December 1989; and GATT, *Submission by Japan*, November 1989.

approaches and emphases taken by the major participants make this common ground less than obvious. The US, while stressing the need for an integrated package, divides the issues to be tackled into four categories: import access, export subsidies, domestic subsidies, and sanitary and phytosanitary regulations. This reflects in part the desire to achieve specific and visible "success" in removing trade barriers and improving the conditions in export markets. The Cairns Group uses a similar categorization of issues, again reflecting an export orientation. They insist that commitments to reduce trade-distorting support and protection be applied directly and uniformly to policies in each category. The EC, by contrast, is less keen on the notion of separate arrangements for import access and export subsidies, preferring to deal with these and domestic subsidies together under a general commitment to reduce support. This approach has the advantage to the EC of retaining more flexibility for governments to choose the mix of policy instruments.

These differences in large part reflect different means to the same end. An agreement to reduce overall support and protection will necessarily translate into changes in domestic subsidies, improved access for imports and restrictions on export subsidies. By the same token, agreement on improved import access and reduced domestic and export subsidies is bound to result in a reduction in the level of protection and support provided by national farm programs.⁵ It would be unfortunate if this presentational difference were to divert attention from the underlying concordance of purpose.

This report seeks to find and explore the issues on which agreement might be reached. It does not dwell on deep-seated philosophical differences on the proper role of government which some claim are at the root of trade problems in agriculture. While such differences clearly exist (within as well as between countries), they are unlikely to be resolved in international negotiations. Instead, the report starts from the premise that negotiators are trying in good faith to find a mutually acceptable solution to the problem of international rules for the conduct of agricultural trade.

The report begins with a discussion of the integrated approach to agricultural negotiations, followed by comparisons of the proposals in the areas of import access, export subsidies and domestic subsidies. This is followed by a discussion of three other areas of negotiation: the issue of trade-related aspects of sanitary and phytosanitary regulations; the question of special and differential treatment of developing countries; and the concern with "non-trade" aspects of national policies, particularly those involving environmental programs and food security. A further section looks at links with other parts of the negotiations. The report ends with a discussion of the common ground among the proposals. The major elements of a more specific package, intended to illustrate one possible outcome, is contained in Annex 1: Annex 2 contains an elaboration of the issue of modified tariffication.

II. Building an Integrated Package

As agreed at the Mid-Term Review, the objective of the negotiations is "to establish a fair and market-oriented agricultural trading system." This is to be achieved through commitments to reduce domestic subsidies that distort trade by encouraging import substitution or expansion of exports, by lowering frontier barriers that hinder or prevent imports, and by reducing subsidies to exports. Agreement has also been reached in the Mid-Term Review to negotiate effective GATT rules and

⁵ *In practical terms, the three-way categorization of the problem has already been agreed: the Mid-Term Review indicates that commitments should be negotiated to cover import access and both export and domestic subsidies. As a result, negotiations will continue to maintain these distinctions.*

disciplines which apply equally to all GATT members and commitments which encompass all internal and frontier measures that affect trade either directly or indirectly. In other words, the negotiated package must deal broadly with all countries, all policy instruments and all commodities if a substantial result is to emerge.

In presenting their proposals for such a comprehensive agricultural reform, the major negotiating countries have stressed the importance of integrating the various elements that are on the table. Although there are differences over how the integration is to be sustained in the negotiation, the intent to do so is clear. The United States calls for reform in four areas, import access, export subsidies, domestic subsidies, and sanitary and phytosanitary regulations, which "should be viewed as integral parts of a comprehensive package." The Cairns Group advocates a reform process that is "comprehensive, integrated and equitable," and mentions the same areas as does the US. Conceptually, the European Community goes farthest in achieving this integration by proposing that commitments to reduce support and protection be made in terms of an aggregate measure of support (AMS). All policy instruments are covered because they are all included in the AMS. But the inclusiveness of the AMS also allows flexibility by governments in the use of policy instruments, and hence could lead to a solution where certain aspects of domestic and trade policy were not affected.

If the AMS is to serve as an integrating device, it may need to be supplemented by other commitments. Both the EC and Cairns Group envisage an AMS, either as part of a formal commitment or as a target and means of monitoring progress towards it.⁶ However, the Cairns Group, because they wish to ensure that the overall commitment to changes in agricultural policies and trade arrangements are tangible, verifiable and legally binding, prefer the overall commitment to be expressed in terms of changes to specific policies. Hence, key commitments will need to be provided in specific policy terms and be subject to remedial actions to give governments the confidence to enter into meaningful concessions.

The possibility of a substantial outcome from the negotiations will be enhanced if some form of aggregate commitments to reduce support and protection by an agreed amount could be agreed at the outset. The first area of agreement should be the form and extent of commitments to substantially and progressively reduce support and protection. Here the EC approach is the more explicit and could serve as an acceptable starting point. For example, agreement could be reached on AMS reductions of a certain magnitude over a five-year period on condition that a number of key commitments are expressed in terms of specific policy changes, tariffs or rules. The commitments could be reviewed mid-way through the transition period and possibly adjusted on the basis of negotiation provided the key commitments are sustained. This would establish target reductions to be pursued in negotiating access barriers, export competition and internal subsidies that affect trade. It should ensure that all significant trade-distorting policies are reduced and all major commodities entering world trade are covered. Farm support programs that have little impact on trade could, of course, be continued and less trade-distorting policies could be introduced.

An integrated package of significant agricultural policy reforms is much more likely to emerge from the negotiations if it is based on an across-the-board commitment to reduce support and protection by an agreed amount over a negotiated period. All agricultural waivers, derogations and country-specific exceptions would need to be included, as would any policies affecting trade that are not specifically

⁶ The US proposal, which envisages a much more limited role for an AMS, is not specific on how to achieve the overall integration that is called for in its proposal.

provided for in GATT. This comprehensive coverage would ensure that reductions apply to the more sensitive sectors of all countries' agricultural and trade policies, a necessary condition if a substantial result is to emerge from the negotiations. Commitments in terms of an AMS provide a framework for negotiating the individual parts of the final result, for verifying compliance with the obligation assumed, and provide the basis for monitoring policy developments in the future.

III. Import Access

Providing improved and assured access to import markets for efficient suppliers of goods and services is the quintessential objective of the GATT. The improvement of import access for agricultural goods entering world trade by changing the level and form of border protection is a central focus of the GATT negotiations on agriculture in the Uruguay Round. However, greater access for imports is not only important for exporting countries, it also provides a means of reflecting international market conditions to producers and consumers in importing countries. Moderation of the effects of surplus and scarcity is facilitated by encouraging internal adjustments to global market developments.

Most barriers to access are put in place to protect and improve farm incomes. Border protection results in higher prices to consumers, greater domestic production, lower consumption and, of course, reduced imports. It is clear that improving import access not only involves the lowering of restrictions at the border but also a reduction in the level of trade-distorting farm and agro-industry subsidies that reduce trade by fostering import substitution. This interrelationship between import barriers and internal farm support programs convinced governments that agricultural negotiations in the Uruguay Round must be concerned with both border measures and internal programs. Hence, the proposals on domestic subsidies are also an integral part of the issue of improving import access.

Import Access in the Comprehensive Proposals

The United States has adopted the most direct approach to improving access. It proposes that all non-tariff import barriers (NTBs) be converted to bound tariffs and that these, together with existing tariffs, be reduced over ten years to zero or low levels. For the transition period, NTBs could be replaced with tariff-rate quotas (with lower or zero tariffs for within-quota imports), and these quotas would be gradually expanded as the over-quota tariffs decline. A safeguard mechanism against import surges is also proposed during the transition. Since it would be made redundant by tariffication, the US would eliminate the exceptional treatment accorded agriculture under Article XI:2 (c) that allows for quantitative restrictions to protect effective supply management systems.

The objectives of the comprehensive proposal of the Cairns Group of exporting countries are similar to those of the US. They "favor"⁷ the conversion of most NTBs to tariffs as part of an integrated process of reform. Specific commitments relating to policies and products are advocated to reduce access barriers (in parallel with reductions in internal farm supports and export subsidies). The Cairns Group countries support the use of global tariff quotas where necessary. Their objective is to reduce protection against competitive imports substantially and to integrate fully trade in agricultural products into the GATT system. In anticipation of the EC request for "rebalancing" protection they add that there should

⁷ This ambiguous word was deliberately chosen to accommodate the desire of Canada to retain import quotas in support of its supply management programs.

be "no scope for raising the protection levels for any product except under carefully circumscribed safeguard provisions."

In contrast, the EC approach to the long-term objective of a "more market oriented agricultural trading system" is progressively to reduce protection "to the extent necessary" to restore balance. The reductions, to be expressed as support measurement units (SMUs), would encompass "all measures which have a real impact on the production decisions of farmers." As these commitments to reduce protection would cover all frontier measures, such as quotas and variable levies, import access would be improved. Under the EC proposal the program of reductions is to be reviewed during the fourth year to determine the extent and rate for continuing reductions.

The Community is willing to include a modified version of tariffication in the rules applying to access provided agricultural support and protection are dealt with together and inconsistencies between policies and sectors within agriculture can be resolved through rebalancing. Since the EC also recognizes that domestic subsidies (such as deficiency payments) result in import substitution, it insists that a parallel treatment of domestic subsidies must accompany the conversion of import quotas, variable import levies and the activities of state trading agencies into tariffs. However, the Community favors the retention of Article XI 2(c) of the GATT, possibly in anticipation of the need to retain the right to restrict imports if the Common Agricultural Policy were to make greater use of supply controls.

The approach of the Nordic countries is broadly consistent with the EC proposal, calling for gradual reduction in agricultural support "as a catalyst for improved world markets." They also advocate use of an aggregate measure of support to guide the reform process with commitments expressed as specific policy changes. They give some support to tariffication, arguing that border protection should be lowered and quantitative restrictions converted to other mechanisms such as tariffs. The Nordic countries also support the use of safeguard mechanisms to avoid endangering "essential policy goals." They envisage a continuation of variable levies but under stronger disciplines that reduce the gap between domestic and world prices.

Japan's basic position on import access stresses the importance of negotiating strong trade rules, but argues that such rules should take into account the special nature of agriculture and non-trade concerns, particularly food security. In particular, it is proposed that border restraints taken for food security reasons be allowed. Japan agrees that all barriers to access should be subject to precise and consistently applied rules and disciplines, and proposes the treatment of agriculture under Article XI:2(c) should be clarified. However, most of Japan's proposals would permit greater use of import restrictions and considerable flexibility to maintain domestic subsidies, regardless of their effects on efficient exporters' access to the importers' markets.

A number of developing importing countries have expressed views relating to food security similar to those expressed by Japan. In addition, many of them have stressed the principle of differential and more favorable treatment for developing countries in the policy reform process, including the need for longer transition periods, lower cuts in barriers to access, and greater flexibility in the conduct of national agricultural policies. The net food importing developing countries are seeking assistance through both trade and non-trade means to strengthen their food situations and their rural economies, and some of the policies they favor would tend to limit access to their markets.

Differences and Similarities

The main differences between the approach on import competition taken by the United States and the Cairns Group countries on one hand and Japan (and many developing countries) on the other is the extent to which the international market should be allowed to influence imports and determine internal agricultural prices decisions. The European Community openly questions the acceptability of world market signals and free trade in agricultural products as a basis for determining agricultural activity, but it acknowledges that government intervention has resulted in distortions in production and trade that must be corrected. The Community advocates that the process of reform be implemented gradually and carried only to the point of re-establishing balanced markets and a more market-oriented agricultural trading system.

The United States and the Cairns Group countries are apparently ready to allow international market signals to exercise the principal influence on the structures and operations of agricultural industries subject only to low levels of tariffs and the availability of contingent protection against import surges, trade-distorting production and export subsidies and dumping. These countries assert that income support, if provided, should not influence production or trade. There are some conditions attached to the support of these exporting countries for relatively free trade in agriculture, but their positions reflect an underlying confidence that their own agricultural sectors are capable of competing successfully in international markets.⁸

The European countries are willing to allow world market forces to exert a greater influence over their agricultural production and trade, but they insist on the right to protect their farmers from all-out competition and wish to retain mechanisms that would buffer national prices against at least some of the variability of world prices and currency movements. They foresee a continuing, albeit restricted and contingent, role for quantitative border controls. Japan and the food-deficit developing countries want to operate border protection for food security, rural development, and farm income support purposes. Thus, an accommodation must be found if the key negotiations on import access are to succeed.

Possible Compromise

The US and CG proposal to convert all NTBs to tariffs and reduce them would result in a major improvement in import access for agriculture. The conversion will be difficult to achieve because border controls (import quotas, variable levies, state trading) are an integral part of the administrative policy arrangements for farm products followed by many countries. A movement to tariffs precludes national price fixing unless extensive use is made of deficiency payments—a development with little appeal to Ministers of Finance. The challenge of tariffication to traditional price setting is common to most of the EC commodity market regimes, to Japan's system of parastatal purchasing, to Canada's administered pricing systems for milk and poultry products, and to the arrangements in the United States for setting support prices for milk and sugar. Even where specific product prices are not set, tariffs do not provide the absolute protection afforded by import quotas and minimum import prices, or by the import licensing, procurement and pricing practices of parastatal trading agencies. In this regard, the fact that the

⁸ Even some exporting countries desire to retain exceptional treatment for parts of their agriculture. The developing country exporters want open access to the markets of industrial countries but wish to retain the flexibility to limit imports to develop their own food and agricultural industries. Canada is seeking a continuation of the right to impose quantitative restrictions consistent with a clarified Article XI:2(c) in support of effective supply management programs.

Community has offered to tariffy partially its variable import levies is particularly significant. It offers a way of providing improved access to import markets and in "recoupling" domestic and international prices for farm and food products. It means, among other things, that the negotiations on import access can avoid market sharing through politically determined minimum access agreements.

Though the Community is not prepared to accept the full conversion of variable import levies to fixed tariffs, their partial conversion would be an important step in that direction. From this perspective, negotiations on the matter of tariffication need no longer be concerned with principles, but they can now move to details.

Essentially what needs to be negotiated now is the extent to which changes in Community variable import levies are to be tariffied. Panel a. of Figure 1 shows one possible option. Currently, under the EC's variable levy system, the entire amount of any decline in an exporter's price (the lowest offer price on the world market) is offset by an increase in the variable levy. The proportion of this price change offset by a change in variable levies could be negotiated and bound in GATT: this would constitute a modified tariffication of variable import levies. As show in Figure 1, in the first year of a transition period, 90 percent of the price decline is offset by an increase in the variable levy, 80 percent in year 2, 70 percent in year 3 etc. thus gradually approaching a fixed tariff.⁹ In this way, producers and consumers in the Community are initially spared some of the variation in world prices but would face increasingly market-oriented price signals over the course of some transition period. The present position of the United States (and the Cairns Group) is for the full amount of the price decline to be reflected in the Community's internal prices.

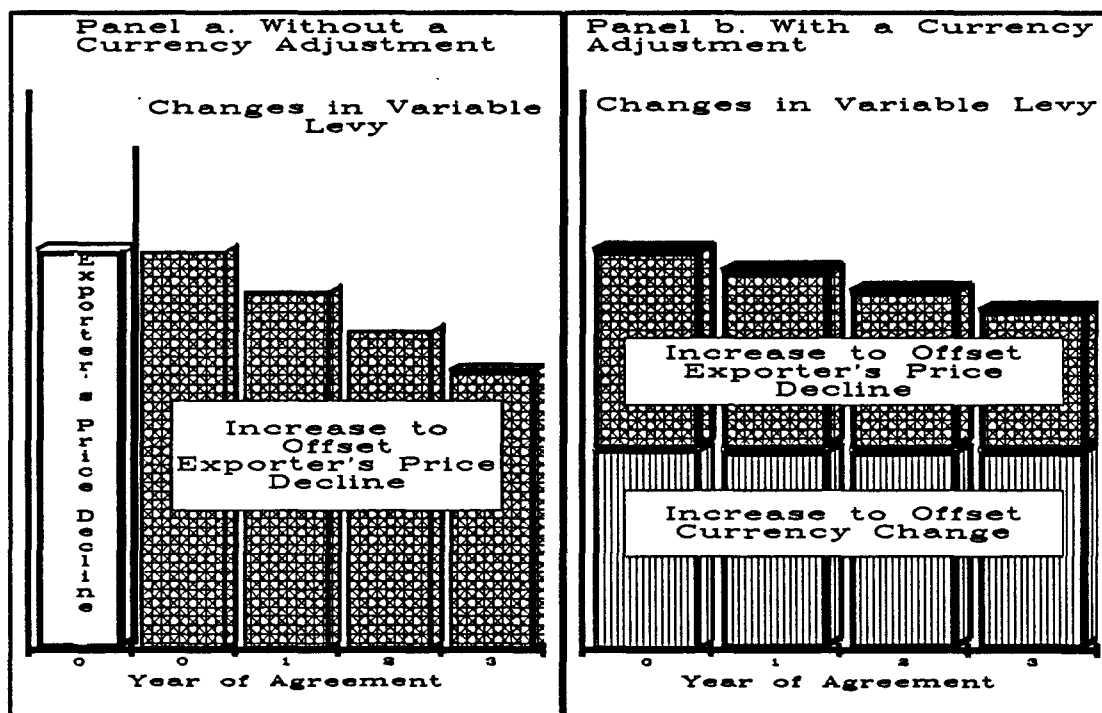


Figure 1. Modified Tariffication of Variable Levies.

⁹ A formal approach to this process is presented in Annex 2.

The limitation on the offset need not be symmetric, adjusting differently to price increases than to decline, nor continuous in that the 'correction factor' could be triggered by large variations but be unchanged for small variations.

The variation in the value of the dollar buffeted the Community in the 1980s, and so it is keen to protect producers and consumers from future variations in exchange rates. The EC's proposal indicates that world price changes arising from exchange rate changes should be treated differently from that arising from other factors. The decline in the world price can be effectively divided into two parts: that due to the decline in the price measured in its currency; and that due to a change in the value of its currency relative to those of the Community. This is shown in Panel b. of Figure 1. Currently, the variable import levy will increase to fully offset both effects. The EC approach of modified tariffication would require that a 'corrective factor' offset, partially or fully, the impact of currency value changes. The offset for a currency value change could be negotiated and bound in GATT. In Panel b. of Figure 1, the increase in the variable import levy offsets the full amount of the price decline due to the currency value change and 90 percent of the decline in the exporter's price in the first year of an agreement. In year 2, it would offset 80 percent of a decline in an exporter's price, etc.

The reform package on import access would have to include the phasing out of all waivers, derogations and country specific exceptions. In addition, to be acceptable as a basis for removing border restrictions or converting NTBs into tariffs, all restrictions not covered by GATT such as variable levies, minimum import prices, and voluntary export restraints would have to be subject to GATT disciplines.

The question of rebalancing protection levels may be negotiable in the context of commitments on AMS-based reductions in border restraints and internal subsidies and the conversion of some of these measures to tariff-equivalent forms. Although increases in presently-bound rates of duty are likely to be strongly opposed by most countries, there may be scope for negotiating tariff quotas to be phased out over a transition period.

The role of Article XI:2(c) will depend significantly on the extent of agreement reached on overall reductions in protection, tariffication and rebalancing. However, based on the latest submissions, a role is envisaged by all countries except the US for Article XI:2(c) at least throughout the transition period. There is a need to clarify the conditions for its use, for example by giving objective precision to such terms as "like products" and "processed form" in relation to the application of quantitative import restraints. But it is difficult to foresee a widening of the exception, such as would be enough to meet Japan's proposals or Canada's supply managed groups' desires. On the contrary, to be consistent with the objectives of the negotiation, and possible compromises contemplated, the exception for agriculture in Article XI:2(c) should be narrowed rather than broadened.¹⁰ The importance and sensitivity of food security to several countries and the existence of supply controls in others may warrant exceptional treatment, but this should not weaken the overall reform package or the fundamental objectives of the GATT system, which *inter alia*, requires that efficient exporters have improving opportunities to satisfy consumer's demands in import markets.

¹⁰ The disciplines applying to export restraints which are contained in this Article should be strengthened as advocated by Japan.

IV. Export Subsidies

The issue of export subsidies is among the most urgent of the tasks to be addressed by the negotiators. In the light of the major disruptions to agricultural trade in the 1980s arising from the use of export subsidies, effective action in this area is imperative. Indeed, an agreement to reduce, to limit, and to discipline export subsidies—and better yet to eliminate them entirely—could be the most significant result for agriculture in the Uruguay Round. An agreement would confer multiple benefits. It would force subsidizing exporters to modify their farm support programs. The frictions between the EC and the US in their grain trade would be reduced. A re-run into the 1990s of the costly competitive subsidy wars of the 1980s would be avoided. The economic damage done to the grain exporting members of the Cairns Group would be eliminated. The dairy and beef exports of Australia and New Zealand, the beef exports of Latin America, and the sugar exports of Australia and many developing countries would be less harmed by the aids to exports of dairy products, beef and sugar provided by the EC. More generally, importing countries would lose a much-used excuse for shielding their producers from international competition.

Export Subsidies in the Comprehensive Proposals

Though there is general agreement on the problem, the question as to how to control export subsidies is still on the table. The choice is essentially between direct and indirect measures to address the issue. Both the US and the Cairns Group propose a complete prohibition of export subsidies after some phase-out period. The US proposal suggests a phase-out period of five years, while the Cairns Group envisages a period of "ten years or less." The EC does not envisage a ban on the use of export subsidies but agrees that there is a need to lower the level and discipline their use. Japan favors the eventual elimination of export subsidies, and the Nordic countries advocate the same approach for these subsidies.

Both the US and the Cairns Group proposals suggest a binding of upper limits of export subsidies during the phase-out period. The US suggests a binding of the total money value of subsidies or of the quantities of subsidized exports. The Cairns Group countries want to bind and reduce both the total value of national expenditure and the unit value of export subsidies, and, though this is not spelled out in their proposal, the probable intention is that the more binding of these two constraints would have to be applied at any point in time.

The bound level of export subsidies would be gradually reduced during the phase-out period, though both proposals are unclear about the exact mode of reduction. The Cairns Group speaks of a "progressive" phase-out which, taken literally, could mean a reduction by a higher percentage in each successive year of the phase-out period. The US proposal does not specify any particular mode of reduction.

The Cairns Group and EC proposals on the use of an AMS could indirectly limit and reduce the use of export subsidies, since agreed reductions of AMS and consequent commitments to cut domestic support prices would impose limits on the amount of output available for export and the rate of subsidization. However, the explicit provisions regarding export subsidies in the Cairns Group proposal are intended to be more direct and more readily handled as contractually binding agreements than such indirect restrictions.

The EC proposal relies mainly on AMS reductions on overall support to reduce export subsidization. Possibly for this reason, the EC proposal is extremely short as far as explicit provisions

regarding export subsidies are concerned. When speaking of reductions in protection and tariffication, the proposal adds, cryptically, that "the same arrangement would apply to exports, the amount granted to exports could not exceed that levied on imports." It is not clear which of the two parts of this statement contains the policy change. If it is the second part, then no new and separate discipline on export subsidies is envisaged in the EC proposal. A binding and reduction of import barriers would de facto impose some discipline on export subsidies as well,¹¹ simply because arbitrage would be triggered if export subsidies exceeded import tariffs. The EC proposal would merely codify this de facto limit. Hence, this interpretation of the EC proposal would mean that there would be no new explicit commitments regarding export subsidies, but that governments would be compelled to reduce export subsidies as tariffs were progressively reduced. This is unlikely to be acceptable to the US and CG for which explicit commitments on export subsidies are a *sine qua non* for a successful negotiation.

In this regard, an alternative and more interesting interpretation of the EC proposal would be that the first part of the statement specifies the policy change. This suggests the establishment of explicit commitments for export subsidies, such that the same basic procedure suggested by the EC for import tariffs ("modified tariffication") would be applied to export subsidies. This would mean that there would be partial bindings on export subsidies per unit, where the permissible export subsidy would have a "fixed component" and a "corrective factor" to buffer some fraction of the effects of world commodity market and exchange rate changes much like the approach to tariffs outlined above. Indeed, the EC should not find it difficult to accept such a discipline on export subsidies once it had agreed to "modified tariffication" on the import side.

One issue has always created problems for a "rules" approach to export subsidies. It is not easy to define what constitutes such a subsidy. Only the US proposal contains an explicit definition of export subsidies. This is in the form of the Illustrative List of Export Subsidies contained in the Tokyo Round Subsidies-Countervail Code which is annexed to the US proposal. The Cairns Group proposal only says that "the subsidy practices involved will need to be clearly identified and defined." The EC proposal is silent on the definition of export subsidies.

Both the United States and the Cairns Group proposals recognize the difficulties involved in distinguishing between subsidized exports and food aid. The Cairns Group suggestion to overcome these difficulties is to propose that all food aid should be provided on a grant basis. The US proposal is less restrictive and only speaks of "new rules (which) may need to be developed to govern the granting of food aid." The EC proposal, in its section on special and differential treatment, explicitly favors food aid "not only in the form of donations, but also in the form of concessional sales with an important grant element."

None of the proposals deals with export subsidies for processed products. The EC proposal, in its section on the SMU, mentions vaguely that "processed products should also be covered," but provides no suggestions as to how this could be done. The US proposal, however, deals with differential export taxes on raw materials and their processed derivatives which favor the domestic processing industry, and it proposes that export taxes should be uniform along the processing chain.¹²

¹¹ Differentiated (targeted) export subsidies can exceed the level of import tariffs by the cost of transportation to and from the target country.

¹² This suggestion may overlook the fact that even with uniform tariffs or taxes along a processing chain there is protection of the value added in processing, equal to the tariff or tax rate.

The central difference between the proposals is of course the issue of whether or not export subsidies should be completely eliminated, and of how to restrict the level of subsidies until they are eventually eliminated. It may look as if the different negotiating positions are too far apart for a compromise to be found. However, it is useful to disregard the polemics of the debate and to concentrate on details of the alternative proposals. The two views may be capable of reconciliation.

Disciplining variable export subsidies could be accomplished in the same manner as that described above for variable import subsidies. Currently, variable export subsidies fully offset a decline in border prices as illustrated in Figure 1. This offset could be limited to some fixed proportion and this proportion be reduced through time. In this way, as was the case for variable import levies, after some adjustment period variable export subsidies would be reduced and approach a fixed export subsidy.

From this point of view the compromise could come in the form of finding parameter values which would determine the extent to which world market price reductions can be reflected in subsidy increases. At the same time, an agreement would be needed regarding the base level of the fixed component, i.e. $F(0)$, and concerning the reference level of world market prices and exchange rates. In all these cases, average values of a base period, say 1986 to 1988, could be chosen.

Another element of the compromise could be that subsidy limits could be agreed on the basis of such formulae for an initial period of, say, five years with meetings held after that period in order to reconsider and possibly revise the adjustment formulae.

Possible Compromise

On the matter of the definition of export subsidy practices, a compromise should not be too difficult to find. The notion of an Illustrative List is certainly a good starting point, but it may have to be extended by adding the commonly used aids intended to promote agricultural exports. The distinction between food aid and subsidized exports may cause problems. It is not certain that the commercial imports of food aid recipient countries would be unaffected if all food aid were provided on a grant basis. One may have to live with a continued negotiating and monitoring process such as that provided by the FAO Sub-Committee on Surplus Disposal, where behavior is constrained partly by written rules but also by the dangers to each country of others emulating its own dubious export practices and behavior. Agreement could probably be reached that export subsidies on processed products could not exceed the permitted level (if any) of the export assistance that could have been legally provided to the raw products they contain.

V. Domestic Subsidies

Domestic Subsidies in the Comprehensive Proposals

All four proposals define the objectives of the negotiations on domestic subsidies within the framework of the 1989 Geneva Accord insofar as they reaffirm their willingness, *inter alia*, to make "substantial and progressive reductions" in those elements of their domestic subsidies to agriculture that are deemed to distort trade. The most notable differences lie in the interpretation of the "reach" and the way in which to operationalize the obligation.

The US has the most ambitious goal in calling for the complete elimination after a 10-year phase-out period of most of the commonly-used instruments of farm price and income support. The US sees

only a minor role for an AMS, relying instead on rules to categorize policy instruments and specify policy constraints to phase out illegal instruments and to reduce the trade effects and discipline the use of other policy measures. The Cairns Group proposal is marginally less ambitious in that it is less prohibitory. It calls for a reform process that would reduce the level of support provided by trade-affecting domestic policy instruments by an unspecified amount over a period of 10 years or less. However, the Cairns Group proposal is operationally far-reaching insofar as it places primary reliance on specific policy commitments. The EC proposal is more conservative in that the Community reaffirms its intention to continue product-price-centered farm income supports and to retain its dual pricing system. Moreover, though it agrees that support levels should be reduced, the Community seeks only to reduce the trade effects of products in surplus and to the extent necessary to restore market balance and responsiveness. The Japanese proposal contains little of a specific nature about domestic subsidies beyond emphasizing the need for the international community to recognize and to accept the larger purposes of subsidies to agriculture, including, but not confined to, the goal of balancing food security by maintaining desired levels of self-sufficiency.

Differences and Similarities

While there is general agreement that the trade effects of a subsidy are influenced by its level as well as its method of operation, all four proposals acknowledge that concrete progress can be made by categorizing farm program instruments and ranking them according to their anticipated trade effects. The US and the Cairns Group have proposed that subsidies be classified on a traffic light system: "red" for prohibited, "amber" for permitted but disciplined; and "green" for permitted. The degree of specificity varies, but there is substantial agreement that there is a large number of programs that do not distort trade, or have effects that are well within any reasonable *de minimus* standard. For these policies, international commitments are unnecessary. These "green light" policies include the provision of public goods, environment and conservation expenditures, disaster relief, food aid, resource retirement, adjustment assistance, and fully decoupled income payments. There is agreement that these permitted policies would have to be clearly defined and tightly circumscribed. There is also broad agreement on which are the policies that most distort trade. These "red light" policies would include administrative pricing arrangements that raise producer prices above competitive levels, by market price supports and deficiency payments, other fully coupled income supports, and subsidies to transport, investments and other inputs that are not generally available to other sectors. These are the policies which would attract binding obligations. However, whereas the U.S. proposes and some Cairns Group countries would prefer their phasing out, the Cairns Group as a whole, the EC and Japan foresee only substantial and progressive reductions in support levels and surer GATT disciplines on their use.

All proposals envision a formula approach to a negotiated reduction in support. However, the U.S. subordinates a formula approach to the phasing-out of prohibited instruments under bound commodity and program-specific commitments. Formula cuts using an AMS are confined in the U.S. proposal to the obligations assumed for "permitted but disciplined" (amber light) programs. The Cairns Group envisions an AMS being used to measure the initial level of protection, to express the overall target reduction in support, and to monitor progress. However, the CG also proposes that obligations to reduce domestic subsidization be in the form of specified adjustments to the prices, quantity and expenditure parameters of commodity-specific programs. The EC wants support cuts to be expressed in terms of an overall obligation, to reduce a SMU, but with the depth and rhythm of cuts to vary with commodities and market conditions. Japan proposes only that obligations on support reductions be expressed in terms of some AMS and suggest the exclusion of programs that subsidize commodities in which self-sufficiency is low.

The attitude to specific policy commitments in the various proposals is the flip-side of their attitude to formula cuts. Specific policy commitments hold fewer attractions for the EC and Japan, whereas the U.S. and the Cairns Group place major reliance on them as the means of giving verifiable substance to overall commitments. In the case of both the U.S. and the Cairns Group, the phase-out of prohibited programs and the reduction in the support levels provided by programs to be disciplined would involve commodity-specific plans for changing administered prices, supported output levels and budgetary expenditures.

There are no specific proposals on the table on the depth of cut to domestic subsidies or on the time-frame, except that the U.S. proposal for prohibiting most of the commonly-used methods of farm income support envisions their complete elimination (zero) over a ten-year period. No target reduction in the support provided by "permitted but disciplined" programs is identified in the U.S. proposal. The Cairns Group envisages a reform process of unspecified dimensions taking place over 10 years or less. The EC proposes that the initial commitments be for five years with further commitments -- if needed -- being established by a review in the fourth year.

The major players all envision that rules changes will be made where appropriate to give legal form to the agreements to reduce the support provided by the domestic subsidies that cause trade distortions. This would entail some unspecified mix of changes to the articles of the General Agreement and to the Subsidies-Countervail Code; the elaboration or addition of interpretative notes to these; or even the adoption of a special agreement on agriculture. The measurement of the proxy indicator of the trade distortions produced by domestic subsidies (the AMS), the agreed cut and time-frame, and the detailed criteria that would characterize and circumscribe the three categories of program instruments would also have to be specified in agreed and legally binding texts. If the route of specific policy commitments on domestic subsidies was taken, then these too would have to be detailed in binding schedules, both to allow monitoring of progress and to discipline countervailing actions.

Notable Omissions

A number of matters pertaining to domestic subsidies are not addressed directly in the proposals. These could be important elements in the subsidy component of the negotiations, in the success of an overall agricultural accord, and to individual countries. Three of these matters are identified here.

First, the linkage between an agreement on agricultural subsidies and the work of the group renegotiating the Subsidies-Countervail Code could be important. Both of these negotiating groups appear to be using a "traffic light" approach to the categorization of subsidies and it is necessary for the general criteria used in each group be coincident, not least because the identification of trade-distorting subsidies has implications both for obligations to change policies or program parameters in a multilateral agricultural accord and for the use of countervail duties in bilateral trade relations.

Second, it is imperative that early agreement be reached on the attributes of policies that cause them to be categorized as non-trade distorting and so permitted, or partially or nonequivocally trade distorting and so to be subjected to negotiated reduction or elimination and prohibition after some phase-out period.¹³

¹³ For a full discussion of these attributes of domestic policies see the IATRC papers on "Designing Acceptable Policies" and "Reinstrumentation of Agricultural Policies."

Third, the various proposals are silent or guarded on the policy instruments which are now in use in some countries and which could become more important in the future. These include both safety nets and supply controls. The status of the first is important because while governments may agree to reduce the degree of subsidization of their farmers, they are likely to want to retain the right to share with farmers the down-side risks of markets and to alleviate the dysfunctional instability that is characteristic of agricultural markets (albeit that instabilities will be reduced by agricultural trade liberalization). The trade effects of supply controls will also have to be addressed: countries that use them want "credits" in the negotiation; their incorporation into AMS variants remains a contentious issue; and decisions will have to be made about whether AMS-based reductions will apply to the administered prices that are implemented by supply management techniques. Also, there is a direct connection between the status of supply controls and changes to national import regimes, the tariffication of NTBs, and the future of Article XI; 2(c) of the General Agreement.

Possible Compromise

There is an important area of agreement among the negotiating countries that many types of government programs are non-trade distorting and not therefore subject to constraints. Also, there is a mounting interest in reinstrumenting policies with price and income support and stabilization objectives so as to decouple them from specific commodities, limit them to maximum quantities of output, adapt them so that at the margin production and consumption are guided by competitive prices, and even to replace them with programs that correct for farm income inadequacies directly. The negotiators provide incentives for national farm policies to be channelled more surely in such directions. Beyond that all agree that the support provided to farmers through programs that have trade effects by changing production, marketing and consumption decisions should be subjected to a formula-based cut. Assuming early agreement can be reached on the list of programs that distort trade, the crucial negotiating step is to agree on the depth of cut and time frame.

Thereafter, negotiations will have to lead to agreements on the other subsidy issues which are in dispute. One of these is whether any domestic assistance programs should be phased out entirely: It could well be that while some border measures will be prohibited, no domestic subsidies will be outlawed. A second matter for decision is the nature of the AMS used for scaling down domestic programs. The SMU proposed by the EC has much merit, but raises issues of credit for supply control and the choice of reference period that still require agreement. A third area—the role of specific policy commitments—presents considerable difficulties. At one extreme, giving countries the flexibility to choose how they would meet an overall commitment to reduce support by an amount expressed in the SMU runs the danger that genuine reforms in sensitive areas will be avoided. On the other hand, to seek agreement on finely-detailed schedules of farm program changes runs the risk of bogging the negotiations down in requests and offers and imposing potentially unacceptable constraints on national authorities. A compromise might be found in negotiating partners being required to indicate how they would propose to meet these objections only in respect of the (dozen or so) most distortive policies for major commodities and countries. A further area for negotiated resolution is whether support should be cut by a uniform percentage or by proportions that vary directly with their base-levels, and whether a support ceiling should be imposed. At this juncture it appears that the negotiators may have to be satisfied with an initial agreement to cut domestic subsidy support by a uniform percentage amount, overall and for all commodities, rather than open the "pandora's box" of differentiated support cuts.

VI. Phytosanitary and Sanitary Regulations (PSR)

Negotiations on improving the operation of sanitary and phytosanitary regulations as they impact on agricultural trade are an integral part of each of the comprehensive proposals. At the Mid-Term Review, ministers endorsed the long-term goal of "harmonization of national regulations" and adopted a work program for the rest of the negotiations which would:¹⁴

- (1) "develop harmonization . . . on the basis of appropriate standards established by relevant international organizations . . . ;"
- (2) "strengthen Article XX so that measures taken . . . are consistent with sound scientific evidence and use principles of equivalency;"
- (3) "review existing notification and counter-notification procedures to ensure . . . the existence of an effective notification process . . . ;"
- (4) "develop a consultative process which would ensure transparency and allow for bilateral resolution of disputes;"
- (5) improve the effectiveness of multilateral dispute settlement processes . . . to provide the necessary input of scientific expertise and judgement . . . ;"
- (6) "assess the possible effects on developing countries . . . ;"

There is, in general, much less disagreement on the steps to be taken to improve GATT rules in this area than in those of import access and subsidies. Nevertheless, important issues have to be resolved. One of these concerns the best way to achieve the "harmonization" called for in the Mid-Term Agreement. Two alternative approaches have been proposed for the harmonization of national regulations. These are summarized in the table below.

TABLE 1. Approaches to Harmonization of Sanitary and Phytosanitary Regulations.

Approach	Negotiations
Harmonization through conformity of national standards	Negotiation of procedures and processes to identify GATT-conforming standards for product characteristics and for production and processing methods (PPM), and the determination of conformity of national regulations with those standards. In this case, regulations would be judged to conform with Article XX. Existing international standards, and the scientific expertise of international organizations, would contribute to the identification of conforming standards and of the conformity of national regulations.
Recognition of the equivalence of different regulations	Negotiation of procedures and processes to determine the equivalence of alternative regulations for product characteristics and PPM. Existing international standards, and the scientific expertise of international organizations would contribute to the determination of equivalence of alternative regulations.

¹⁴ GATT Mid-Term Review Agreement, April 1989.

Conformity insures national treatment (i.e. that imports receive the same treatment as domestic production) on the basis of conformity with internationally-recognized standards. Equivalence allows national treatment on the basis of a comparison of national regulations in the importing and exporting nations. In either framework, GATT rules and disciplines must be strengthened, and a dispute settlement process must be developed.¹⁵

Differences and Similarities

The main issues on which the proposals concentrate include the modification to Article XX of the GATT, that covers general exceptions to the GATT rules, including Sanitary and Phytosanitary Regulations; the process for notification and consultation; the arrangements for dispute settlement; and the form of any strengthened GATT rules in this area. There is substantial agreement that Article XX must be strengthened. It would seem that at a minimum, Article XX could be amended to require nations to participate fully in international standards organizations. Countries could agree to utilize existing international standards in formulating national regulations and to recognize those organizations as the principle source of scientific and technical expertise in international trade disputes. Countries could be asked to accept that conformity or equivalence must be based on sound scientific evidence. In this regard, the United States has proposed that Article XX(b) be amended to provide that:

"nothing in the agreement shall be construed to prevent the adoption or enforcement by any Contracting Party of measures necessary to protect human, animal or plant, life or health, provided that these measures are consistent with sound scientific evidence and recognize the principle of equivalency."¹⁶

The European Community has proposed almost identical rights and obligations, although in less definitive and formal language.¹⁷ The Japanese proposal is generally supportive of other proposals, but stops short of a change in Article XX. The amendment of Article XX must, of course, be supported by the strengthening of other GATT instruments to address the issues of notification and dispute settlement. All proposals have drawn heavily from the Standards Code in the area of notification and counter-notification. The EC proposal calls for the determination of notification procedures on "the basis of those procedures which exist in the Standards Code" and a "consultation process along the lines of that contained in the Standards Code . . ."¹⁸ The language in the U.S. proposal dealing with these two areas is almost identical to that found in the Standards Code. The Nordic Countries propose a strengthening of the existing Code or the negotiation of a separate code. Thus, substantial agreement exists on the nature of the notification and consultation processes.

Proposals for dispute settlement so far have been rather vague. The EC has proposed that all issues be examined by a single panel, and noted that the provision for technical consultations already exists in the GATT's rules. The United States has proposed that GATT instruments be drafted that would

¹⁵ A third approach to the issue of different national regulations is being used by the European Community in liberalizing its internal market. The principle of "mutual recognition" of the standards of other countries implies that different standards can co-exist (with adequate labelling) in the same market. This approach has not been suggested for the GATT negotiations.

¹⁶ GATT, *Submission of the United States*, Oct. 1989.

¹⁷ GATT, *Global Proposal of the EC*; Dec. 1989.

¹⁸ GATT, *Global Proposal of the EC*.

require international standards to be considered by panels in determining whether a particular national measure is based on sound scientific evidence. The U.S. proposal also implies greater rights for the challenging countries. Along the lines of proposals made in the negotiations on the Standards Code, the burden of proof would be shared by the challenging and the challenged country. Specifically, the challenged country could be asked to show that the offending regulation is consistent with sound scientific evidence.

There is still some disagreement on the appropriate form of the GATT instrument to formalize areas of agreement on sanitary and phytosanitary regulations. The options are to write additional GATT articles, or to add an interpretive note to Article XX; to strengthen and expand the Standards Code, or to negotiate a separate code for agricultural sanitary and phytosanitary regulations. The United States favors the negotiation of additional GATT articles or the addition of an interpretive note to the revised GATT articles; the Nordics favor the negotiation of a separate code; and the EC has not indicated a preferred approach.

Possible Compromise

Given the broad areas of substantive agreement, there should be ample opportunity to arrive at a compromise that contributes to a lessening of the adverse effects of sanitary and phytosanitary regulations on agricultural trade. Such a compromise could include an amendment to Article XX along the lines discussed above to formalize the role of sound science and international organizations, and a strengthening and expansion of the Standards Code to more fully address production and processing methods, and dispute settlement. In addition, it should be possible to add either an interpretive note, a further amendment to Article XXIII (which defines nullification or impairment of benefits derived from the GATT), or an additional article to formalize a dispute settlement process that would apply to all contracting parties in dispute over sanitary and phytosanitary regulations.

These elements should embrace the concept of equivalence rather than that of strict conformity for two reasons. First, the world of sanitary and phytosanitary regulations is far too complex to arrive at a single set of GATT-conforming standards. Second, the GATT process should focus on resolving bilateral disputes; that is, to consider only those (few) areas of substantial bilateral disagreement. Negotiations on sanitary and phytosanitary regulations should not be viewed in the traditional sense of gains and concessions. Each country is trying to improve trading conditions. If successful, all countries will be "winners" in improved transparency in international trades. All countries will gain from the removal of unnecessary trade barriers, from the prevention of the use of standards as concealed protection, and from the enhanced predictability that flows from transparency, national treatment and non-discrimination.

VII. Special and Differential Treatment

General agreement exists among the four major proposals from the United States, the European Community, the Cairns Group and Japan that special and differential treatment (S&D) should be accorded to developing countries (LDCs). However, the nature of the special treatment and the degree to which it should be allowed to be different in relation to GATT rules and disciplines varies among the proposals. The developed countries are reluctant to write a generalized "dual standard" in the GATT, and are unwilling to ignore the great differences among developing countries in their ability to contribute to the reform process.

All agree that LDCs should be full participants in the negotiations and in GATT agreements and obligations. The main component of S&D common to all four proposals is to allow LDCs more policy flexibility and a longer time frame in which to make overall reforms of agricultural policy and trade in the Uruguay Round. Both the United States and the European Community indicate that the advanced developing countries—presumably the Newly Industrialized countries (NICs)—should be expected to comply on the same schedule as the developed countries.

The Cairns Group and the United States further suggest that special concessions should be granted to LDCs for interventions aimed at basic infrastructural and long term agricultural development that lead to increased food self-sufficiency and food security, although the United States would have this special treatment phased out as development occurs.

A distinction is often made between the treatment of developing country food importers and developing country food exporters with regard to S&D. Even the developing country proposals and submissions to the GATT tend to emphasize the role of S&D mechanisms for LDC food importers rather than for LDC food exporters. The implied consensus is that LDC food exporters would benefit from trade liberalization along with developed country agricultural exporters, and thus have less or no need for S&D. The United States, however, suggests that priority be given to reduction of protection on products of export interest to the LDCs.

The European Community proposal, alone among the four major proposals, joins the developing country food importers in calling for compensation in the form of additional food aid donations and grants to offset the higher world market prices for food expected under trade liberalization. Some of the developing countries' proposals go further and are more specific. For example, one proposal lists concessional sales, subsidized credit, grants and increased food aid, along with early increased import access (perhaps on a preferential basis) for products of export interest to the LDCs. It goes on to suggest special consideration be given to higher food import bills in structural adjustment programs related to external debt restructuring and increased technical and economic assistance from the developed world for LDC agricultural development. Finally, the developing countries that are not members of the Cairns Group appear to support the continuation of the concept of the Generalized System of Preferences (GSP) established in prior GATT rounds.

At this stage in the negotiations, all countries, including the LDCs, are trying to stake out bargaining positions that are clearly in their self interest. But there appears little disagreement on the underlying issues. The developed countries have already accepted that developing countries may need a longer time frame for compliance with any agriculture agreement and greater flexibility in the instrumentation of their national agricultural and trade policies. It should be possible to negotiate the specifics, given the acceptance of the principle. This real concession, along with priority reduction of import access barriers on products of interest to developing countries, coupled with some concessions relating to food security and a general undertaking by developed countries to use their best efforts to respond to increased demands by LDCs for food, technical and economic assistance, should provide an acceptable compromise without unduly weakening the nature of the global agreement on agriculture.

The negotiations on S&D are unlikely to hold up progress in the Uruguay Round.¹⁹ The developed countries have already recognized the special and differential needs of the developing countries and agreed to their minimum agricultural demands. With an overall outcome that promises the LDCs improved export earnings, the issue of S&D need not be a stumbling block in this negotiation.

VIII. Non-Trade Concerns

In the April Mid-Term GATT Agreement a new concept was introduced, the notion of the importance of taking into account "non-trade concerns" in shaping agricultural and food trade policies. Japan and several European countries took the lead in introducing this concept into the Mid-Term Agreement. The apparent rationale was that every country has food security, social, environmental and food safety objectives that they wish to satisfy with their domestic agricultural policies. The EC, in supporting this concept, was thinking particularly of issues of environmental quality and rural community viability that are increasingly important elements in the evolution of Europe's agricultural policies.

The introduction of this concept into the negotiations is not surprising since it is at the heart of many domestic policy interventions. But the way the concept has been picked up and interpreted in the self interest of each negotiating nation is disturbing, if not counterproductive. Japan has interpreted non-trade concerns as one way to avoid concessions being required of major food importing countries (such as itself). Japanese concern over food security is very real, and certainly at the heart of domestic policy.²⁰ But in the Japanese case, the worry over food security is of a different nature than the concerns of many developing countries. The Japanese even in periods of short supply and high international prices have little difficulty paying the bill for the food imports required. Japan's main concern is that supplying countries might use export embargoes in periods of short supply, thus making it difficult to obtain food needs from the international market. This Japanese concern can be addressed rather easily and directly by GATT rules on assurances of unfettered access to sources of supply, parallel to a set of rules on assurances for exporters of minimum market access. The centerpiece of such rules would be a prohibition on short-supply embargoes, perhaps supplemented by rationing rules prohibiting the licensing of exports at less than some agreed percentage of the historical level of shipments.

While the developing countries appear willing to let Japan take the lead in interpreting "non-trade concerns" as a being mainly about food security, their initial position was somewhat different. In both the combined and individual submissions by the developing countries, they sought to link non-trade concerns with proposals for special and differential treatment, including compensation for higher international commodity import prices under trade liberalization, concessions on debt relief, increased food aid, and expanded technical and economic assistance. The introduction of non-trade concerns into the negotiation as a legitimate reason for resisting policy reform is particularly unfortunate if it reduced the pressure for needed trade liberalization in developing countries.

¹⁹ With regard to S&D, the tactical question seems to be what minimum S&D concession package on agriculture (along with better access into developed country markets from trade liberalization for products of particular export interest to the LDCs) do the LDCs require from this negotiation to keep them from blocking agreements reached in other phases of the Uruguay Round.

²⁰ Groups seeking to maintain protection are only too happy to use the food security argument to maintain present high price support policies under the banner of "self sufficiency". In practice, a "self-sufficient" Japan would still depend on the international market for the agricultural inputs (fertilizers, fuel, chemicals) needed to grow its own food.

One way to treat these non-trade concerns is to deal with them as specific issues rather than as an ill defined category of concerns that somehow take priority over the main thrust of the negotiations. This would remove the concept of "non-trade concerns" from the discussion and get on with resolution of the basic trade issues involved. This would also prevent "non-trade concerns" from clouding the issue of what should be conceded by the developed countries under the rubric of special and differential treatment for developing countries. Those countries that want "non-trade concerns" considered should be required to request specific derogations from the obligations embodied in the comprehensive global accord on agriculture. In this way the global accord would not contain within itself a potentially destructive escape clause for "non-trade concerns."

IX. Links With Other Parts of the Negotiations

The agricultural negotiations are only one part of the activity in the Uruguay Round. Consideration of the options for agriculture requires an assessment of the links between agricultural talks and progress in other areas. These linkages are of two kinds, which one might call "outcome" linkages and "substance" linkages. Outcome linkages refer to the impact that the outcome of one part of the negotiations can have on another, whereas substance linkages refer to the connections between the content of agricultural and non-agricultural discussions.

The substance of the agricultural negotiations has considerable overlap with that in other groups. The tariff negotiating group has been considering the role of "across-the-board" tariff cuts, as opposed to ad hoc request and offer procedures. This issue has some similarity to the use of an AMS in the agricultural talks. The issue of converting non-tariff import barriers to tariffs has been discussed in the Non-Tariff Measures Group. Resolution in favor of tariffication in one group could influence the discussion in the other. Although the group considering changes in the GATT articles has not concerned itself with the agricultural provisions of Article XI and Article XVI, changes in other articles (e.g. XVII and XIX) could have an impact on the discussion of rule changes in the agricultural talks.

The Group dealing with the MTN Codes is concerned with the operation of the Standards code, thereby overlapping with the discussion on sanitary and phytosanitary regulations in the Agricultural Group. The MTN Code group is also considering amendments to the Subsidies-Countervail Code, which has a direct bearing on the discussion of export subsidies in agriculture. In addition, a separate Subsidies and Countervailing Measures Group is looking at issues of domestic subsidies, dumping and countervailing duties (as covered in the GATT articles, as opposed to the MTN Subsidies-Countervail Code which applies only to signatories to the Code), has been considering the classification of subsidies in much the same terms as in agriculture.

Among the major outcome linkages are the impact that agreement in other areas of the negotiations would have on the pressure to conclude an agricultural pact. Although agricultural trade has considerable importance for a number of countries, it is unlikely that the major participants (such as the EC, Japan, and the US) would allow the Uruguay Round to fail on account of an impasse in agriculture. This gives a boost to the pressures to reach an agricultural deal. The EC and Japan could choose to give way on long-held positions in farm trade in order to secure their other objectives in the Uruguay Round and to avert the dangers of a collapse of the multilateral trading system. But just as likely is a less satisfactory outcome, where the bold objectives that emerged in the early part of the Round would be shelved for a weak compromise, or a complex deal that contains little benefit for the trading system. The US, Canada, and Australia, along with other exporters, would, under this scenario, have to make the

concessions that allowed the EC and Japan to retain the essential elements of their agricultural and food trade policies in exchange for an overall "successful" Round.

Such a compromise nearly emerged at the Mid-Term Meeting in Montreal, in December 1988, only to be rejected by the developing countries interested in agricultural trade. Whether the strategy of issue linkage would be employed (or be successful) a second time is not clear. But it is not impossible that LDC food exporters might once again decline to agree to progress in new trade areas, such as services, intellectual property rights and investment, unless they are given relief from the economic damage they suffer from the import protection, export assistance and subsidies given to farmers in developed countries.

Even if the final outcome on agriculture does not depend upon a last-minute deal among the major actors, the balance of outcomes from the various groups is important. The Trade Negotiating Committee, the highest-level negotiating body, has agreed on the need for balanced outcomes, and instituted ways in which this can be pursued. This again puts pressure on negotiators in groups where progress is slow to arrive at meaningful results. The agricultural negotiating group has followed an impressive schedule of meetings and considered numerous proposals, many of which would entail sharp departures from present practice if implemented. The willingness of agricultural negotiators to work toward an agreed package may not be in doubt, but the diversity of views as to what would be in that package may still be too great to be bridged in a few months. Significant breakthroughs may be needed in other areas to create the climate for rapid agreement on ambitious goals in agriculture.

X. The Common Ground and an Acceptable Compromise

Earlier sections have revealed considerable areas of overlap among the major proposals. This "common ground" gives some degree of optimism that an agreement on agriculture may be possible. The next question is whether such a feasible compromise is also an adequate response to the problems of agricultural trade within the GATT. This section explores this common ground and also identifies the minimum elements which would make a compromise package also desirable from the point of view of agricultural trade in the sense that it would lead to a more efficient use of the world's agricultural resources and incorporate trade in agriculture into a liberal and lawful world trading system.

There appear to be eight elements of broad agreement among the comprehensive proposals. These are:

(i) That all Contracting Parties should abandon waivers, exemptions, grandfather clauses and other special treatments negotiated in the past for agricultural trade policies within the GATT. This principle of equal treatment of all countries would not interfere with special and differential treatment for developing countries, but would remove the waivers under which certain developed country policies operate in violation of GATT principles.

(ii) That all parties should substantially reduce the levels of protection and trade-distorting subsidization inherent in their agricultural programs. Differences among countries about the ultimate depth and pace of such reductions should not prevent an agreement on the initial steps.

(iii) That more specific commitments on individual policies are necessary, both as a way of ensuring that such reductions in support and protection do in fact lead to greater market access for

exporters and to discourage the use of certain policy instruments which have a particularly undesirable impact on trade relationships.

(iv) These commitments would include an element of "tariffication" of import levies and quotas and measures with like effect to make import access barriers more transparent, domestic prices more responsive, and conformity with the principles, rules, and disciplines of the GATT more easily achieved.

(v) That specific commitments to reduce or remove export subsidies of at least equal force are also necessary in view of the fact that the problem of subsidized export competition is among the most serious facing agricultural trade.

(vi) That some domestic subsidies should be subject to discipline and a phased reduction, whilst others should be allowed to go undisciplined and even encouraged as an alternative to trade-distorting policies.

(vii) That the GATT Article XX dealing with restrictions on trade arising from sanitary and phytosanitary regulations be modified to deal better with the issues that arise from diverse standards in this area.

(viii) That special and differential treatment should be afforded to those developing countries that would otherwise not be in a position to implement fully these changes.

This area of common ground constitutes a remarkable step forward from earlier agricultural negotiations in the GATT. Among the few topics discussed in earlier pages on which no common ground seems to exist are those of "non-trade concerns" and "rebalancing." The US and the Cairns Group appear to be far away from accepting that major parts of farm programs can be excluded as being subject to a "higher imperative" and unwilling to see any increase in protection for oilseeds and cereal substitutes in the EC. In all other areas the major negotiating countries agree on the direction they should take their agricultural policies and associated trade arrangements and behavior. They have different visions about the ultimate destination and the most appropriate paths to follow. But for the first time in the 40-year history of the GATT, they agree on the general direction to be taken and are agreed that the journey should begin now.

To be broadly satisfactory as an outcome the following elements should appear in the final package:

a. A general commitment to reduce the level of trade-distorting support and protection by at least the same magnitude as in the negotiations on tariff reductions. The AMS should be used for setting the target and monitoring progress in this reduction. These reductions should in principle apply to all countries and commodities equally. Some flexibility in the policy mix and levels of adjustments may have to be negotiated to achieve greater harmony in protection levels and to respond to special cases. Progress towards that target should be monitored through a series of annual Policy Reviews, allowing some limited modification of the pace of adjustment in response to unexpected world market changes. Domestic policies should be restructured to use less trade-distorting instruments, though the overall level of support given to the agri-food sector, farm people and rural areas would not itself be controlled.

b. Import barriers would be lowered by an amount at least comparable to that agreed for the overall level of trade-distorting support. In addition there would be a phased conversion of non-tariff import barriers to tariffs. There could be an allowance in such a conversion for some part of world market or exchange rate developments. Alternatively, a special safeguard mechanism applicable for the transition period could be negotiated. These new tariffs would also be subject to the common reduction rules, and the "buffering" component would be progressively reduced. All waivers and similar exemptions would be removed as a part of the reinstrumentation of import barriers.

c. Export subsidies would be removed or reduced by at least the same proportion as import barriers. Until such time as countries can avoid altogether the use of export subsidies, these should also be subject to stronger disciplines to establish maximum levels of such subsidies and mandate annual reductions. These disciplines could also involve an agreement not to target export subsidies at particular markets. In addition, an agreement could include a decision to replace variable export subsidies with a fixed component tied to the bound tariff on the same items, but with the provision that such subsidies be reduced in annual increments and more rapidly at times of firm market prices.

d. Domestic subsidies should be classified into categories depending on their presumed trade-distorting nature. A "green" category would contain those that satisfied certain agreed criteria, and illustrative lists would be provided to encourage the constructive conversion of existing programs. These program would not be subject to countervailing duties. The "amber" category would initially contain all other policies not specifically prohibited in the GATT. These would be subject to a phased reduction at the same rate as the overall commitment. The issue of whether any particular policy instrument should be placed into a "red" category of unacceptable practices should be taken up in the discussion of rule changes.

e. A number of specific trade issues are best dealt with as Special Cases in the final stages of the negotiations. This includes the rebalancing of EC support policy, specifically by increasing border protection for non-cereal feeds as a counterpart to cereal support reduction. Limited rebalancing confined to the cereal substitutes may be negotiable as a part of a package, even if not on its own merits. The so-called "non-trade concerns" come under the same category. Rather than make general agreements on the scope for protection on non-economic grounds, it is best to treat this as an issue which must be faced to get agreement on the broader package. The basis for such special arrangements must, however, be the overall commitment on reduction of support. Supply management (and the associated changes needed in Article XI) could also be treated as a special issue in specifying the obligations of countries that employ this technique.

f. In addition to the negotiated reduction of support and the reinstrumentation of domestic and trade policies, it is also desirable that the GATT rules be updated to underpin this process and to reflect the experience with the current articles. The major changes that are needed are: changes in Article XX to improve the transparency of regulations in the health and phytosanitary area; clarification of the scope of Article XI so as to make clear the exceptional circumstances under which non-tariff import restrictions are to be permitted; improvement of the safeguards provision of the GATT so that countries may know when they may take exceptional action; elaboration of the exceptional conditions under which export subsidies are allowed; and improvements in the disciplines governing the use of anti-dumping and countervail duties in bilateral trade.

g. A general agreement to allow the developing countries and the former centrally planned economies to participate fully in the GATT process without being forced to make adjustments or grant

concessions beyond what is practical or desirable for them. This should be done however without modification to the rules and agreements as such, but merely to the extent of their application.

The task facing the negotiators between now and December 1990 is to extend the common ground so as to encompass a satisfactory outcome. If all sides wish to see an end to the unsatisfactory conditions surrounding agricultural trade and the adoption of constructive and workable rules within which domestic policy can operate, the task should not be impossible.

Annex 1: An Illustrative Agreement

The package to be agreed for agriculture in the Uruguay Round negotiations has to contain a number of elements relating to the issues discussed in detail in the report. An example of such an agreement is outlined below. This example illustrates, in a more concrete way, the general comments on the various issues relevant in the negotiations which have been made in the body of this report. It should not be read as describing what the authors of this report would consider to be the only sensible or even the optimal outcome of the negotiations, but it does outline an ambitious but feasible agreement.

1. National agricultural policies and their accompanying trade arrangements will be reformed during a transition period, the first stage of which is agreed to be five years. In the fourth year, contracting parties will meet to agree on the need to vary targets and procedures for the second stage of the reform process.
2. The overall level of protection and support will be reduced from the 1986 levels by 50 percent during the first stage of the reform process (five years). This overall target for the reform process is to be expressed in an AMS form, and the reduction applies equally to all countries and all policy instruments, except for those domestic policies which have been designated as having no, or negligible, trade effects. It applies to all agricultural and food commodities as included in the commodity list annexed to the US comprehensive proposal.
3. All tariffs on agricultural and food products will be bound and then reduced by at least 50 percent during the first stage, giving particular priority to the reduction of the highest tariffs.
4. All non-tariff import barriers, independently of their legal status, are to be converted into specific or ad valorem tariffs during the first year. The maximum tariff levels are the tariff equivalents of the existing import barriers on average during the period 1986-88. Where price-related import measures (such as variable levies) contained a redundant element ('water in the tariff') during that reference period, the redundant element is reduced by 50 percent at the time of conversion into a tariff.
5. The newly established tariffs are to be reduced by 50 percent during the first stage, in equal annual steps.
6. During the transition period, the newly established tariffs can be varied, at the margin, and by agreement, in order to offset the effects of fluctuating world market prices. For this purpose, a reference world market price will be fixed for each commodity and country in all those cases where tariffs have been newly established. The reference price is to be expressed in the currency of the country concerned (ECU in the case of the EC). The reference price will be the average cif price during the period 1986-88 (i.e. the same price which is used for calculating the tariff equivalent). When the actual world market price is above the reference price, the tariff is to be reduced by the full difference between the actual price and the reference price. When the actual world market price is below the reference price, the tariff can be increased by a given percentage of the difference. This percentage is agreed to be 90 percent in the first year, 80 percent in the second year, and so on.
7. Article XI:2(c) is to be eliminated from the GATT after an agreed transitional period. Countries which so far have relied on that Article in connection with supply management programs (and have

notified the GATT of it) can establish a tariff which is twenty percent above the tariff equivalent defined above. However, this tariff, too, has to be reduced like all other tariffs.

8. Existing levels of export subsidies per unit expressed in national currencies are to be bound, and then reduced by at least 50 percent during the first stage.
9. It is agreed that in each country export subsidies must not be higher than the level of import tariffs of that country for the same commodity.
10. In order partially to offset fluctuations of world market prices, export subsidies can be varied in the same way as import tariffs over the transitional period (see No. 6 above).
11. Article XVI:3 is to be eliminated from the GATT (and the Subsidies Code amended accordingly). An interpretative note is to be added to Article XVI:4 which states that during the transition period countries can continue to use export subsidies on primary products, as long as these subsidies do not exceed their bound (and reduced) levels. Export subsidies on processed products may not exceed the accounts payable on their raw product components.
12. The criteria for (and a list of) trade distorting domestic subsidies is to be agreed. All subsidies not contained in that list are considered to be not trade distorting. The list is to be reviewed annually.
13. Domestic subsidies which are not on the list of trade distorting subsidies and fall outside the criteria will be permitted, and their level will not be constrained.
14. Aggregate government expenditure on trade distorting subsidies is to be bound for each country by commodity, and is reduced by 50 percent during the first stage, in equal annual steps.
15. The most trade distorting domestic subsidies (such as deficiency payments) are bound, on a per unit basis, in the schedules of concessions of the countries concerned.
16. Article XX is amended such that consistency with sound scientific evidence and the principle of equivalency are embodied in that Article. At the same time, Article XX is amended such that notification requirements according to those specified in the Standards Code are introduced.
17. An interpretative note is added to the third sentence of Article XXIII which requires that in cases of disputes over sanitary and phytosanitary matters the appropriate international standards organizations have to be consulted.
18. Developing countries participating in these agreements can extend the first stage of the transition period to ten years.
19. It is agreed that commitments under the Food Aid Convention should be increased to 12 million tons per year. A minimum of 50 percent of food aid should be provided either through multilateral institutions or as development aid granted with the assistance of multilateral institutions. All bilateral food aid will be provided as grants.
20. A specific review process is established in order to oversee, on an annual basis, the operation of these agreements during the transition period. If a majority of the countries participating in these

agreements agree, the first stage of the transition period can be extended by a maximum of three years.

Annex II: Possible Formulae for Modified Tariffication

The concept of "modified tariffication" discussed in the text of the report requires some elaboration in order to see better how it compares with the more traditional concept of tariffication. The analogous concept of modifying export subsidies is also explored.

Tariffs

According to the EC proposal, variable levies (and other non-tariff measures) would be replaced by a tariff which would consist of a 'fixed component' and a 'corrective factor in order to take into account exchange rate variations and world market fluctuations which went beyond certain limits to be agreed'. Such a modified tariff in any year t , $MT(t)$, could be calculated according to the formula

$$(1) \quad MT(t) = FC(t) + (\alpha * DIF(t)) ,$$

where $FC(t)$ is the 'fixed component' in year t , $DIF(t)$ is the extent to which the actual world market price is below the 'limit to be agreed' and α is a parameter, $0 \leq \alpha \leq 1$, which determines the extent to which downward variations of the world market price (in ECU) would lead to an increase in the tariff.

The separate mention of 'world market fluctuations' and 'exchange rate variations' in the EC proposal for "modified tariffication" requires that changes in world market prices be decomposed into (a) price changes in US dollar and (b) changes of the ECU exchange rate against the dollar. The reasoning may be that exchange rate fluctuations 'have nothing to do with agricultural support' (as argued in the section on the Support Measurement Unit (SMU) in the EC proposal) while changes in world market conditions (supposedly reflected in dollar price variations) could be allowed to influence, to some extent, domestic market developments.

This could be done if the variable element in the modified tariff, $DIF(t)$, were defined by the equation

$$(2) \quad DIF(t) = \beta * [PR\$ - PW\$(t)] * XR + [XR - X(t)] * PR\$ + [PW\$(t) - PR\$] * [XR - X(t)] .$$

In this equation, the first term on the right hand side is the difference between the reference price in dollars, $PR\$$, and the actual dollar world market price, $PW\$(t)$, multiplied by the reference exchange rate XR (defined as ECU per dollar), in order to be expressed in ECU terms. The second term on the right hand side is the difference between the reference exchange rate and the actual exchange rate $X(t)$ (again defined as ECU per dollar), multiplied by the reference price in order to express the exchange rate effect on the wheat price. In order to add up to the actual difference between the ECU reference price and the ECU world market price, the cross term of the two differences also has to be included.

Since any deviation of the actual exchange rate from its reference value would, according to the EC proposal, probably be allowed to be more fully compensated (through an increase in the tariff) than a variation in the dollar world market price, a parameter β , $0 \leq \beta \leq 1$, has to be included in the definition

of DIF(t) in order to be able to give different weights to price variations and exchange rate fluctuations. In equation (2), this parameter is applied to the first term on the right hand side.²¹

According to the EC proposal for "modified tariffication", the fixed component of the tariff 'would be reduced at a similar rate as the SMU'. In essence the reduction of FC(t) would probably mirror the reduction of domestic support prices which the EC would have to implement in accordance with its SMU commitment.²² If this reduction of the domestic price level would have to take place in equal annual steps of δ ECU per unit, the development of FC(t) over time could be described by a formula like

$$(3) \quad FC(t) = FC(0) - (\delta * t),$$

where FC(0) is the fixed component in the base year.

A final formula would probably have to deal with an issue which is not mentioned in the EC proposal, nor in other proposals for tariffication. In periods of rising world market prices it can well happen that the "old" variable levy system of the EC would lead to a lower import tax than a "new" fixed tariff. This would become the more likely the higher the domestic price cuts are which may result from the negotiations. One way of dealing with this issue would be to subtract any excess of the actual world market price in ECU, PWE(t), over an upper limit level in ECU terms, PUE(t), from the fixed component. The tariff actually applied, TA(t), would then be calculated according to

$$(4) \quad TA(t) = \min \{ MT(t) ; FC(t) - [PWE(t) - PUE(t)] \}.$$

The interesting feature of such formulae is that in their general form they can be used to describe all sorts of different import taxes. For example, the current variable levies of the EC result if FC(t) is set to zero, PR\$ * XR is set to the EC threshold price, and α and β are set to one. On the other hand, a fixed per unit tariff results if α and δ are set to zero, and FC(0) is given an appropriate fixed value.

Export Subsidies

In the text it was suggested that a similar arrangement could be envisaged for export subsidies. This would mean that there would be bindings on export subsidies per unit, where the permissible export subsidy would be calculated from a "fixed component" and a "corrective factor."

In this case, the maximum permissible export subsidy in year t, SUB(t), would be calculated according to the formula

$$(5) \quad SUB(t) = \min \{ FC(t) + (\alpha * DIF(t)); PI(t) - PW(t) \},$$

where FC(t) is the "fixed component" in year t, DIF(t) is the extent to which the actual world market price differs from (in particular: is below) the "limit to be agreed" and α is a parameter, $0 \leq \alpha \leq 1$,

²¹ The same result could have been obtained if such a parameter had been applied to the second term on the right hand side, though the parameter α would then have to be set in a different way. Note that with $\beta = 0$ equation (2) yields exactly the difference between the reference price in ECU and the actual price in ECU.

²² Note that the new SMU proposal of the EC also opens up the possibility of having some variation in the external reference price.

which determines the extent to which downward variations of the world market price (in ECU) can lead to an increase in the export subsidy. The parameter α would have to be agreed in the negotiations. The second term on the right hand side of this equation specifies the existing definition of the EC variable export subsidy, which essentially is the difference between the EC intervention price, $PI(t)$ and the world market price in ECU, $PW(t)$. This traditional form of the (fully) variable export subsidy would still be used when the world market price exceeds that reference level below which the new (less variable) export subsidy would become relevant. The reason for keeping this traditional form for high price periods is that otherwise the new EC export subsidy would in such periods be higher.

By analogy with the arrangements for tariffs, the difference between the agreed reference price in ECU and the actual world market price, $DIF(t)$, would have to be split up into (a) the difference between the reference price in dollar, $PR\$$, and the actual dollar world market price, $PW\$(t)$, and (b) the difference between the reference exchange rate, XR , and the actual exchange rate, $X(t)$, both defined as ECU per dollar. In order to add up to the actual difference between the ECU reference price and the ECU world market price, the cross term of the two differences has to be included.

$$(6) \quad DIF(t) = \beta * [PR\$ - PW\$(t)] * XR + [XR - X(t)] * PR\$ + [PW\$(t) - PR\$] * [XR - X(t)]$$

Since any deviation of the actual exchange rate from its reference value would probably be allowed to be more fully compensated through an increase in the permissible export subsidy than would a variation in the dollar world market price, a parameter β , $0 \leq \beta \leq 1$, has to be included in the definition of $DIF(t)$.

According to the EC proposal for "modified tariffication," the fixed component of the tariff would be reduced in parallel with the SMU. At the same time, the fixed component of the bound export subsidy, $FC(t)$ would mirror the reduction of domestic support prices which the EC would have to implement in accordance with its SMU commitment. If this reduction of the domestic price level would have to take place in equal annual steps of δ ECU per unit, the development of $FC(t)$ over time could be described by a formula like

$$(7) \quad FC(t) = FC(0) - (\delta * t).$$

The current fully variable export subsidies of the EC can be described by these equations if $FC(t)$ is set to zero, $PR\$ * XR$ is set to the EC intervention price, and α and β are set to one.