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# AGRICULTURE IN THE GATT: AN ANALYSIS OF ALTERNATIVE APPROACHES TO REFORM

Joachim Zietz
Alberto Valdés

November 1988

INTERNATIONAL FOOD POLICY RESEARCH INSTITUTE

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# FOREWORD

The Uruguay Round of multilateral trade negotiations under the aegis of the GATT provides a unique opportunity to move toward resolution of the crisis that has characterized international trade in agricultural products for some time. The outcome of the Uruguay Round may well set the framework for trade relations for years to come. The stakes in the negotiations are high, not only for industrialized countries, but in particular for developing countries. Security and predictability of market access, and stability of trade relations and international agricultural markets are of great importance to the economic growth of the food and agricultural sectors of developing countries as well as their overall economy.

The International Food Policy Research Institute has published several other studies on similar trade-related topics. These include an analysis of the international effect of Soviet grain imports and of European grain policies, the political economy determinants of U.S. and European agricultural and trade policies, and an earlier quantitative study by Valdés and Zietz of the costs to developing countries of protectionist policies in OECD countries.

In a sense, the current study is a sequel to the authors' previous research report. Having established earlier the high costs of trade protectionism that characterize the current crisis in agricultural trade, they now offer a comprehensive conceptual analysis of the main ideas for trade reform in agriculture. As the Uruguay Round is now going into its second and decisive half, this report is particularly timely. Its careful analysis of numerous trade reform ideas using a common reference system offers the reader a much-needed orientation as well as a new perspective on the problems surrounding trade reform.

IFPRI is grateful to the Kiel Institute of World Economics and to its president, Herbert Giersch, for their generous support of this undertaking. We hope that this joint effort will advance the goals of the Uruguay Round and thus contribute to a better trading environment in agriculture.

John W. Mellor

Washington, D.C.
November 1988

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# 1

## SUMMARY

Much trade in agricultural products is conducted under conditions that bear little resemblance to the letter or the spirit of the General Agreement on Tariffs and Trade (GATT). Nontariff barriers proliferate, export subsidies increasingly substitute for a natural competitive advantage, trade wars erupt with frightening regularity.

There is some hope that the Uruguay Round can achieve more for agricultural trade than prior GATT rounds. Sharply rising budgetary costs of national farm policies in recent years seem to have made the European Community (EC), the United States, and other industrial countries more open to the idea of agricultural trade reform than ever before. There is a danger, however, that diminishing budgetary pressures, which are the result of recently rising world prices and certain adjustments in domestic farm policies, could reduce the current momentum for reform. Piecemeal accommodation on a commodity-by-commodity basis could then be the outcome of the Uruguay Round. Although this might suffice to further stabilize government budgets, it would not bring lasting improvement. It is therefore important not to lose sight of the final objective of trade reform in agriculture: to establish an environment that is free of trade-distorting government interventions, fully integrated into the GATT, yet flexible enough to deal with domestic structural adjustment problems and income instability.

Not every reform proposal that is under current discussion is likely to ease the transition to this state of world trade. Some may make it actually impossible to ever get there. It is important, therefore, to analyze the properties of a given reform proposal before much time is spent on it during the trade negotiations. For that purpose, a number of criteria are developed to check (1) to what extent a given reform proposal is consistent with the final objective of trade reform, (2) whether the proposal has any practical value in day-to day operations, and (3) whether it has the potential to win the approval of the main players in the Uruguay Round—the United States, the EC, the nonsubsidizing exporters united in the Cairns Group, and Japan.

When these criteria are confronted with actually proposed ideas for trade reform, it becomes clear that there is no single idea or element of trade reform that would satisfy all the criteria that are established. Yet there is some evidence that an appropriate combination of reform ideas might achieve this goal. One such combination would consist of two elements: a strict ban on export subsidies, and comprehensive tariffication.

The ban on export subsidies would eliminate the special treatment for agricultural, fishery, and forestry products in the General Agreement and the Subsidies Code. Tariffication consists of two components: the replacement of all unbound tariffs and nontariff barriers with bound base tariffs that are uniform across broad commodity groups for each country, and the extension of that change to the safeguard Article XIX of the General Agreement.

The bound base tariff represents the basic tariff concession of a country. It is the tariff level that a given country would apply uniformly across broad commodity groups, once the adjustment to a system based only on tariffs is completed. A country is bound to this tariff at all times unless it invokes Article XIX. Extending tariffication to Article XIX implies that safeguard measures are limited to temporary tariff increases. A revised safeguard Article XIX is envisioned to operate as follows. A country using a temporary tariff increase, or excess tariff for short, would bind itself to a timetable for lifting the safeguard measure. This timetable would specify the dates on which the excess tariff would be reduced to zero as well as the step size of the individual reductions. To avoid prohibitive tariffs the use of excess tariffs under the safeguard article could be conditioned on some minimum-access provision similar in spirit to that currently written into Article XI:2(c). Article XI:2 could be rewritten so as to apply to all trade regardless of sector and whenever a country uses any import restriction other than its bound base tariffs.

The excess-tariff provision is envisioned as the major vehicle to eventually reach a system based only on bound, uniform tariffs. Excess tariffs would offer temporary import relief for all products that are currently protected by nontariff barriers with tariff equivalents far in excess of the uniform base tariff that a given country would adopt after the adjustment to the new system.

As excess tariffs are lowered over time, according to some fixed schedule, to the level of the bound base tariff, and as the resultant adjustment pressure grows, countries may resort to gray-area measures to reduce this pressure. Four types of gray-area measures to avoid the disciplines of tariffication are of particular interest in this context: voluntary export restraints, state trading arrangements, domestic subsidies, and exchange-rate manipulations.

The potential problem of voluntary export restraints could be contained by prohibiting them explicitly and, at the same time, giving the GATT Secretariat an active role in supervising this prohibition, including the right to initiate cases against a country that forces export-restraint agreements on its trading partners. Treating export subsidies in agriculture the same as in other sectors should go a long way toward eliminating implicit export subsidies by state trading enterprises in agriculture. Implicit quantitative import restrictions, in contrast, are more difficult to prevent. The only practical solution may be to restrict their operations on the import side indirectly through binding the nominal rate of protection for all those goods under their control. In particular, it could be stipulated that the price difference between the border price and the domestic wholesale price of products under the control of state trading enterprises should not exceed the equivalent of the bound base tariffs for those products.

As long as it is believed that domestic subsidies will not be a major issue under a system of relatively low uniform tariffs, it may be most efficient to resolve domestic subsidies issues on a case-by-case basis. This could be achieved either through negotiations outside the GATT or through dispute settlement inside the GATT. The latter would require, however, that the current dispute-settlement procedure be made more responsive. This is in the special interest of developing countries because they generally lack the necessary political or economic clout to settle subsidy issues (or other issues, for that matter) through direct negotiations outside the GATT. Attempts of governments to circumvent the disciplines of tariffication and an export subsidy ban through exchange-rate manipulations may be handled in the same way as domestic subsidies, that is, without adding new provisions to the General Agreement or to its subsidiary codes law.

Compared with alternative suggestions for trade reform (for example, fixing overall protection levels), the above package has a number of advantages. At its core, the reform proposal is not dependent on new policy instruments or measurement techniques that have not been tested. Rather, it relies on well-known GATT instruments and principles. Everything else being constant, this should ease rather than complicate the transition from the current state of trade in agriculture and other industries to the final objective of free trade. Trying to incorporate a completely new, untried approach such as the Producer Subsidy Equivalent into the GATT framework could not only cause the negotiations to deadlock over measurement concepts and problems, but would also have the negative side effect of firmly establishing a "special case" for agriculture rather than integrating this sector fully into the GATT system.

Whether a proposal such as tariffication has a realistic chance of being adopted during the Uruguay Round depends ultimately on its ability to garner enough domestic political support in the major trading nations. Domestic acceptability hinges on a favorable political constellation. It is particularly important that the political power of the groups that stand to lose from a trade-reform proposal in the short run be kept in check by a sufficient amount of countervailing power. This means there have to be other special interest groups, apart from consumers, that are strongly in favor of a trade reform and, at the same time, have enough political influence to counter the efforts of those groups that oppose the reform.

Sector-specific, commodity-based reform proposals that lead to piecemeal trade arrangements for one commodity at a time do not generate the necessary countervailing power. Instead they maximize the influence of special interest groups on the negotiations at the expense of the interests of the whole country. The aggregate negotiating approach advocated by the United States in its reform proposal for agriculture fares somewhat better in generating countervailing power. It suggests that an agreement on all agricultural support programs be concluded in a single package. In this way the political influence of a commodity group that is losing can be counteracted by the influence of a commodity group that stands to gain. This negotiating approach runs into a problem, however, if there are countries with few or no commodity groups that expect to gain from a given reform package. Japan, some northern European countries, and, to some extent, the EC are likely to fall into this category.

The obvious solution is to negotiate in one package not only all of agriculture but all sectors, so that gains anticipated in industry can help to compensate for losses in agriculture or vice versa. Countervailing power would be established across sectors and industries. But just as a package deal in agriculture alone requires a unifying negotiation and measurement concept, so will negotiations across sectors necessitate a unifying principle. Tariffication as defined above could be this sought-after unifying theme or principle. It is applicable for all sectors and is fully compatible with the spirit of the GATT. It could replace the "across-the-board" tariff-reduction idea of the Kennedy and Tokyo rounds.

# 2

# INTRODUCTION

Previous rounds of multilateral trade negotiations under the aegis of the General Agreement on Tariffs and Trade (GATT) have brought little substantive change to agricultural trade. Some observers even go as far as calling agriculture the GATT's greatest failure (Leddy and Reinstein 1987, 45). This conclusion is understandable in view of the crisis that has unfolded in agricultural trade over the past few decades. Its signs are all too familiar: for example, competition by export subsidies rather than comparative advantage, trade disputes over domestic subsidies, rising costs of farm support but falling incomes of farmers, and increasing uncertainty of market access for developing countries.

The Uruguay Round has set out to change this. In contrast to prior trade negotiations, agriculture now occupies center stage. In addition, the negotiations on agriculture have been better prepared than ever before. A Committee on Trade in Agriculture was set up within the GATT in 1982, four years before the beginning of the Uruguay Round, to identify promising reform proposals. Also in 1982, a ministerial meeting of the Organisation for Economic Co-operation and Development (OECD) commissioned a comprehensive study of national agricultural policies and their trade implications. Completed in 1987 (Organisation for Economic Cooperation and Development 1987), the study's intent is to provide a common denominator for the Uruguay Round negotiations among the industrialized countries. Finally, because of the rapidly rising budgetary costs of national farm policies, the European Community (EC), the United States, and other industrialized countries now seem more receptive to the idea of agricultural trade reform.

Commodity prices appear to be rising again after a long period of depression. At the same time, the United States and the EC have made a number of adjustments in their farm support programs to cut budgetary outlays on agriculture. Both events could bring some relief to agricultural commodity markets. However, they could also reduce the incentive to embark on a thorough reform of agricultural trade. Although accommodation on a commodity-by-commodity basis might further stabilize government budgets, it is unlikely to result in lasting improvement. It is therefore important to keep in mind the final objective of agricultural trade reform in the Uruguay Round: an environment without government interventions that distort trade, fully integrated into the GATT, yet with the flexibility to deal with domestic problems of structural adjustment and income instability.

With the Uruguay Round almost two years under way, it has become obvious that progress on agricultural trade is a far more complex problem than negotiating tariff reductions in manufactures. This is because, in most countries, government intervention in agriculture is much more pronounced than in any other industry or sector. The objective of these domestic interventions is to support and stabilize the income of farmers relative to nonfarmers. Many countries consider this to be an issue for domestic policy only. However, many domestic interventions are intimately tied to border measures with a strong trade-distorting effect. This linkage has serious consequences: without a willingness on the part of protecting countries to change the way they manage their domestic income-support programs for farmers, it is difficult if not impossible for them to negotiate on border measures, which happen to be the traditional focal point of multilateral trade negotiations under the aegis of the GATT.

The United States, the EC, the nonsubsidizing exporters united in the Cairns Group, and Japan are the main players of the Uruguay Round. The early part of the current round appears to confirm the practice of the years leading up to this round: the main dividing line for agricultural policy and trade reform is located between the United States and the EC. Most major disputes in the field of agriculture have taken place between these two participants. The sheer size of their economies and their importance for agricultural trade implies that little progress will be possible without resolving their differences. The importance of these two players is reflected in this study, in that much of the analysis is spent on developing their likely responses to alternative reforms of agricultural trade and hence the structure of their domestic support programs.

In contrast, issues specific to developing countries, such as the question of reciprocity, trade preferences, and tropical products, are neither examined as separate topics nor do they occupy center stage.[1] But although the study does not revolve around these issues, this does not make it irrelevant to less developed countries (LDCs). On the contrary, concentrating on the broader aspects of agricultural trade reform makes it easier to reflect more sharply on the value to developing countries of such things as trade preferences, market access, and reciprocity than if they were discussed in isolation.

There is a final caveat the reader should keep in mind. It is not intended to present and discuss in detail all the various trade reform proposals either suggested in the literature, discussed by the Committee on Trade in Agriculture, or already tabled in the negotiating group on agriculture at the Uruguay Round meetings in Geneva. This would probably be a poor approach because of the sheer number of proposals, their sometimes imprecise statement, and their character as bargaining instruments. The preferred alternative is to break down the proposals into their main generic elements or ideas and to examine these. Examples of such elements that make up comprehensive trade reform proposals are further disciplining or banning export subsidies, providing exporters with minimum access to import markets, converting nontariff barriers into tariffs, and binding the overall protection level.

The analysis concentrates on the economic aspects of agricultural policy and trade reform. However, where appropriate, relevant political-economy considerations and implications are taken up. The analysis is conducted at a level that makes it comprehensible to the nontechnically inclined. Most of the analysis relies on verbal reasoning. Graphs are added where they help illustrate some more involved points.

The following chapter gives a brief overview of the current state of agricultural trade. It touches on the legal environment of the General Agreement, the extent and economic consequences of protectionism in agricultural trade, and the current status of the Uruguay Round negotiations. The subsequent chapter establishes the criteria to be used for discriminating among various ideas for trade reform. Next, these criteria are confronted with the major reform ideas under current discussion. The last chapter draws the conclusions from the prior analysis by combining a number of reform ideas into a trade reform package that both lives up to the criteria established earlier and is reasonably realistic.

[1] Interested readers are referred to the specialized literature: Hudec 1987; Finger and Olechowski 1987; and Valdés 1987. These studies contain a large number of further references that deal specifically with the problems of developing countries.

# 3

# AGRICULTURE IN THE GATT: AN OVERVIEW

## The Legal Background

Although the rules and regulations of the General Agreement apply in general to agriculture as they do to manufacturing, there are several significant exceptions. They relate mainly to the treatment of quantitative trade restrictions and export subsidies. (Of the GATT's 38 articles, only 4 contain special provisions for agriculture. These are Articles VI, XI, XVI, and XX. See Appendix 1 for a reprint of these and other articles referenced in this report.)

Articles XI to XIV and Article XIX of the General Agreement specify the rules for quantitative import restrictions. Of these, Article XIX provides a justification for quantitative import restrictions on all goods, not just primary goods, if surging imports are thought to harm domestic producers. Article XI is of particular interest to agricultural trade. Its importance derives from its exemption of primary goods, under certain circumstances, from the general prohibition of quantitative import or export restrictions established in the General Agreement. (Since the Tokyo Round, the primary goods category has included agricultural, fishery, and forestry products; before the Tokyo Round, it also included mineral products.) The circumstances justifying quantitative trade restrictions for agricultural goods are the prevention of or relief from shortages of food or other essential products; the enforcement of domestic marketing or production control programs, or the removal of temporary domestic surpluses; and the application of standards of commodity classification, grading, or marketing.

These special exemptions for agricultural and fishery products were incorporated into the original General Agreement in 1947 at the insistence of the United States. In their absence, several U.S. farm support programs that were in effect at that time would have had to be given up. The U.S. Congress, however, was unwilling to trade domestic farm support legislation in favor of a General Agreement without special rules for agriculture. Article XI was weakened even further in its relevance for agriculture in 1955, when the United States asked for and received a permanent exemption from the provisions of Article XI.[2] Since 1955 this exemption has been used at various times by the United States to justify quantitative import restrictions for dairy products, sugar, and beef. Even though the U.S. waiver may not have been important quantitatively, it has been of significance in a qualitative sense. By taking the bite out of Article XI for agriculture, it is likely to have contributed to a more lenient international trading environment. In this way the waiver has advanced the propagation of quantitative import restrictions, state trading, and gray-area measures such as voluntary export restraints.

Regarding subsidies, the GATT has undergone a number of changes since its creation. The treaty's initial version called upon countries applying subsidies only to give adequate notice to all affected GATT signatories. There were no provisions for outlawing subsidies altogether, regardless of whether they were intended to promote exports or address domestic policy objectives. This changed with the 1955 revision of the treaty, when three paragraphs (now XVI:2

[2] The U.S. request was the result of a congressional amendment of section 22 of the Agricultural Adjustment Act of 1933, which was passed after the GATT had found the United States to be in violation of Article XI for dairy products in 1951. The amendment of section 22 required the administration either to use import quotas to lower imports up to one-half the level of previous period imports or to impose excess ad valorem tariffs of up to 50 percent whenever domestic farm support programs were endangered.

to XVI:4) were added to the original subsidy article, thereby transforming its character.

The most important innovation of the 1955 revision of the General Agreement was the ban on export subsidies. Primary goods, however, were exempted from this general prohibition. Instead, a statement was included to the effect that export subsidies for primary goods should be avoided and that, if applied, they should not result in a more than equitable share of world trade.

The exemption of agriculture, along with fishery and forestry products, from the general ban on export subsidies can again be traced to the influence of the U.S. farm lobby. When the 1955 revisions of the export subsidy Article XVI were reviewed by GATT in 1958, the United States took the lead in defense of that article (Paarlberg 1987, 36). The U.S. position on the export subsidy issue changed only when it became clear in the 1960s, after the establishment of the EC's Common Agricultural Policy in 1962, that the provisions would be used to the detriment of the U.S. agricultural sector. However, no progress was made on the subsidy question either in the Dillon Round (1961-62) or the Kennedy Round (1963-67). In fact, both of those rounds achieved little for agriculture except some statutory tariff reductions.[2]

During the Tokyo Round of multilateral trade negotiations (1973-78) the United States championed, with some success, an effort to further restrain the spreading use of trade-related subsidies. A Subsidies Code was added to the General Agreement.[3] (Articles 8 through 13 of the Subsidies Code, as well as its Annex with an illustrative list of export subsidies, are reprinted in Appendix 2 of this report.) Strictly supplementary to the General Agreement, and binding only to its signatories, the Subsidies Code widened the definition of "more than equitable share" of the world market to cover the displacement of exporters in third-country markets. In addition, some other provisions of Article XVI were somewhat sharpened, and a dispute-settlement mechanism was put in place to enable signatories to enforce their rights under the Subsidies Code. (See Articles 12 and 13 of the Subsidies Code. A thorough discussion of the dispute mechanism can be found in Hudec 1978.)

Only about a quarter of the GATT members have signed the Subsidies Code. It appears that this code is among the least effective of those negotiated during the Tokyo Round. A lack of consensus on the wording and interpretation of the negotiated agreements has given rise to numerous disputes among the signatories. Although the Subsidies Code relates to all trade, most of the disputes have occurred in agriculture. This problem is discussed in more detail in Chapter 5.

## The Practice of Agricultural Trade

The legal exemptions granted to agriculture in Articles XI and XVI of the General Agreement have contributed to making agriculture one of the most contentious areas of international trade. Agricultural trade seems to have become increasingly separated from the letter and, in particular, the spirit of the General Agreement. When compared with other sectors or industries, agriculture stands out in at least the following respects: on average, tariff protection is higher than in most other sectors (Table 1), with many tariffs still unbound and at levels that discourage trade; tariff escalation is commonplace and serious (Table 2); the number of nontariff barriers is high compared with the manufacturing average (Table 3); and export subsidies are used on a large scale, distorting trade flows and sparking frequent trade disputes.

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[2] During the Dillon Round, the United States managed to secure a "zero-duty binding" for oilseeds, oilseed meals, and some other feed substitutes from the EC. Although not considered of major importance at that time, this concession has proven to be one of the most significant ever achieved by the United States.
[3] The addition of codes to the General Agreement during the Tokyo Round is discussed in Stern and Hoekman 1987, 59-66.

## Table 1—Average applied tariffs for 11 developed market economies, by product group, 1983

| Product Group | Tariff Application: All Imports | Tariff Application: Imports from Less-Developed Countries |
|---|---|---|
| | (percent) | |
| Food | 5.3 | 5.5 |
| Agricultural materials | 0.5 | 0.5 |
| Fuels | 0.6 | 0.6 |
| Chemicals | 3.1 | 3.7 |
| Other manufactures | 4.7 | 6.7 |
| All items | 3.0 | 2.7 |

Source: Based on data from Samuel Laird and J. Michael Finger, "Protection in Developed and Developing Countries: An Overview," paper presented at the World Bank-Thailand Development Research Institute Conference, Bangkok, October 1986 (mimeographed), p. 7.

Table 3 reveals that nontariff barriers are more prevalent in agriculture than in manufacturing for most referenced countries. The extent of nontariff protection in agriculture is similar to that of the most highly protected industries within manufacturing—textiles and clothing as well as iron and steel. Table 4 provides a breakdown of nontariff protection in agriculture by type of measure. Both Tables 3 and 4 omit a number of potentially important trade restrictions. Among those nontariff barriers excluded are domestic policy measures such as subsidies to import-competing sectors, government procurement, and restrictions on the domestic sale of foreign goods; generalized procedures applying to all imports; restrictive business practices;

## Table 2—Post-Tokyo Round applied tariffs for raw and processed products of selected developed countries

| Product | Austria | EC | Japan | Norway | Switzerland | United States |
|---|---|---|---|---|---|---|
| | | | (percent) | | | |
| Meat | | | | | | |
| Fresh and frozen | 0.2 | 6.6 | 10.1 | 8.3 | 4.2 | 1.6 |
| Processed | 2.6 | 17.9 | 22.5 | 8.1 | 5.2 | 2.3 |
| Vegetables | | | | | | |
| Fresh | 2.1 | 6.7 | 9.0 | 3.4 | 4.9 | 7.6 |
| Processed | 13.3 | 15.1 | 17.5 | 6.6 | 11.4 | 11.0 |
| Fruit | | | | | | |
| Fresh | 3.1 | 7.7 | 21.5 | 1.0 | 7.4 | 1.1 |
| Processed | 17.3 | 16.6 | 21.8 | 3.1 | 13.7 | 20.3 |
| Vegetable oils | | | | | | |
| Oilseeds | 0.5 | 0.0 | 0.3 | 0.0 | 0.1 | 1.0 |
| Oils | 1.1 | 6.1 | 6.2 | 4.5 | 8.2 | 0.7 |
| Sugar | | | | | | |
| Raw | 0.0 | 0.0 | 3.2 | 3.6 | 42.3 | 0.6 |
| Refined | 0.0 | 0.0 | 82.5 | 2.7 | 34.1 | 9.9 |
| Tobacco | | | | | | |
| Raw | 9.7 | 0.0 | 0.0 | 0.0 | 0.0 | 8.8 |
| Processed | 211.3 | 61.2 | 82.1 | 5.1 | 17.6 | 9.1 |

Source: Based on data from Alexander Yeats, "The Escalation of Trade Barriers," in *The Uruguay Round: A Handbook on the Multilateral Trade Negotiations*, ed. J. Michael Finger and Andrzej Olechowski (Washington, D.C.: World Bank, 1987), p. 114.

## Table 3—Percentage of seven industrial countries' imports subject to nontariff barriers, by product group, 1983

| Country | Agriculture | Manufacturing | Textiles | Iron and Steel |
|---|---|---|---|---|
| | | (percent) | | |
| Australia | 21.6 | 28.6 | 29.1 | 42.5 |
| | 47.7 | 22.7 | 28.1 | 57.8 |
| Austria | 40.5 | 6.1 | 15.1 | 0.0 |
| | 39.9 | 2.4 | 0.0 | 0.0 |
| EC | 26.9 | 29.9 | 68.0 | 31.9 |
| | 47.7 | 15.2 | 15.6 | 51.8 |
| Japan | 53.3 | 4.4 | 13.0 | 0.0 |
| | 36.8 | 9.7 | 11.0 | 0.0 |
| Norway | 15.4 | 20.9 | 59.5 | 20.6 |
| | 27.0 | 3.2 | 39.5 | 0.0 |
| Switzerland | 67.3 | 19.5 | 45.8 | 7.7 |
| | 74.9 | 17.4 | 60.3 | 3.8 |
| United States | 25.1 | 18.6 | 64.0 | 48.9 |
| | 23.5 | 16.5 | 31.1 | 35.6 |

Source: Selected data from Julio J. Nogues, Andrzej Olechowski, and L. Alan Winters, *The Extent of Nontariff Barriers to Imports of Industrial Countries*, World Bank Staff Working Papers 789 (Washington, D.C.: World Bank, 1986), p. 52.

Note: Upper numbers refer to imports from developing countries, lower numbers to imports from industrialized countries.

## Table 4—Percentage of seven industrial countries' imports of agricultural products subject to nontariff barriers, by type of measure, 1983

| Country | Quantitative Restrictions | Decreed Prices[a] | Tariff Type[b] | Monitoring[c] |
|---|---|---|---|---|
| | | (percent) | | |
| Australia | 21.4 | 9.2 | 0.0 | 0.0 |
| | 44.8 | 1.7 | 0.0 | 3.0 |
| Austria | 37.8 | 3.0 | 1.2 | 0.0 |
| | 14.3 | 24.6 | 9.1 | 0.0 |
| EC | 14.1 | 13.4 | 6.6 | 2.7 |
| | 21.3 | 27.2 | 8.0 | 2.2 |
| Japan | 46.0 | 0.0 | 7.9 | 0.0 |
| | 31.4 | 0.1 | 6.2 | 0.0 |
| Norway | 14.4 | 5.2 | 5.6 | 0.2 |
| | 24.9 | 5.0 | 3.6 | 0.5 |
| Switzerland | 19.4 | 0.2 | 0.9 | 50.3 |
| | 47.0 | 8.8 | 2.6 | 26.7 |
| United States | 18.1 | 15.2 | 3.8 | 3.3 |
| | 8.7 | 4.1 | 2.2 | 13.0 |

Source: Selected data from Julio J. Nogues, Andrzej Olechowski, and L. Alan Winters, *The Extent of Nontariff Barriers to Imports of Industrial Countries*, World Bank Staff Working Papers 789 (Washington, D.C.: World Bank, 1986), p. 55.

Note: Upper numbers refer to imports from developing countries, lower numbers to imports from industrialized countries.

[a] Variable levies, minimum import and export prices.

[b] Tariff quotas, seasonal tariffs.

[c] Price and volume investigations, surveillance, antidumping, and countervailing duties.

and technical or sanitary standards. (More detail is provided in Nogues, Olechowski, and Winters 1986, 7.) Especially the omission of quality standards and state trading is likely to seriously underestimate the extent of nontariff barriers for agriculture. (See Bale and Koester 1983 for an assessment of the importance of nontariff barriers for agriculture.)

Recently, domestic production subsidies have also grown in importance for agricultural trade, threatening to nullify or impair market access in an indirect way, other than through border protection. For example, in early 1988 the United States was about to bring before the GATT a dispute it has had for some time with the EC regarding production subsidies by the EC to soybeans and other oilseeds. The subsidies are considered by the United States to be a violation of Article XXIII of the General Agreement because they have effectively nullified or impaired the zero-tariff binding the United States received from the EC on these products during the Dillon Round.

High tariff and nontariff protection are indicative of a massive diversion of resources in favor of agricultural support programs. Table 5 provides some idea of the order of magnitude of the financial transfer for the larger OECD countries. It should be noted at the outset that not all expenditures listed in the table are equally trade distorting. Deficiency payments, for example, which fall under the category "price and income support," distort trade less than variable levies that give rise to domestic surpluses and their eventual disposal via export subsidies. Subsidies to domestic consumers, a big expenditure item of the U.S. agricultural program and included under the item "processing, marketing, consumer aid," even counteract some of the trade-distorting effect of agricultural support programs.

The figures on taxpayer and consumer expenditures in Table 5 are for the period 1979-81. Although they are lower than the presently incurred costs for most countries, they have the advantage of being roughly comparable across countries. In particular, the EC and Japan clearly stand out in that their consumer expenditures are particularly high relative to taxpayer expenditures. This reflects in part their heavy use of frontier barriers to trade relative to other

**Table 5—Financing of agricultural policy by seven industrial countries, 1979-81 average**

| Expenditures | Australia | Austria | Canada | EC-Total[a] | Japan | New Zealand | United States |
|---|---|---|---|---|---|---|---|
| Taxpayer expenditures | | | | | | | |
| Total (ECU billion) | 0.47 | 0.49 | 1.64 | 21.15 | 10.19 | 0.25 | 19.39 |
| Share due to— | | | | | | | |
| Processing, marketing, and consumer aid (percent) | 7.0 | 1.9 | 14.9 | 10.2 | 1.6 | 0.1 | 54.6 |
| Price and income support (percent) | 21.7 | 69.3 | 51.8 | 56.8 | 43.8 | 33.3 | 18.3 |
| Research and extension (percent) | 4[illegible].4 | 2.9 | 10.6 | 6.0 | 3.3 | 19.9 | 4.2 |
| Other[b] (percent) | 24.9 | 25.9 | 22.7 | 27.0 | 51.3 | 46.7 | 22.9 |
| Consumer expenditures (ECU billion) | 0.2 | 0.9 | 0.9 | 35.8 | 16.7 | 0.0 | 7.0 |
| Total expenditures[c] | | | | | | | |
| Per capita (ECU) | 43 | 188 | 103 | 208 | 204 | 79 | 115 |
| Per worker in agriculture (ECU) | 1,558 | 4,736 | 4,203 | 7,465 | 4,090 | 1,778 | 7,453 |
| Per hectare (ECU) | 1.3 | 384.2 | 35.9 | 613.4 | 4,361.5 | 17.0 | 61.3 |
| As percent of GDP | 0.5 | 2.6 | 1.2 | 2.8 | 2.9 | 1.4 | 1.3 |

Source: Based on data from Organisation for Economic Co-operation and Development, *National Policies and Agricultural Trade* (Paris: OECD, 1987), pp. 128, 132, 134.

Note: ECU European Currency Unit.

[a] Includes expenditures by the European Community authorities and those of the national governments of member states.

[b] Inspection services and disease control, rationalization of production, improvement of structures, rural development, and other expenditures whose breakdown by category of expenditure is not available.

[c] Includes taxpayer and consumer financed expenditures.

countries (Table 3). Heavy reliance on border measures is likely to be more disruptive to international trade than nonfrontier barriers. Yet from the viewpoint of domestic politics, such measures look rather attractive. Not only can border measures be more easily justified in terms of food security, they also make it easier to maintain larger agricultural support programs because their financial burden is borne by generally uninformed and hence docile consumers rather than by possibly not-so-docile taxpayers.[5]

The share borne by consumers via higher prices is far more difficult to ascertain than federal budget allocations to agricultural support programs that are subject to highly public discussions. Hence, viewed from this perspective, higher levels of agricultural support would be expected in countries relying more heavily on consumers than on taxpayers to pay for agricultural support. This seems to be borne out in reality. Austria, the EC, and Japan, the three countries that make their consumers bear the brunt of the financial burden of agricultural programs, also have the highest overall expenditures on agricultural support programs, both per capita and per hectare of cultivated land.

Tables 6 and 7 provide a glance at fiscal expenditures over time for the EC and the United States, respectively. (Note that, unlike Table 5, Table 6 considers only the supranational expenditures of the EC. National expenditures in addition to these are included in Table 5.) Unlike the more comprehensive Table 5, Tables 6 and 7 refer only to expenditures for price and income support. For the EC as a supranational institution, this category comprises about three quarters of all fiscal expenditures on agriculture. By contrast, it is much less important for the United States, although it has increased in significance since the passage of the 1985 farm bill.[6] Most of the expenditures of the United States are concentrated downstream from farm production. They are used to improve sales of agricultural products through marketing assistance, better processing infrastructure, market research, and, in particular, through consumption subsidies (Table 5).

Tables 6 and 7 not only document the growth in fiscal expenditures on agriculture, both in absolute terms and relative to gross domestic product (GDP), they also give a rough idea of the distribution by commodity of these expenditures. For both the United States and the EC, dairy products and cereals receive most of the support payments. As a result, it is not surprising to find that the world markets for these products are among those that are the most distorted.

Table 8 provides some recent estimates of the degree of world market distortion for some cereal and dairy products and a few others. The figures in the table give just an order of magnitude: differences in methodology and data base can lead to somewhat different results without, however, changing the basic message that many markets for agricultural products are heavily distorted by government intervention.[7] World market prices and trade flows, rather than comparative advantage, have come to reflect the relative ability of countries to subsidize. Market access has become highly uncertain for exporters, thereby inflicting a heavy burden on nonsubsidizing exporters, including numerous highly indebted developing countries. In addition, market or price stability has been lost as world markets increasingly degenerate into

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[5] See Hayami 1986, 37-38. Note, however, that export subsidies, although classified as frontier barriers, are financed out of tax revenue.

[6] For the years 1979 through 1981, the average percentage of U.S. fiscal expenditures in this category was only 18.3 percent according to Table 5. With the farm bill of 1985, however, this ratio has increased, as expenditures for income and price support have risen about sevenfold from 1979-81 to 1986-87.

[7] Numerous quantitative studies have appeared in the 1980s, among them Valdés and Zietz 1980; Organisation for Economic Co-operation and Development 1987; and Tyers and Anderson 1986. A convenient survey of quantitative results is provided in Valdés 1987. A very readable account of the anomalies of international agricultural trade is provided by Miller (1986).

# Table 6—Gross expenditures by the EC for price support and income transfers, 1974-87

| Type | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | (EUA/ECU billion)[a] | | | | | | | |
| Outlays of EAGGF[b] | 3.1 | 4.7 | 5.6 | 6.8 | 8.7 | 10.4 | 11.3 | 11.0 | 12.4 | 15.8 | 18.4 | 19.7 | 22.1 | 23.0 |
| | | | | | | | (percent) | | | | | | | |
| As share of EC GDP | 0.34 | 0.46 | 0.44 | 0.48 | 0.55 | 0.59 | 0.57 | 0.49 | 0.51 | 0.61 | 0.66 | 0.66 | 0.63 | 0.62 |
| Share of— | | | | | | | | | | | | | | |
| Restitutions[c] | 19.0 | 20.5 | 26.2 | 37.5 | 40.8 | 47.7 | 50.6 | 46.8 | 40.8 | 33.8 | 34.5 | 33.8 | 33.5 | 39.8 |
| Interventions[d] | 81.0 | 79.5 | 73.8 | 62.5 | 59.2 | 52.3 | 49.7 | 53.2 | 59.2 | 66.2 | 65.5 | 66.2 | 66.5 | 60.2 |
| Share of— | | | | | | | | | | | | | | |
| Dairy products | 39.4 | 24.3 | 40.8 | 42.8 | 46.3 | 43.4 | 42.0 | 30.0 | 26.8 | 27.6 | 29.6 | 29.9 | 24.4 | 26.6 |
| Beef | 10.5 | 20.7 | 11.0 | 6.8 | 7.4 | 7.2 | 12.0 | 12.9 | 9.3 | 10.9 | 13.9 | 13.8 | 15.7 | 10.2 |
| Cereals | 12.9 | 13.1 | 11.7 | 9.2 | 12.8 | 15.0 | 14.8 | 17.2 | 14.7 | 15.3 | 9.0 | 13.8 | 15.3 | 15.9 |
| Sugar | 3.5 | 6.5 | 4.1 | 8.8 | 10.1 | 9.0 | 5.1 | 6.9 | 10.0 | 8.3 | 8.9 | 11.6 | 7.8 | 7.1 |
| Oils and fats[e] | 4.6 | 4.9 | 5.5 | 4.5 | 3.7 | 5.8 | 6.1 | 9.2 | 9.8 | 10.2 | 9.5 | 9.1 | 11.8 | 13.2 |
| Fruit and vegetables | 2.2 | 1.9 | 3.3 | 2.6 | 1.2 | 4.2 | 6.1 | 5.8 | 7.4 | 7.5 | 7.3 | 9.1 | 4.4 | 4.2 |
| Wine | 1.4 | 2.9 | 2.4 | 1.3 | 0.7 | 0.6 | 2.6 | 4.1 | 4.6 | 4.1 | 6.6 | 6.2 | 2.8 | 5.5 |
| Other products | 25.7 | 25.5 | 21.1 | 24.0 | 17.8 | 14.9 | 11.3 | 13.9 | 17.4 | 16.1 | 15.2 | 15.6 | 17.8 | 17.3 |

Source: Based on data from: Commission of the European Communities, *The Agricultural Situation in the Community*, various issues (Brussels and Luxembourg: CEC, various years).

[a] From 1974 to 1978, expenditures are given in European Units of Account; from 1979 to 1987, they are in European Currency Units. Figures do not include expenditures by national governments.

[b] European Agricultural Guidance and Guarantee Fund; the figures exclude expenditures of the "guidance section."

[c] Export subsidies.

[d] Including stock holding, less production levies for milk.

[e] Includes expenditures for olive oil.

## Table 7—Net expenditures by the United States for price support and income transfers, 1974-87

| Type | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | (US$ billion) | | | | | | | |
| Total expenditures[a] | 1.0 | 0.6 | 1.0 | 3.8 | 5.6 | 3.6 | 2.7 | 4.0 | 11.6 | 18.8 | 7.2 | 17.6 | 25.8 | 22.4 |
| | | | | | | | (percent) | | | | | | | |
| As share of U.S. GDP | 0.07 | 0.04 | 0.06 | 0.19 | 0.25 | 0.[illegible] | 0.10 | 0.13 | 0.37 | 0.56 | 0.19 | 0.44 | 0.61 | 0.50 |
| Share of[b]— | | | | | | | | | | | | | | |
| Maize | 44.2 | 26.1 | 11.0 | 10.[illegible] | 30.2 | 24.3 | 46.2 | [c] | 36.9 | 30.5 | ... | 25.1 | 40.7 | 55.1 |
| Wheat | 20.8 | 4.4 | 6.9 | 49.[illegible] | 14.9 | 8.4 | 31.9 | 38.5 | 19.2 | 18.2 | 35.1 | 26.4 | 13.3 | 12.7 |
| Dairy products | 4.6 | 73.8 | 4.0 | 12.[illegible] | 4.3 | 0.7 | 37.2 | 47.4 | 18.8 | 13.5 | 20.9 | 11.9 | 9.0 | 5.2 |
| Cotton | 72.2 | 40.5 | 0.8 | 2.[illegible] | 4.0 | 4.0 | 2.4 | 8.4 | 10.3 | 7.3 | 3.4 | 8.8 | 8.3 | 8.0 |
| Soybeans | 2.6 | ... | ... | 0.[illegible] | 0.6 | 0.1 | 4.3 | 2.2 | 1.5 | 1.5 | ... | 4.0 | 6.2 | ... |

Source: Selected data from Joachim Zietz. "Der Agrarsektor in den GATT-Verhandlungen," *Die Weltwirtschaft* 1 (June 1987): 200-211.
Note: Expenditures on PL480 food aid are excluded.
[a] Gross expenditures minus repayments of credit.
[b] Shares of the net expenditures do not sum to 100.
[c] Receipts exceed expenditures because of repayment of credit.

**Table 8—Price and trade effects of agricultural protection, by various products and countries, 1980-82**

| Effect | Wheat | Feed-grains | Rice | Beef and Veal | Dairy Products | Sugar |
|---|---|---|---|---|---|---|
| | | | (percent) | | | |
| Change in world market price | -9 | -3 | -10 | -21 | -38 | -10 |
| Change in world trade volume | 6 | -9 | -15 | -63 | -39 | -3 |
| | | | (million metric tons) | | | |
| Absolute change in export volume | | | | | | |
| Group 1[a] | 4.5 | 4.0 | 3.8 | 5.6 | 14.0 | 2.3 |
| Group 2[b] | 3.0 | -8.6 | 0.2 | -2.1 | 14.4 | 0.7 |
| Group 3[c] | -2.6 | 1.9 | -0.0 | -0.5 | -6.2 | -0.0 |
| Group 4[d] | -4.9 | 2.3 | -4.0 | -2.9 | -22.0 | -2.9 |

Source: Based on data from Rodney Tyers and Kym Anderson, "Global Interactions and Trade Liberalisation in Agriculture," University of Adelaide, April 1987 (revised mimeo).

[a] Western Europe (12 countries in the European Community, 5 in the European Free Trade Association), Japan, Korea, Taiwan.

[b] Australia, New Zealand, Canada, United States.

[c] Centrally planned economies of Eastern Europe.

[d] Other developing countries.

dumping grounds of domestic farm policies that have run out of control.[8] It is not surprising then that agricultural trade has become the area of many, if not most, trade disputes and conflicts in recent years.

What have been the reasons for the persistence and growth of agricultural protection? This question is not trivial; the costs of protection are large and extend beyond agriculture into other sectors of the economy.[9] In addition, the agricultural population is rather small in most industrial countries and is continuing to shrink. For example, the average percentage of the labor force employed in agriculture for the 19 countries classified as Industrial Market Economies by the World Bank was only 6 percent in 1981, compared with 14 percent in 1965 (World Bank 1985, 215). Nevertheless, farmers seem to be able to muster considerable political clout.

To a large degree the political influence of farmers simply reflects a rational complacency on the part of consumers. Although consumers potentially gain the most from trade liberalization, there are well-known problems in rallying their support: (1) lack of appropriate information regarding the costs of agricultural protection for food prices, but also for job creation in nonagriculture, results in small perceived personal gains from liberalizing agricultural trade; (2) other things being equal, the costs of agricultural protection per capita decrease with rising incomes because the income elasticity of demand for agricultural goods is generally less than unity; (3) high transaction costs make it difficult to organize a large body of people with diverse interests, such as consumers, as opposed to a smaller and shrinking group with distinct concerns in just one subject; and (4) the income loss that results from agricultural protection may be

[8] Quantitative evidence on the instability of world agricultural markets as it results from import protection is provided in Schuh 1985. See also Tyers and Anderson 1987.

[9] The analysis of the costs of agricultural protection to sectors outside of agriculture is rather new. Examples of this type of work were recently presented at a joint conference of the American Enterprise Institute and the Center for International Economics (Australia) on "Agricultural Policies and the Non-farm Economy" in Washington, D.C., May 26-27, 1988. For example, see Stoeckel and Breckling 1988 and Donges et al. 1988.

considered akin to an insurance premium that buys social solidarity if an individual's job should be in danger. (See Hayami 1986 and Honma and Hayami 1986 for more detailed analyses of these problems.)

The aspect of solidarity also goes some way in explaining why protection in agriculture, however costly it may have come to be, meets with little resistance from other sectors and industries. As long as persistent protection in agriculture does not directly affect other industries in the form of reduced subsidies or forgone profits of significant magnitude, little change can be expected in their acceptance of agricultural protection. In sum, an insufficient degree of domestic countervailing power, that is, the lack of a forceful and influential antifarm lobby, is a reason, if not the main one, for the political clout of farmers.[10]

Apart from that, the growth of agricultural protection can be traced mainly to two factors: the decline in the relative size of the agricultural sector and trade retaliation. A decrease in the relative size of the agricultural sector allows, all else being equal, for an increase in protection without requiring a change in the level of budget outlays. Retaliation for one country's protective actions may partially or fully eliminate the intended effect of the protection. Hence, in a world where trade retaliation is the rule rather than the exception, securing a certain protective effect to farmers may require, if not an ever-increasing level of protection, then certainly an ever-increasing level of budgetary outlays (Tables 6 and 7).

Even the high degree of protection currently applied in many industrialized countries and their considerable budgetary outlays do not appear to be sufficient to compensate for the effect of similar actions in most industrialized countries. Indeed, retaliatory actions have resulted in making farmers worse off now than they were years ago. Despite escalating costs, recent experience in many industrialized countries has seen declining rather than rising farm incomes (Organisation for Economic Co-operation and Development 1987, 59). In addition, there is no evidence that agricultural policies have managed to reduce income disparities within agriculture, one of the prime reasons for government intervention in the market in the first place. Instead it appears that the large, well-to-do farmers are reaping most of the benefits of governmental programs, thereby making agricultural protection a highly inefficient redistribution scheme (see Koester and Tangermann 1987). A recent study found, for example, that for both the United States and the EC more than 75 percent of agricultural assistance is received by less than 25 percent of all farmers (Organisation for Economic Co-operation and Development 1987, 59).

## Reactions to Mounting Protection

Mounting budgetary costs, disruptive trade disputes, and the realization that the target group of agricultural market intervention is not reached to the intended degree seem to have made industrialized countries more perceptive of the need for agricultural trade reform in recent years. In line with this sharpened awareness, work on a new multilateral trade round started in the Committee on Trade in Agriculture in 1982, when it was established within the GATT framework by a ministerial conference. At about the same time the OECD Secretariat was given the mandate by its Ministerial Council to analyze the effects of agricultural protectionism and ways to improve the functioning of world markets for agricultural products.

Efforts for a new trade round culminated in the Special Session of the GATT Contracting Parties in Punta del Este (Uruguay) in September 1986. On the occasion of this special session the ministers of GATT member countries adopted a declaration launching a new round of

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[10] For a discussion of the political-economy problems in the EC, see Schmitt 1986. A more comprehensive study that includes the United States is Petit 1985.

multilateral trade negotiations—the Uruguay Round. The main results of the constituting meeting in Punta del Este, as they relate to agriculture, broadly reflect the concerns expressed in recent research: improving market access, reducing direct and indirect subsidies with trade impact, and minimizing the trade impact of health regulations and standards.[11] That an agreement was reached at all in Punta del Este is by itself no small surprise, given the diversity of interests represented at the conference. However, identifying the agenda for action, although a necessary first step for reform, is not equivalent to agreement on the needed course of action. After all, disagreement on the appropriate policy reforms is not limited to policymakers of different countries, but also figures prominently among economic researchers.

Almost two years after the Punta del Este declaration, overall progress is rather modest. Separate negotiating groups have been set up for each of the 14 "Subjects For Negotiation" mentioned in the Punta del Este declaration (see Appendix 3 for a list of these subjects). Of these, four are sector- or commodity-specific—the groups for tropical products, natural resource-based products, agriculture, and textiles and clothing. It may be noted that agricultural products are discussed in three of the four groups. Other negotiating groups are dealing with barriers to trade, such as tariffs, nontariff barriers, and subsidies, and yet others with GATT articles, safeguards, and related matters.

Within the various groups, much of the time has been spent on taking stock of the various proposals that have been put forth by the contracting parties. Depending on the complexity of the issues, progress is rather varied among the groups. The group on tropical products,[12] for example, which is of central importance for many low-income developing countries, seems to have progressed rapidly. (See Valdés and Zietz 1980 for the quantitative importance of the tropical products group for LDCs.) It even seems possible that an initial round of tariff reductions can be put into effect for tropical products by 1989. By comparison, the negotiating group on agriculture, which is of central interest to most industrialized and many higher-income developing countries,[13] took until the end of 1987 just to collect the reform proposals of the main participants in international trade.[14]

Six major reform proposals have been tabled in the negotiating group for agriculture (an overview of these proposals can be found in U.S. General Accounting Office 1988). They come from the United States, the Cairns Group,[15] Canada,[16] the Nordic countries,[17] the EC, and Japan. The proposals can be grouped into two broad categories, one with a comprehensive scope covering all commodities and calling for the removal of all trade-distorting measures, and one

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[11] The complete text of the Punta del Este Declaration can be found in GATT Secretariat 1986. An abbreviated version of the Ministerial Declaration on the Uruguay Round with citations of those passages of particular interest in the context of this study is presented in Appendix 3.

[12] Seven product groups are part of this negotiating group: tropical beverages (coffee, cocoa, and tea); spices, flowers, and plants; certain oilseeds, vegetable oils, and oilcakes; tobacco, rice, and tropical roots; tropical fruits and nuts; tropical wood and rubber; and jute and hard fibers.

[13] Higher-income developing countries are mainly affected as exporters. The concerns of many food-importing low-income developing countries, whose terms of trade would deteriorate with restrictions on export subsidies, have been given rather scant attention so far in the negotiating group on agriculture, although Jamaica, supported by a number of other developing countries, has put forth a communication to this effect. See GATT Secretariat 1988b, 6.

[14] The second phase of the negotiating group for agriculture, which began in February 1988, will concentrate on the actual negotiations. It has no fixed completion date.

[15] The Cairns Group was established in Cairns, Australia, in August 1986. Its members are Argentina, Australia, Brazil, Canada, Chile, Colombia, Hungary, Indonesia, Malaysia, New Zealand, the Philippines, Thailand, and Uruguay. The countries of the Cairns Group represent some 550 million people and account for roughly one quarter of the total amount of agricultural exports.

[16] Although a member of the Cairns Group, Canada proposed a more detailed plan of its own.

[17] This group consists of Finland, Iceland, Norway, and Sweden.

with a narrower scope, particularly regarding the removal of import restrictions and domestic subsidies. The proposals of the EC, Japan, and the Nordic countries fall into the latter category, the remaining proposals into the former.

The most sweeping proposal comes from the United States (see the statement of Undersecretary of Agriculture Daniel Amstutz in U.S. Department of Agriculture 1987). It calls for the elimination, gradually over 10 years, of all barriers to agricultural imports and of all farm subsidies that distort agricultural trade either directly or indirectly.[18] In adopting the measurement concept of the OECD Ministerial Mandate study (Organisation for Economic Co-operation and Development 1987), the U.S. proposal suggests converting all support programs to a common denominator, such as the Producer Subsidy Equivalent (PSE), which is discussed in detail in Chapter 5. Exempted from this are programs with little or no effect on production and trade, such as certain forms of food aid and income supplements not linked to production. The proposals by the Cairns Group and Canada are similar to the U.S. proposal in principle. (The idea behind the Cairns Group proposal is discussed in some detail in Reeves 1987.) These proposals also subscribe to some degree or other to the measurement concept of PSE or modifications thereof. In contrast to the U.S. proposal, however, they also contain some suggestions for short-term measures, such as a freeze on import restrictions and all subsidies affecting trade.

The EC position is far removed from that of the United States. In fact, compared with the U.S. proposal it is at the opposite end of the spectrum. Its main focus is short run rather than long run. What the EC proposes, at least in a much-emphasized initial phase, is essentially a system of market management, that is, an item-by-item agreement on minimum prices and market sharing for those commodities for which the world market appears to be particularly distorted—grains, dairy products, and sugar. (Part of the short-run solution appears to be the EC's desire to harmonize protection levels for grains and grain substitutes, which implies raising the protection levels for grain substitutes to those for grains.) In a second phase, the EC envisions some longer-term concerted reduction, though not elimination, of farm support programs. However, the EC has not made it clear how the second phase is linked to the first. Despite the general vagueness of the EC proposal, it seems clear that the EC is not willing to discuss the basic structure of the Common Agricultural Policy.

The trade reform proposals of Japan and the Nordic countries have in common with the EC proposal that they do not call for the complete elimination of all import restrictions and domestic subsidies, but only for their reduction. Both are disposed toward severe restrictions on export subsidies because that is where they appear to see the main root of the current problems in agricultural trade—a position that essentially reflects their status as net importers of agricultural products. The Nordic countries support the aggregate negotiating approach, favored also by the United States, for reducing levels of support based on PSE or similar measures. Japan, in contrast, has rejected the PSE approach to the negotiations on the grounds that it could not reflect the special characteristics of a country's agriculture.

Given the disagreement over agricultural trade reform between the United States and the EC, the two main players in the negotiations, the initial optimism after the signing of the Punta del Este declaration seems to have given way to pessimism and frustration.[19] Apart from the EC and Japan, most participants appear to favor at this time a closer look at the usefulness of the PSE measurement concept, which was at the center of the OECD Ministerial Mandate

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[18] In addition, the United States proposes harmonizing health and sanitation regulations among GATT signatories so that differences cannot be used as indirect trade barriers. This idea is not controversial among the participants of the Uruguay Round. Essentially all countries have a similar element in their own proposals.

[19] See, for example, *Agra Europe*, March 18, 1988, E/1-E/2.

study. The hope behind this seems to be that by establishing a general approach to the negotiations in agriculture, the current deadlock can be overcome.

This idea may of course be generalized for the whole Uruguay Round. What appears to be missing at this point is a simple central theme or unifying principle, similar to the across-the-board tariff-cut idea of the last two multilateral trade negotiation rounds. It may be asked to what extent concepts such as PSE that appear attractive for agricultural products, but only agricultural products, will not enhance but inhibit progress for the Uruguay Round as a whole by preventing agreement on a truly general reform concept that is applicable across all products. It seems that not only the negotiating group on agriculture is in need of a unifying concept or a clearer set of guideposts by which to organize its discussions. Other negotiating groups appear to face a similar problem.

The following two chapters undertake to facilitate the process of finding such a unifying principle for the Uruguay Round by clarifying some of the more important issues surrounding various proposals for trade reform in agriculture, providing some needed structure to the debate on diverse proposals, and discussing the likely economic consequences and political-economy implications of some ideas for reforming agricultural trade within the GATT.

# 4

# CRITERIA FOR EVALUATING TRADE REFORM PROPOSALS

## Conformity With GATT Principles

The GATT is built around a number of fundamental principles that form the backbone of the current trading system. Nondiscrimination by country of origin and a general ban on quantitative import restrictions are the two most important of these principles. During a time when trade disputes seem to be a regular occurrence, the disciplines that these principles are supposed to impose on the trading system and its participants appear to be eroding (see Teese 1982). GATT rules based on these principles are simply being ignored—for example, the provisions of the safeguard clause of Article XIX—or they are being circumvented by resort to gray-area measures such as voluntary export restraints.

In the light of this erosion process, at least one school of thought, popular in the EC, draws the conclusion that the growing disregard of GATT rules can be stopped only by rewriting them in a way that relaxes their reliance on pristine principles such as nondiscrimination. The idea is to bridge the apparent gap between reality and the rules of behavior mandated by the General Agreement by adjusting the rules so they better reflect reality (see the discussion in Adlung 1987). In practical terms this means, for example, eliminating the nondiscrimination or compensation provisions from the safeguard clause of Article XIX. This would increase, it is argued, the incentive to stick to Article XIX, or its watered-down revision, rather than to opt for mechanisms outside of GATT, such as voluntary export restraints. Experience with vague GATT rules in agriculture, however, does not give much credibility to this view. On the contrary, the experience of agriculture amply demonstrates that vaguer, less-demanding formulations of GATT rules that chip away at the fundamental principles of the General Agreement are more likely to provoke serious trade disputes or even trade wars than to bring about more GATT discipline. Hence there is evidence to suggest that weakening the rules of behavior mandated by the General Agreement and its underlying principles is a serious mistake.

A better alternative may be to try to reinforce the GATT and its basic principles through improved operational rules and regulations. Improvement in this sense does not mean compromising the principles of the General Agreement through weakened rules of behavior but rather making the rules that incorporate these principles more compatible with the incentives governments face. The principles themselves are too important to be given up. Their significance for a proper functioning of the GATT system is discussed in the remainder of this section.

### Nondiscrimination

The cornerstone of the GATT trading rules is the principle of nondiscrimination, also known as the principle of "unconditional most-favored-nation" (MFN) treatment. It requires that any trade advantage granted to one signatory of GATT be extended to all others. Likewise, import restrictions apply equally to imports from all sources. The MFN principle ensures equal trading opportunities for all signatory countries and provides a multilateral as opposed to a bilateral framework for the international trading system.

The importance of the MFN principle for the international trading system can hardly be overestimated. It is by far the simplest and, if enforced properly, probably one of the most effective ways of moderating the growth of protectionism. Indeed, the spread of protectionism can be traced largely to the growing disrespect for the MFN principle.[20] Voluntary export restraints or selective import restrictions are examples of blatant violations of the MFN principle. A single country or a few of the most efficient and hence lowest-cost exporting countries are singled out under these schemes and subjected to trade restrictions.

Strict adherence to the MFN principle would mean imposing import restrictions on all trading partners in an equal manner, with two important consequences. First, it would mean treating the most efficient and hence lowest-cost producer in the same way as less efficient producers, thereby improving the efficiency of international resource allocation. Second, the level and duration of import protection would probably be reduced. As all actual and potential suppliers would be affected by import restrictions, more political pressure would be put on the import-restricting country than is applied in a system dominated by bilateral trade agreements.

Stepped-up pressure would most likely result from three sources. First, the largest trading nations with the most political power would be subjected to the same restrictions as smaller and politically less influential countries. This would raise significantly the price to be paid by protecting countries for additional import protection. A particular special interest group, such as grain farmers or the farm lobby in general, would have a harder time convincing politicians of the merit of protectionist measures in their area of interest when retaliation by a potent trading partner was threatening to damage the trade interests of other special interest groups in the country such as meat producers or machine tool manufacturers. Second, global restrictions would eliminate the quota rents that many exporters now receive as partial compensation for their export restraint. As these rents can be substantial,[21] their removal would make exporters much less likely to quietly accept restraint agreements. Third, nondiscriminatory protection is making it easier for consumers and voters to identify the true economic costs of protection. Better knowledge may provide an additional impetus to the eventual removal of import protection. (See Banks and Tumlir 1986 for a discussion of this and other advantages of the MFN principle for international trade.)

Since the MFN principle has great potential for restraining protectionism, it is worth every effort to strengthen it. This would include, among other things, avoiding the introduction of new rules that are either not in full agreement with the MFN principle or are silent on it, thereby allowing signatory countries to easily avoid its disciplines. Chapter 5 includes a discussion of the possibility that rewriting the GATT rules for agriculture around the concept of PSEs could weaken the force of the MFN principle.

The history of the General Agreement demonstrates that full and unconditional enforcement of the MFN principle is not easy to achieve. It may conflict with such matters as customary procedures in international trade, the interests of powerful lobbies, and conceptions of fairness. For example, a common argument against an unconditional application of the MFN principle in agriculture is the potential terms-of-trade loss for LDCs with preferential access, under the Lomé agreement, to the market of the EC. (The Lomé Convention provides 44 African, 13 Caribbean, and 8 Pacific countries with preferential access to the EC market.) However, this argument against the MFN principle is based on weak foundations, for several reasons. First, any move toward trade liberalization is likely to increase world price compared with what

[20] The MFN principle has never had much force behind it in the GATT system, particularly not in the parts of the General Agreement that sanction trade restrictions in specified circumstances, such as Article XIX.

[21] For example, Hong Kong's quota rents derived from textiles and clothing amount to approximately 2 percent of gross national product. See Hamilton 1986.

it would otherwise be.[22] This alone would provide exporting LDCs with some degree of compensation for the loss of preferential access.

Second, there is some evidence that preferential access may actually distort the domestic allocation of resources in LDCs (Dick, Gerken, and Vincent 1982). Economic growth is guided by artificial price signals that may have little relationship to world market conditions in the absence of protection. Preferences then lead to artificial, possibly unsustainable, economic structures in LDCs, requiring restructuring measures that are costly both in economic and political-economy terms once protection in importing countries is dismantled. Unconditional MFN treatment would eliminate this distortion and hence might raise potential real income.

Third, the EC could compensate LDCs directly via income transfers for any remaining income loss. It is unlikely that the required budgetary costs of such a transfer program would exceed the additional market support expenditures currently needed to maintain the preferential access schemes in the face of mounting domestic surpluses. For example, the benefits of the Lomé Convention to the African, Caribbean, and Pacific (ACP) countries that receive preferential access to the EC are not considered to be significant on average. This does not mean that there are not some countries that do capture substantial benefits in certain products (see Koester and Herrmann 1987).

Direct compensation is likely to be possible also in lieu of the Generalized System of Preferences (GSP),[23] especially if the newly industrialized countries are eliminated from the list of countries receiving tariff preferences. As they now reap most of the benefits of the GSP,[24] their graduation would cut any potential compensation payments to a minimum. The GSP scheme seems dispensable also on other grounds. It includes only tariffs, not quotas. Unlike the EC-ACP convention of Lomé, the GSP gives LDCs little certainty about the preferences. Since the GSP is not part of a binding commitment under the GATT, but is a completely voluntary concession, it may be revoked at the discretion of the preference-giving country at any time. Clearly, this introduces a great deal of uncertainty and is therefore not conducive to long-run investment decisions in preference-receiving countries.

Finally, preferential-access schemes, regardless of the type, have a definite drawback from a political-economy viewpoint. They tend to promote an alliance of preference-giving and preference-receiving countries against MFN reductions in protectionism. Such reductions are likely to hurt the short-run interests of both import-competing sectors in the protecting country and exporters with preferential access to these protected markets. Both groups are likely to be well organized in their respective countries relative to consumers and other groups that are affected negatively, but less directly, by a system of protection cum preferences. Therefore, governments in protecting countries face little countervailing pressure for a removal of protection, either from within the country or from exporting countries. Preference schemes can thus be a formidable obstacle on the way to an elimination of trade barriers in a multilateral setting.

Although complete and unconditional implementation of the MFN principle will not be easy to achieve, its further erosion has to be avoided because the costs of scrapping the MFN idea are high, both for industrialized and developing countries. The trade regime covering textiles and clothing (known as the Multifiber Arrangement) provides an example of the costs to the international trading system if basic GATT principles such as nondiscrimination are given up.[25]

[22] The many studies on the effects of trade liberalization in agricultural products all point in this direction. See Leddy and Reinstein 1987, Organisation for Economic Co-operation and Development 1987, Hudec 1987, Finger and Olechowski 1987, and Valdés 1987.

[23] Opinions vary widely on this. See, for example, GATT Secretariat 1985.

[24] Details are given in, for example, Langhammer and Sapir 1987.

[25] Donges et al. (1981) provide a summary account of the issues surrounding the trade regime in textiles and clothing. Spinanger and Zietz (1986) give a shorter description with some illustrative figures.

Put into effect in 1974, prolonged and extended in coverage as well as severity four times since then, the Multifiber Arrangement is the prime example of a sectoral, discriminatory system founded on the principle of managed trade. (A comprehensive discussion of the Multifiber Arrangement and its economic costs can be found in Wolf et al. 1984.)

Managed trade of the Multifiber Arrangement type is synonymous with a tangle of bilateral contracts, with industrialized countries setting their terms. Essentially all efficient, low-cost, developing-country exporters are forced into "voluntary" export restraint agreements, thus leading to the virtual cartelization of the textiles and clothing trade and leaving little if any room for the forces of competition. Also lost on the way is the simplicity of trading in a world of bound tariffs known in advance with certainty to all traders, established and potential. Managed trade under the Multifiber Arrangement has brought relative security of access for a few established exporters, but at the expense of a maze of bureaucratic trade rules and regulations that even experts find ever harder to understand and keep track of. In a word, experience has shown managed trade to be far removed from the letter and spirit of the General Agreement. Its high economic costs make the alternative, that is, the MFN principle, look like a very good deal economically.

## Reliance on the Price Mechanism

A second important principle of the GATT is its reliance on the price mechanism as opposed to quantitative rules characteristic of managed trade. This principle is expressed in the use of bound tariffs as the GATT's main form of protection, whereas quantitative barriers to trade are limited to exceptional cases (see Article XI and the corresponding explanatory notes in Appendix 1). The rationale behind this principle is straightforward. Leaving aside for the moment the possibility of prohibitive tariffs, it helps to keep international trade market-oriented in the sense that national economic policies and the resulting trade flows are not allowed to become totally delinked from market forces. Reliance on bound tariffs ensures that the price mechanism is not suspended but merely modified, with all its well-known consequences such as transparency of import protection, predictability of market access, nondiscrimination among suppliers, sourcing from the most competitive supplier, and improved international market stability.

Although most of these results favor all exporters, they are particularly important for developing countries that may have neither the resources nor the expertise to find their way through a thicket of continually changing regulations characteristic of systems of managed trade. Last but not least, bound tariffs as the principal form of protection provide a good basis for further liberalizing trade. Negotiations on tariff reductions are vastly less complicated than negotiations involving quantitative import restrictions like those characteristic of managed trade.

It should be stressed at this point that it is their binding that makes tariffs consistent with the spirit of the General Agreement. Only tariff binding guarantees that the price mechanism is allowed to operate. Notice in this context that variable levies are also tariffs. Yet the fact that they are not bound, but vary along with the world price, makes them equivalent in their effect to quantitative restrictions. They do not allow the price mechanism to operate. On the contrary, they completely insulate the domestic market.

Tariff binding has an important aspect apart from ensuring that the price mechanism is allowed to function. It operates as a natural shield for governments against demands by special interest groups for higher levels of protection. This is because bound tariffs cannot be raised without cost. Once a tariff concession has been made, that is, once a tariff is bound, it cannot be rescinded without extending compensation to the affected trading partners. In the absence of compensation a country faces retaliation (see GATT Articles XIX and XXVIII in Appendix 1).

Compensation is also mandatory when measures are adopted that nullify or impair the value of the tariff binding to the trading partners (Article XXIII). An example of such a measure would be the tax on soybean and soybean products contemplated by the EC in the early 1980s to circumvent the zero-tariff binding on these products that was granted to the United States at the end of the Dillon Round in return for its acceptance of the Common Agricultural Policy. This tax on vegetable fats would have nullified the tariff binding and hence mandated compensation payments to the United States. Because of the clear stand on this by the United States and its threat of massive retaliation in the absence of adequate compensation, the EC dropped the idea of a vegetable oil tax.

**Concentration on Direct Trade Effects**

Another element of the GATT is its emphasis on the reduction of government market interventions with a direct, as opposed to an indirect, trade effect. Those with a direct effect, also known as frontier barriers, consist of trade-inhibiting measures that are commonly applied at the border—such as import and export taxes, quotas, and export subsidies—and discriminate between domestic and foreign sources of supplies or between domestic and foreign destinations. (For a thorough discussion of the distinction between frontier and nonfrontier measures, see Snape 1987, 216.) The treatment of products or factors of production depends on their nationality. Measures with indirect trade effects, that is, nonfrontier policies, are made up of taxes and subsidies on production, consumption, or factors of production. They do not generally discriminate between foreign and domestic sources or destinations. For example, a production subsidy is not conditional on the destination of the product. Also, unlike an export subsidy, a production subsidy does not discourage domestic consumption. Similarly, consumption or factor taxes or subsidies do not qualify as frontier barriers as long as they are administered without regard to nationality. (See Snape 1987 for a more comprehensive discussion as well as various qualifications.)

Free international trade as envisioned by the GATT is commonly understood to mean the absence of frontier measures. Most GATT rules and regulations address the containment and reduction of tariff and nontariff barriers to trade as well as of export subsidies and taxes, whereas only a few rules relate to nonfrontier measures, either directly or indirectly. Examples of those related to nonfrontier measures are the rules pertaining to countervailing duties and subsidies as laid down in Articles VI and XVI:1, respectively, and in the Subsidies Code. Domestic subsidies are taken up in an indirect way in Article XXIII in the context of nullification and impairment of tariff concessions.

The historical emphasis on frontier barriers derives from three considerations. First, they generally tend to be visible and therefore more tractable than nonfrontier barriers. This also makes them easier to negotiate.

Second, nonfrontier barriers are more difficult to maintain in the absence of frontier barriers because of their high budgetary costs to governments. (A detailed account of this argument is given in Snape 1987.) Indeed, the complete removal of frontier barriers would probably suffice to keep domestic subsidies in check. The high budgetary cost of domestic subsidies in the absence of border measures contrasts with the budget outlays for frontier barriers. If export subsidies are exempted, frontier barriers can not only be administered cheaply, they can even earn revenue for governments. (This is one of the reasons that border taxes, on either exports or imports, are so popular with developing countries.) They also have certain advantages over domestic subsidies from a political-economy point of view. Border measures invoke less political resistance—because their consequences are difficult to assess in quantitative terms—if they come, as is commonly the case now, in the form of nontariff barriers and their economic costs are spread widely in the economy. Subsidies, in contrast, attract more political attention—because taxes have to go up or other programs have to be cut—thereby provoking conflict with other vested interests. Since even voluntary export restraints or orderly marketing arrangements that generally worsen the terms of trade for the importer are often preferred over domestic subsidies, the strong preference of countries for border measures is clear.

Third, from a theoretical point of view, domestic subsidies have long been considered a superior means of providing assistance to domestic industry when contrasted to frontier barriers. (See Blackhurst 1981 and the references therein for a discussion of this point.) The standard arguments for domestic subsidies as opposed to frontier barriers are that they can be better targeted; they do not distort consumer prices and hence reduce imports by less than equivalent frontier barriers;[26] they are subject to annual budgetary review and hence are much more visible than protection at the border; they are more equitable, assuming the tax system itself is considered equitable; and they provide a convenient way to correct certain market imperfections or failures.

Even if one discounts for the latter arguments, the strong revealed preference of governments for frontier measures and the GATT's traditional focus on this area seem to provide enough reason to question the wisdom of devoting much attention to nonfrontier barriers in the Uruguay Round. What makes domestic subsidies less of an urgent problem is their concentration in just two areas: high technology products (the classic example is the subsidization of the Airbus project by several European countries) and agriculture.[27] But even in agriculture, the subsidy issue plays a role mainly in trade disputes between the EC and the United States.[28] In addition, it appears that essentially all subsidy disputes in agriculture between the United States and the EC result from sharply different protection levels among products in the EC's Common Agricultural Policy. For example, recent EC subsidies on oilseeds are clearly intended to nullify the zero-tariff binding on soybeans, soybean meals, and certain other feedgrain substitutes that considerably raises EC budget expenditures. It may be hypothesized that the domestic subsidy issue would largely disappear with uniform levels of protection within major groups of agricultural products.

Hence, even though domestic subsidies currently seem to be the cause for considerable friction in trade relations in agriculture as well as certain other areas of trade,[29] this may not warrant spending much time and effort in the Uruguay Round on finding a possibly illusive general solution to the subsidy problem, either within the General Agreement or the Subsidies Code. It may be preferable to negotiate subsidies between the affected parties when and where they arise and otherwise concentrate on border measures in the Uruguay Round (see Finger 1987, chap. 20).

## Ease of Measurement and Enforcement

Trade reform proposals have little practical merit and are unlikely to improve the international trading regime unless the rules and regulations to enforce them can be defined or measured adequately and are fairly straightforward to monitor. Difficult problems arise with

[26] "Equivalent" is used in the sense of granting domestic production activities an equal amount in income transfer. There are cases, however, where frontier barriers are less trade-distorting than equivalent domestic subsidies. For more detail on this subject, see Snape 1987, 222-224.

[27] Otherwise, the claim that foreign exporters are unduly subsidized appears to be used mainly by declining industries to gain border protection through countervailing duties. Several pertinent provisions of the Omnibus Trade and Competitiveness Bill of 1987, as drawn up by the U.S. Congress, seem to fall into this category. See the assessment provided in *Economic Report of the President, 1988*.

[28] There are exceptions, of course. One notable case involves the U.S. production subsidies to southern rice growers and their negative effect on the international competitiveness of rice grown in Thailand.

[29] See, for example, Blackhurst 1981.

rules that leave too much room for avoidance strategies or break down as productivity or demand, or both, change over time. In the following section, these issues will be discussed in somewhat more detail.

## Definitions, Measurement, and Monitoring

Reform proposals that rely for their working on exact definitions of highly controversial subjects are difficult to negotiate and to enforce once they are agreed upon. Examples of such difficult-to-define subjects are subsidies with an appreciable effect on trade flows and the equitable market share rule that conditions the use of export subsidies for primary goods. Owing to its generality, this rule has neither managed to effectively restrain countries from using export subsidies nor been of much use for dispute settlement.[10] On the whole, it is safe to say that domestic or nonfrontier policies are more difficult to define in multilateral trade negotiations than are frontier measures. The reason is that domestic policies and conventions can be quite different among countries because of historical, cultural, political, or other circumstances. In contrast, external trade is governed by rather similar rules in most countries.

Measurement and monitoring can be a problem whenever large amounts of detailed data are needed, when the required data become available only with a considerable time delay, or when there is no formal procedure established to collect the data. The measurement of domestic subsidies with a trade effect could be such a problem case. At times, the amounts actually spent are difficult or impossible to extract from official sources, given the numerous ways of hiding them. Also, the actual outlays in a budget year, as opposed to planned expenditures, often become available only after some time. Such problems usually do not arise with price data, which may be required by certain trade reform proposals. However, when prices are used for the purpose of price comparisons, other well-known problems arise. Examples are quality differences, either at a particular point in time or over time, and exchange-rate changes.

Quantity-based rules such as quotas are, in general, more easily measured and monitored—the stricter the definition, the easier the task. Whereas "equitable export market shares" can, for all practical purposes, be neither measured nor monitored, import or export quotas defined in tons per time period can be rather easily checked. Hence, for the purpose of striking "deals" among GATT members during multilateral trade negotiations, such quotas seem ideal. This may be one reason that quota-type arrangements appear to be favored sometimes by practical-minded negotiators.

## Avoidance Possibilities

Ideally, the rules governing international trade should be structured so that avoiding them by applying gray-area measures (trade instruments not subject to formal GATT disciplines) will be impossible or at least very costly, both economically and politically. This is to say that there should be few loopholes, since special interest groups, in looking for ways to increase protection for their products, can always be counted on to find them. Faced with intense lobbying

[10] For example, the first case based on the dispute-settlement mechanism of the Subsidies Code involved EC export subsidies for wheat flour. Although the GATT panel established that the EC increased its market share substantially by its use of export subsidies, the panel was unable, due to the Subsidies Code's imprecise language, to characterize the EC's enlarged market share as inequitable. In other cases, for example those involving subsidized EC pasta exports to the United States and the preferential treatment of Mediterranean citrus imports by the EC, the United States managed to obtain favorable panel decisions, yet the EC either blocked the decisions or chose to simply ignore the panel's recommendation. See Paarlberg 1987, 52-53

from such groups, however, governments rarely manage to evade the pressure to take advantage of these loopholes. Clearly, loopholes in the system of international trade obligations deprive governments of a protective shield against the political pressure of special interest groups.

Typical examples of loopholes related to frontier measures in the current GATT system are voluntary export restraints, variable levies, the activities of state trading enterprises, and the right to employ export subsidies and import quotas for agricultural products.

There are at least three ways to reduce the use of such loopholes. As mentioned earlier, the stringency of certain rules of behavior could simply be reduced, thus adjusting them toward actual behavior. This could be done for all trade or it could be limited to particular sectors. An example of the latter route is the establishment of the Multifiber Arrangement for clothing and textiles, whose negative consequences have already been outlined. The special exemptions for agricultural trade in the area of export subsidies and import quotas also fall into this category. When the General Agreement was drawn up in the 1940s, these special exemptions had the effect of adjusting the GATT rules for agriculture toward the reality of agricultural trade as it prevailed at that time. The discussion in Chapter 3 gives a short overview of the results in agriculture of adjusting rules of behavior toward actual trade practice.

Alternatively, a system based on bound tariffs could be changed over to one based on summary measures of protection such as nominal rates of protection (NRP). This way, bound tariffs, for example, could not be circumvented by dubious state trading practices, voluntary export restraints, quotas, or similar frontier barriers. In addition, to cut the option to substitute domestic subsidies for frontier barriers, the NRP measure could be extended to cover domestic subsidies. This would lead to the fixing of overall levels of support, an idea that has recently received considerable attention in agriculture (see, for example, Organisation for Economic Cooperation and Development 1987). Although it is possible with these measures to further reduce avoidance behavior,[31] they also have certain disadvantages. One of the drawbacks of these types of overall measures is their limited applicability outside of agriculture. Limiting their use to agriculture, however, would mean establishing another special sectoral trade regime. But sectoral trade regimes are problematic from a political-economy point of view, an issue that will be taken up shortly. Also, the experience with the sectoral trade regime for textiles and clothing has not been encouraging.

A third way of dealing with loopholes in the GATT system would be to tighten existing GATT rules, such as those pertaining to state trading, export subsidies, and import quotas in agriculture; to improve the dispute settlement procedures of the General Agreement; and to introduce a limited number of new mechanisms to deal with gray-area measures such as voluntary export restraints. The idea would be to make avoidance behavior more difficult, yet stay with the General Agreement in its present form, without creating new special cases for particular sectors or industries. In Chapter 6 this third alternative is taken up in more detail as part of a comprehensive reform package that is applicable not only to trade in agricultural products but to trade in general.

## Resilience to Long-Term Demand and Supply Trends

Another question to be addressed in assessing trade reform proposals is how sustainable they are in the face of productivity improvements, possibly combined with slow growth in demand. To put it differently, will the suggested reform proposals make much of a difference given the natural evolution of all other factors that determine quantities and prices? To answer

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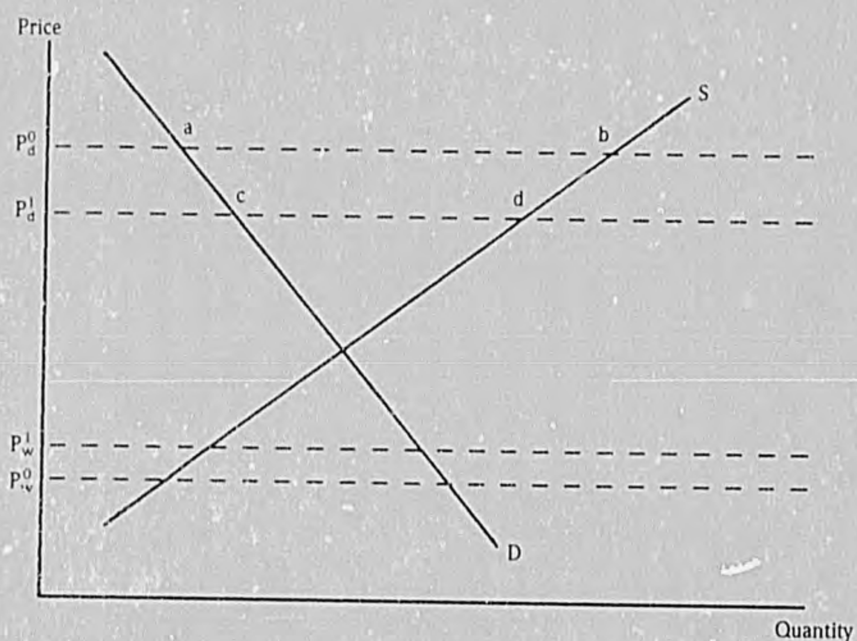
[31] As discussed in more detail in Chapter 5, comprehensive measures such as bound producer subsidy equivalents cannot totally eliminate avoidance activities that reduce imports.

this question, an analysis has to distinguish between a reform proposal's ceteris paribus effects[32] on prices, quantities, and trade and its predicted actual effect. The first type of analysis would compare the state of the world in n years for situations both with and without the policy change. The second type would compare the policy's effects in n years, assuming all other factors were also at work during that time, with the current state of the world. The difference between these two views can be illustrated with the help of a simple graphic example (Figures 1 and 2).

Assume the reform proposal calls for a reduction of the NRP, as measured by $(P_d^0 - P_w^0)/P_w^0$ in Figure 1, of x percent over a period of n years. A typical analysis based on ceteris paribus principles would predict a reduction of excess supply in the import-protecting country from ab to cd. The resulting fall in subsidized exports causes the world price to increase from $P_w^0$ to $P_w^1$. Clearly, the nature of this exercise is such that it predicts what would happen if all other factors were held constant. No prediction is made for the actually occurring quantities or prices in n years. This is because the dynamic aspects shaping the actual long-run outcome, that is, the effects of changes in productivity and income, cancel out in this type of analysis. Hence, the prediction of a rise in $P_w$ in Figure 1 implies only that the world price would be higher than without the trade reform, not that it will actually rise in the wake of trade reform, given that all other factors are also changing. This important point is illustrated in Figure 2. It is based on the assumption that, over a longer period, productivity rises by an amount sufficient to shift the domestic supply curve from $S_0$ to $S_1$. During the same time period, income increases so as to move domestic demand from $D_0$ to $D_1$. The shifts in demand and supply curves effect an increase in net exports[33] despite a reduction in nominal protection (the new

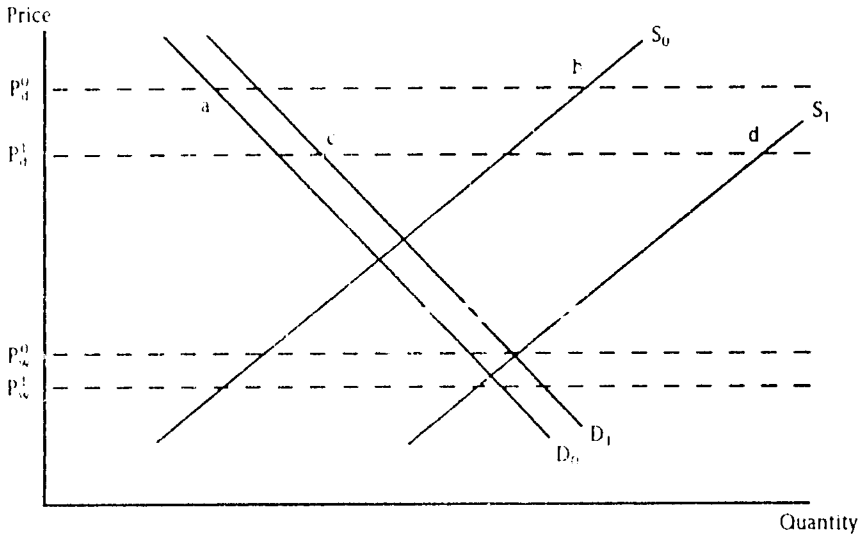
**Figure 1—Predicted impact of trade reform on trade volume in n years, with everything else assumed constant**




[32] The effects above and beyond the predicted changes resulting from innovations in all other determining factors of prices and quantities.

[33] Distance cd exceeds distance ab in Figure 2.

**Figure 2—Predicted change in observable trade volume over n years, with trade reform as well as demand and supply growth**




level of nominal protection is measured with reference to $P_w$). Assuming the development in other import-protecting countries is similar and productivity also increases in nonsubsidizing countries, the observed world price is going to decrease rather than increase compared with today's price. Naturally, the world price would show a larger decline in the absence of trade reform.

For the negotiations on trade reform, the predictions for actually observed changes, such as those in world price and market shares that emanate from an analysis along the lines of Figure 2, probably have an information content at least as important as ceteris paribus-type predictions, such as those associated with Figure 1. Besides, past experience with multilateral trade negotiations has shown that considerations relating to such factors as productivity have, at least implicitly, featured prominently in the negotiations. Otherwise, trade reform proposals such as freezing market shares or self-sufficiency levels could not be explained. The sole merit of these types of proposals lies in their ability to counteract possibly detrimental effects on export markets of either discretionary increases in protection or, more important, dynamic changes in demand and productivity in import-protecting countries. They are largely devoid of implications that can be captured with an analysis along the lines of Figure 1. A proper analysis of these reform proposals requires a framework like that of Figure 2.

## Political-Economy Considerations

There are two levels at which political-economy considerations play an important role for the multilateral trade negotiations within the GATT: the level at which country representatives negotiate with each other, and the level at which domestic interest groups interact with each other and with the government in a given country. As the following discussion will show, these two levels are very much related. Also, the idea of fairness or evenhanded treatment plays a significant role at both levels.

Proposals for trade reform are likely to be uniformly acceptable among negotiating parties only if all signatories to the GATT are treated in an evenhanded manner. However, this cannot be taken to mean evenhandedness in every sector or even in every commodity group, especially if evenhandedness is defined as a balancing of requests and offers of trade concessions. If this is not clearly understood, the Uruguay Round may not succeed. This point becomes apparent in a consideration of, for example, the new active role in this trade round of developing countries such as the Group of 48 or the Cairns Group on agriculture. The vast majority of their requests for concessions are concentrated in two areas: agriculture and light industries such as textiles and clothing. Nearly all of their potential offers of concessions, however, are in other areas, the major examples being graduation of industrial goods, intellectual property rights, services, trade-related investment measures, and the Generalized System of Preferences. Hence, the balancing of offers and requests of trade concessions would seem to require a look beyond agriculture.[31] To put it more directly, developing countries could use concessions in property rights, services, and similar areas to force concessions from industrialized countries in, for example, agriculture and textiles.

Evenhanded treatment of countries implies another important point: aligning trade in agricultural products more closely with trade in manufactures. This involves, among other things, the elimination of special rules and waivers, such as the legality of export subsidies in agriculture as opposed to industry. Failure to do this may make it impossible to garner the support of countries that export mainly agricultural products, such as those countries loosely aligned in the Cairns Group. It would be hard to convince them of the merits of a partial trade reform that improves the trading environment only of countries that happen to export mainly industrial goods. (Clearly, the same argument applies for integration of the textiles and clothing complex into the GATT.)

If the latter point is accepted, then reform proposals specific to agriculture should be avoided. Otherwise the sector will again become subject to rules that are different from those for other trade, thereby treating agricultural exporters differently—most likely less favorably—than exporters of industrial goods. This is both unfair and inherently inconsistent with the GATT's underlying principle of nondiscrimination. In fact, it is just this type of differentiated treatment that has made the whole GATT system increasingly less credible.

The issue of evenhandedness of trade reform is also crucial in any effort to secure the support of special interest groups within a given country for trade reform and thereby to solve the problem of its domestic acceptability in the major trading countries. Domestic acceptability becomes a particularly tricky subject if it is simply measured by the amount of satisfaction or dissatisfaction within the farm lobby. Clearly, any trade reform package emanating from the Uruguay Round should be structured to avoid this. The following considerations would thus seem to be of vital importance.

First, most governments would probably favor the imposition of binding restrictions on protectionist measures (to roll back the influence of special interest groups) in agriculture as much as in other areas. As mentioned earlier, binding international restrictions serve as a kind of protective shield against the demands of special interest groups. If this view is correct, it would make a strong case for trade reform proposals that reduce the discretion of governments over changes in frontier barriers, such as variations of tariff rates, export subsidies, or restrictive state trading practices. As the farm lobby is known to be very powerful in many countries, with a strong representation in most agricultural ministries, too much decision leeway on the part of governments can keep them captives of internal politicking and hence impart a protectionist bias to their trade policy. Tighter restrictions on frontier barriers, through such means

[31] Support for this view can be found in Winters 1987. The opposite view is represented by McCalla (1987), who refers in this context to the unsuccessful attempts at negotiating compromises across sectors in previous multilateral trade negotiation rounds.

as mandatory binding of all tariffs and the closing of loopholes for protectionist activity, could make it possible, in principle, to move away from the present unfortunate situation in negotiations between the farm lobby and the government on changes in support or target prices. These negotiations increasingly resemble those for higher wages and benefits between the government and the unions representing its employees.

Second, domestic acceptability of a reform package is a function of the relative political influence of those groups of society that will gain from it and those that stand to lose, in the sense that they are subjected to adjustment costs. (Even groups that have to adjust are likely to gain, since, in the long run, adjustment costs fall solely on factors in fixed supply, mainly land.) As already discussed, consumers would gain the most from a trade reform directed toward more liberalization. But for reasons stated earlier, they are unlikely to form a strong lobbying group. Hence, in terms of making trade reform acceptable to a country, the size of consumers' potential welfare gains means little in getting a trade reform past the legislature. To counter the dominant influence of the farm lobby in countries such as the United States, the EC, and Japan, strong support in favor of trade reform has to come forth from groups that also stand to gain from trade liberalization in agriculture, yet are better organized and more vocal than consumers and hence have sufficient economic and political clout (see Duchêne, Szczepanik, and Legg 1985, 192). Recent quantitative evidence strongly suggests that industry and labor unions are such groups.[35] Both industry and labor outside of agriculture could expect to gain considerably from trade liberalization in agriculture. Estimates show, for example, that in the absence of the Common Agricultural Policy, employment in the EC-10 would rise on the order of 2-4 million people (Stoeckel and Breckling 1988). Results for Germany indicate that liberalization of agriculture would create 850,000 new jobs and raise gross domestic product by 3 percent and exports by even more. Net exports of investment goods by the mechanical engineering and electrical engineering industries, for example, are predicted to rise by 12 and 16 percent, respectively (Donges et al. 1988). Since similar findings are reached for other countries and industries, and on the basis of different model structures, they seem to be rather robust.

What still needs to be done, however, is to disseminate these results. Given the high degree of organization of industry and labor relative to consumers, this should not be an impossible task.[36] Once the basic facts about intersectoral linkages are fully understood, industry and other sectors in industrialized countries may become sufficiently motivated to stand up against agricultural protection and hence provide a viable countervailing power against the farm lobby. For governments this would provide a type of protective shield against overly zealous demands by the farm lobby similar to that of international obligations that are backed by the threat of financial compensation requirements or retaliation.

The countervailing power from industries and organized labor versus the farm lobby can be maximized when trade reform in agriculture, as well as other highly protective sectors such as textiles and clothing, is linked *in one package deal* with liberalization and hence with the prospect of trade expansion and higher profits in most of manufacturing and the services.[37]

[35] This is the conclusion that can be drawn from the various analyses conducted for the Global Agricultural Trade Study, organized by the Centre for International Economics, Canberra, Australia. The research findings are summarized in Centre for International Economics 1988. Earlier studies on this topic are summarized in Winters 1987a.

[36] For example, the message seems already to have reached the influential Federation of German Industry, which recently came forth with some reform proposals of its own for agriculture. See Bundesverband der Deutschen Industrie 1987.

[37] See Baldwin 1987. In this context it has to be remembered that higher profits result not only from better market access in foreign markets, a prospect of interest primarily to exporters subject to significant trade barriers, but also from cost reductions due to cheaper intermediate inputs and more competitive factor prices in the wake of liberalization, a point of potential interest to all firms.

Such a single cross-sectoral reform package makes a successful completion of the Uruguay Round a lot more likely than an array of separate sectoral accords.

Apart from stimulating countervailing power against a resisting farm lobby and hence enhancing the acceptability of trade reform *within a given country*, such a cross-sectoral approach to trade reform also strengthens the prospects of balancing requests and offers for concessions *between countries*. This subject was discussed above in relation to developing countries trading more openly with industrialized countries in the areas of services and manufacturing in exchange for better market access in agriculture.

Up to the middle of 1988, the negotiations in the Uruguay Round have not paid much attention to the need for cross-sectoral agreements (see the discussion in Chapter 3). The idea of a package-deal negotiating strategy, however, has been brought up in the Negotiating Group on Agriculture—although not in the form of cross-*sectoral* deals as suggested above, but in the form of a sector-specific deal. The United States has made the package-deal idea part of its reform proposal for agricultural trade.

The aggregate approach proposed by the United States implies that the farm policies and programs affecting all agricultural commodities would be negotiated as one package. This certainly represents a step in the right direction, although whether an intrasectoral package-deal approach is sufficient may be questioned. It presupposes that one commodity group in favor of liberalization can countervail the political power of another one that is opposed. This idea may work in the United States, but what about Japan, for example? Is there any commodity group in Japanese agriculture that could provide enough countervailing power to effectively counteract the strong opposition of rice farmers to more open markets in agriculture? If there is no such group, then countervailing power can only come from outside of agriculture, assuming consumers cannot be counted on.

At any rate, the aggregate approach suggested by the United States certainly contrasts sharply with the procedure followed in previous multilateral trade negotiations that proceeded commodity by commodity. The latter approach appears to be still favored by the EC and is also clearly the one favored by the farm lobby. The representatives of farm interests are naturally disposed against cross-sectoral arrangements, a unifying principle for the trade negotiations, or even an aggregate negotiating approach limited to agriculture. These negotiating structures strengthen the countervailing power against either farm interests in general, as in the case of a cross-sectoral approach, or the interests of specific commodity groups within agriculture, as in the case of an aggregate approach to agriculture. This has become very clear, for example, from the response of certain U.S. commodity and farm group representatives to the U.S. proposal. The aggregate approach favored by the U.S. administration has been met with open resistance from some powerful commodity groups. Several groups considered themselves simply too special to be dealt with in a package deal. Others voiced their concern that U.S. negotiators would not focus on the best interests of a particular commodity group in such negotiations but would instead consider overall U.S. benefits in agriculture (see U.S. General Accounting Office 1988, 31-32).

In short, more emphasis on cross-sectoral negotiations and compromises appears to be critical to eventual achievement of the objectives stated in the Punta del Este Declaration. This requires, however, some changes in the procedural foundations of the Uruguay Round. First, the trade talks are in urgent need of a unifying principle, one that is applicable across all sectors. It could perceptively facilitate cross-sectoral compromises and, at the same time, force discipline on all negotiating groups. (See Nau 1987 for a similar proposition, and GATT Secretariat 1988a 1.)

Second, government representatives at the highest echelon have to be more directly involved in the negotiations. Their involvement has helped significantly in getting the Uruguay Round started in Punta del Este. It is needed again midway through the Uruguay Round. Only at the highest government level is it possible to agree on the core of GATT reforms, that is, on a unifying principle or formula similar in spirit to the "across-the-board" tariff-reduction idea of the Tokyo Round. Experts from agriculture or other sectors cannot be counted on to achieve much progress on their own. They operate in a direct shooting line from their sectoral clientele. This special relationship makes it difficult for them to agree to more than marginal adjustments of the present system. Far-reaching changes that extend beyond the sector, and hence could generate compromises at a higher level, need the involvement of nonspecialists who are able and willing to see beyond narrow sectoral concerns.

# 5

# THE THEORETICAL CONSEQUENCES OF CHANGING CERTAIN GATT PROVISIONS

## Restricting the Use of Export Subsidies

In contrast to trade in manufactures, where export subsidies are explicitly prohibited by the GATT, export subsidies have become a frequently employed trade instrument in agriculture. Their main use has been to help industrialized countries such as the EC and the United States dispose of domestic production surpluses resulting from policies that support the domestic market price above its world market level.[38] The subsidies have enabled subsidizing countries to expand their exports at the expense of nonsubsidizing industrial countries such as Australasia and, above all, developing countries. Such is the case, for example, for beef and veal as well as sugar. A comparison of the average market shares for 1970-74 with those of 1980-84 shows that the OECD countries have expanded their export market share of beef and veal from 40.3 percent to 62.1 percent while that of developing countries dropped from 52.1 percent to a mere 26.9 percent. The figures for sugar indicate an increase in market share for OECD countries from 17.0 percent to 28.5 percent and a drop from 73.8 percent to 67.4 percent for developing countries (Organisation for Economic Co-operation and Development 1987, 220, 226). Although some of the decline in market share for developing countries can probably be attributed to overvalued exchange rates and other similarly unfavorable domestic conditions for exporters (see Krueger, Schiff, and Valdés 1988), the larger part of the market share decline is certainly due to export subsidization combined with import protection in industrial countries.

The wide range of suggestions on how to solve the issue of export subsidies includes proposals on limiting their negative trade effects by fixing market shares, as well as proposals aimed at restricting their use. The latter proposals extend from a complete prohibition of subsidies to allowing them subject to certain restrictions.

### Strengthening the Equitable Market Share Rule

Many, if not most, of the trade conflicts in agriculture have arisen because the equitable market share rule, which conditions the use of export subsidies for primary products, has turned out to be too general to be ascertained objectively. The evidence accumulated by GATT panels that addressed the issue of equitable market shares demonstrates that it has not been possible to find operationally meaningful criteria for what constitutes an equitable market share.[39] As a result, the market share rule has been rendered meaningless for all practical purposes. Taking

[38] Whereas the EC has long subsidized exports for numerous agricultural commodities, export subsidies by the United States have become more frequent only since the passage of the 1985 Farm Bill. Since then, exports of beef, dairy products, sugar, wheat, rice, corn (maize), and cotton have been directly or indirectly subsidized via the Export Enhancement Program, the Marketing Loan Program, deficiency payments covering all production rather than only domestic consumption, and various other devices. See Hathaway 1987.

[39] So far, four GATT panel decisions have involved the equitable market-share rule. In the Australia versus France dispute on French wheat flour exports of 1959, the GATT panel concluded that export subsidies had expanded France's market share to a more than equitable level. No conclusive decision was reached in the subsequent three cases—Australia versus the EC and Brazil versus the EC on EC sugar export subsidies in the late 1970s, and the United States versus the EC on EC wheat flour export subsidies in 1983.

this as the point of departure, redefining the equitable market share rule in the direction of improved operational effectiveness seems to be a natural suggestion for reform. The basic premise behind the proposal to refine rather than discard the idea of market sharing is the notion that focusing the negotiations on the outcome of government interventions as they relate to trade flows—in particular, changes in export market shares—can be more easily achieved than trying to define export subsidies and then to outlaw or otherwise restrain their use. Although this focus on the ultimate trade effect of government intervention in trade is very much in the spirit of the GATT, it remains to be seen whether this can be said also of the conceivable ways of implementing a refined market share rule.

Ways to make the market share rule more operational have been deliberated on in some detail by the Committee on Trade in Agriculture. The suggestions developed in these discussion rounds rely in one form or another on predetermining exports in numerically fixed form for the major commodities and exporters. Market sharing in the conventional sense would imply that an exporter's share in world exports would be limited to a particular percentage. An alternative proposal would fix the exports of a given country in a particular commodity to a fixed tonnage amount that is related to past export performance. For example, the export quota could be set equal to exports in the past year or to average annual exports in the past five-year period. In contrast to the conventional export market share idea, this method has three distinct advantages: the amount of uncertainty for nonsubsidizing exporters would be reduced; verification would be made easier both in terms of data requirements and of the time lag between the end of the trading year and the necessary review of the export performance; and, perhaps most important, taking advantage of world export growth would be reserved for nonsubsidizing countries, allowing them to capture at least some of the effect of their competitive advantage. To avoid the problem of legitimizing existing market shares acquired through unrestrained past subsidization, modifying the above approach by replacing actual historical market shares with negotiated ones could be considered.

On the positive side, market-sharing arrangements of the above type would clearly cause few definition or measurement problems. They are also fairly easily monitored, although unfortunately only after the fact in many cases. (For commodities that are exported fairly evenly over the course of a trading year, monitoring is possible before the end of the year.) A possible problem could develop, however, for those commodities for which nonsignatories of the GATT supply a major share of world exports, such as Cuba for sugar. Another advantage of fixed export market shares is their resilience to avoidance strategies on the part of exporters. Regardless of what form of government intervention is applied by a given country, its end result, the actual trade volumes, cannot be manipulated. (Exporters could, however, switch to higher-quality exports, which might infringe on the interests of other exporters.) In principle, fixed export quantities or shares are also resilient to long-run changes in supply and demand. Increased productivity of subsidizing countries, for example, would have no effect on other countries, yet would increase the financial burden on price-supporting governments. Productivity increases in nonsubsidizing countries would mean either higher government outlays or lower farm prices for farmers in subsidizing countries. In either case, there would be an incentive to lower price supports and hence subsidies.

Market-sharing agreements are similarly without problems from the political-economy perspective. They clearly cater to the interests of the farm lobby because they are likely to involve only marginal adjustments for farmers, not the establishment of a completely new and unfamiliar incentive structure, with possibly significant economic losses for fixed factors in the short and medium runs. For example, there would be no pressing need for the EC to abandon the principles of its Common Agricultural Policy. The system of variable levies and export subsidies could be left essentially intact, although the requirement to maintain export market shares at present or slightly reduced levels would force more discipline upon demands of farmers for increased support prices. Politically then, market sharing would seem to be very attractive. Such a proposal for agricultural trade reform would be almost guaranteed smooth sailing through the legislatures of subsidizing countries because domestic opposition to such a solution would be weak, at best. After all, consumers are unorganized and other industries or sectors that could gain from agricultural trade liberalization would be dealt with in separate arrangements, fully delinked from agriculture. Overall then, there appear to be several arguments strongly in favor of market-sharing agreements or what is sometimes called "managed trade."

Market-sharing agreements can be criticized on two grounds. First, they do not have a successful track record. The experience with various commodity agreements for wheat, cocoa, and coffee suggests that they do not last very long. Usually they run into trouble over problems of long-run demand and supply effects. In theory, strong increases in productivity combined with stagnant world demand would call for internal adjustments in the form of lower production in subsidizing countries. In practice, however, production is often not curtailed, thus leading to declining world prices and ultimately to a breakdown of the commodity agreement itself. In other words, market-sharing arrangements can work quite smoothly in the face of strong demand growth, but they hardly ever survive the double blow of stagnant or diminishing demand and growing supply.

Second, market sharing in agriculture would strongly contradict two basic GATT principles: nondiscrimination and reliance on the price mechanism for trade restrictions. Countries that mainly export agricultural products would be put at a clear disadvantage compared with countries that mainly export manufactures. Only the former would be constrained in their exports, being able to make use of their comparative advantage only at the margin and starting from an artificially low base. Fixed export quantities would allow an efficient resource allocation, both within countries and among countries, only for that part of world trade that results from future demand growth, not for current levels of world trade. If demand growth is expected to be low, as is the case for numerous agricultural commodities, little export expansion is possible for efficient exporters unless the export share or export quantity granted to subsidizing countries is reduced over time.

Negotiating and then fixing export quantities or shares for a large number of countries and commodities years into the future is no small task. In all likelihood, this would involve arrangements outside the confines of the General Agreement and very similar in principle to the Multifiber Arrangement in textiles and clothing. This assumes that an arrangement could be reached at all. In this case, however, agriculture would have become the second area subject to managed trade. Such a development could severely weaken the GATT system and its credibility, not only in the eyes of nonsubsidizing countries but also in the eyes of sectors and industries that are still subject to GATT disciplines. Extending a system of managed trade to agriculture would confirm that export subsidies pay off after all in the sense that, eventually, the market share achieved this way will be vindicated by international agreement. It would also send a strong signal to the effect that hard lobbying is really all it takes to eventually receive special treatment, that is, to gain relief from the forces of international competition. Special conditions, which supposedly make agriculture a unique case and thereby justify this special treatment, can surely be claimed also by other industries and sectors.

## Prohibiting Export Subsidies

Instead of developing further the existing rules on export subsidies in agriculture, a more drastic solution may be chosen—disallowing export subsidies altogether, with some well-defined exceptions. The rationale for this can be understood in light of the disappointing experience with the equitable market share rule discussed above and the largely ineffective attempt to "strengthen" the GATT rules on export subsidies through the introduction of the Subsidies

Code negotiated during the Tokyo Round. (Hufbauer and Erb [1984] provide a discussion of this code.)

*Some Theoretical Preliminaries.* Export subsidies affect the terms of trade of trading partners. In particular, they improve the terms of trade of importing countries. Consumers in importing countries experience a welfare gain. This is the reason that net importers of grains, among them many low income developing countries, do not favor an end to all export subsidies. If all else remained the same, ending these subsidies would worsen the net importers' terms of trade. The ceteris paribus condition, however, is questionable. By raising the profitability of the subsidized product, export subsidies divert resources away from other uses, that is, from industry in the case of agricultural export subsidies. In short, agricultural export subsidies raise the world market price of industrial goods relative to agricultural goods. Hence an end to agricultural export subsidies is likely to lower the relative price of industrial goods. If industrial countries have a comparative advantage in industrial products relative to agricultural products and vice versa for many poor developing countries, a ban on agricultural export subsidies can therefore improve the allocation of resources without negatively affecting the terms of trade of developing countries, at least in the medium to long run.

For the export-subsidizing country, a general export subsidy is equivalent to a general import subsidy, barring any deviations from the conditions of long-run general equilibrium.[40] An export subsidy can therefore serve a useful purpose: it can compensate for import restrictions.[41] Applying this idea to the two broad sectors of agriculture and industry means that export subsidies on agricultural products could be used to compensate for the negative effects on domestic resource allocation of import restrictions for industrial goods. This argument for export subsidies may have some validity for developing countries. Many of them continue to protect import-competing industries heavily, thereby levying a hefty tax on agriculture (see Krueger, Schiff, and Valdés 1988). Yet export subsidies are seldom observed. One obvious reason is their high budgetary cost. But even if funds were plentiful, the removal of import protection is certainly the obvious best choice rather than an attempt to counteract one distortion with another. For industrial countries, export subsidies on agricultural products can be even less justified by import restrictions outside of agriculture. As discussed at some length in Chapter 3, agriculture is generally more protected than industry (there are some exceptions, such as Australia). Hence, industrial goods rather than agricultural products would have to be subsidized in most industrial countries.

In short, the theoretical reasons against a ban on export subsidies appear of little practical importance for either developing or industrial countries.

*The Scope of a Prohibition on Subsidies.* Before the potential trade effects of a prohibition of export subsidies can be analyzed, it is necessary to define the scope of such a subsidy ban. As the discussions of the Committee on Trade in Agriculture have made clear, this issue is in itself far from settled. Two basic approaches are seriously considered: defining export subsidies in a comprehensive way, and treating agricultural goods like nonprimary goods.

A comprehensive definition of export subsidies would include all indirect subsidies as long as they operate to increase agricultural exports. Included in such a comprehensive prohibition would be any form of price and income support to farmers, making avoidance behavior of governments difficult if not impossible, at least in theory. However, it is clear that it would be difficult to draw the line between subsidies that affect exports and those that do not, especially because a number of subsidies are well known to have a distinctly different effect in the long

[40] This is the essence of the well-known Lerner symmetry theorem. See Lerner 1936.
[41] Export subsidies increase domestic prices for exportables relative to importables. This is equivalent, in principle, to a decrease in import prices or a subsidy on importables.

run as opposed to the short run. Subsidies for research and extension as well as infrastructure, for example, are in this category. Hence, if an all-encompassing definition of prohibited subsidies is applied, it may be wise to add an illustrative list of government assistance measures that are exempted from the subsidy ban. Such a list could include support payments with only indirect links to trade, such as deficiency payments on domestically consumed production or cash payments unrelated to production. A general prohibition of subsidies could thus be made more manageable, and the unwanted effect of preventing domestic agricultural policy reforms that are in the interest of world trade, such as a switch from market price support to income support, would be minimized.[42]

A comprehensive definition of illegal export subsidies is less appealing because it would again give agriculture a special status, although with the policy on subsidies completely reversed from the lax rules that obtain currently. As the rules on subsidies would be more stringent in agriculture than in any other sector or industry, such a reform proposal seems unlikely to have a realistic chance in the legislatures of industrialized countries. Simply extending the prohibition of export subsidies on nonprimary goods contained in Article XVI:4 to agriculture seems to be the most appealing solution. (This would imply that the Subsidies Code be changed accordingly.) First, it would mark a move toward a more consistent GATT treaty. With agriculture losing its special status and trade reforms consequently being negotiated for all trade, possibilities of true progress in international trade relations could be opened up (see the discussion of political-economy considerations in Chapter 4). Second, surveillance and enforcement would be made easier compared with the first option. For countries that have signed the Subsidies Code, its more detailed provisions would be binding, including the illustrative list of prohibited export subsidies (see Appendix 2). For all other signatories of the General Agreement, Article XVI:4 would be relevant, linking export subsidies to the existence of a positive price difference between domestic price and export price. This latter definition of export subsidies will form the basis of the discussion in this and the following chapter.

*The Trade Effect of Discontinuing Export Subsidies.* To analyze the trade impact of a discontinuation of export subsidies, it will be assumed that they serve to dispose of domestic surpluses generated by a policy of import protection in combination with price guarantees to farmers. As already mentioned, this is likely to be the most important application of export subsidies in agriculture. A typical example is the Common Agricultural Policy of the EC for wheat and beef. Without a change in the system of market price support, a discontinuation of export subsidies would involve a policy choice between accumulating ever-growing stocks, destroying excess supplies, or shipping the excess overseas as food aid. All of these methods have in fact been used for one product or another by countries with surpluses, sometimes substituting for and sometimes accompanying subsidized exports. If it is recognized that none of these methods offer viable long-run solutions, the cause of the surpluses, that is, the method of market price support, has to be changed. It should come as no surprise that there is a multitude of options available to countries to react to a general ban on export subsidies, with each alternative having a potentially different trade effect. In trying to identify some likely reaction patterns, it is helpful to distinguish between behavioral adjustments working primarily on the demand side and those affecting mainly the supply side.

One solution to the excess supplies problem and one very much in the spirit of a free market approach would be to lower support prices and frontier barriers to a level where the domestic

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[42] An interesting scheme of decoupled income payments was suggested in the Boschwitz-Boren Bill, which was considered for the 1985 U.S. Farm Bill but was ultimately defeated. It called for gradually declining "transition payments" to farmers, based on past acreage and yield, with high payments at the beginning to offset losses during the adjustment toward market oriented farming. See Paarlberg 1987, 118-120.

price coincides with the price that just clears the domestic market. In contrast to a pure demand- or supply-side policy, this approach would have both a negative production and a positive consumption effect, reinforcing each other in curbing excess supplies. The trade effect of such a change in domestic policy would operate only on the world export supply schedule—not on world import demand. Subsidized exports would be eliminated, thereby shifting the world export supply curve to the left and causing, ceteris paribus, an increase in world price. As the specified country would not turn into an importer, world import demand would be unchanged. Nonsubsidizing exporters would benefit not from better access to the country but from the fact that competition from subsidized exports in third markets would cease.

To make a policy of lower protection levels socially acceptable, income transfers would be called for. To minimize unwanted production effects, transfers would have to be personalized, limited to the current generation of farmers, and not bound to specific production decisions of farmers. Payments under this scheme are simply intended to maintain income, leaving it to farmers to adjust production fully to market conditions. To take the stigma of welfare payments out of decoupling, payments could be linked to the idea of structural adjustment. Transfer payments could be made at one time or at a continually decreasing rate over time to make up for the loss in land values associated with an elimination of market price support policies or the need to move out of agriculture or both.

Decoupling is still likely to meet with resistance from the farm lobby because it has to be funded out of general tax revenue, thereby making farm policy highly visible and subject to annual budgetary scrutiny. From a trade perspective, this is obviously exactly what is intended, because for nonsubsidizing countries it ends the uncertainty associated with open-ended support programs by subsidizing exporters. In this context it may also be noted that farmers are not the only ones with a vested interest in the continuation of present policies. The industries upstream and downstream from agricultural production and basically the whole rural economy are to some extent benefiting from current farm support policies (see Koester and Nuppenau 1987). Hence, compensating farmers alone may not be sufficient to get a sweeping trade reform bill passed by the legislature. As discussed in Chapter 4, strong support in favor of trade reform may have to come from outside of agriculture.

A pure demand-side policy would try to solve the problem of excess supplies by stimulating domestic demand for the product in question. This could involve any combination of a variety of methods, such as selectively lowering consumption taxes on that good, its complements, or the products it enters as input; raising taxes on substitutes, in raw or processed form; subsidizing new demand niches;[43] and restricting import demand for substitute products or their complements, again in raw or processed form.

For the product in question, each of these pure demand-side policies results in a shift to the right of the domestic demand curve. Depending on the price elasticities of demand and supply, the supported market price prior to the policy shift could be maintained, making income transfers or deficiency payments unnecessary. In contrast to a policy response based on a reduction in protection levels, the degree of protection need not change. The trade effect would be the same in both cases, as long as the view is restricted to the product in question. However, the trade effect of the two policy responses may differ appreciably if the analysis is extended to include the other products, complements, and substitutes that are influenced. In particular,

[43] An example would be to subsidize the conversion of "natural resources" such as cereals or sugar beets into a fuel substitute, or of milk into butter or cheese. Such a subsidy would be equivalent to an input subsidy on the end product, with the possible effect of increasing exports of the derivative, again at the expense of nonsubsidizing exporters. Hence, the excess-supply problem would simply be shifted to a different market.

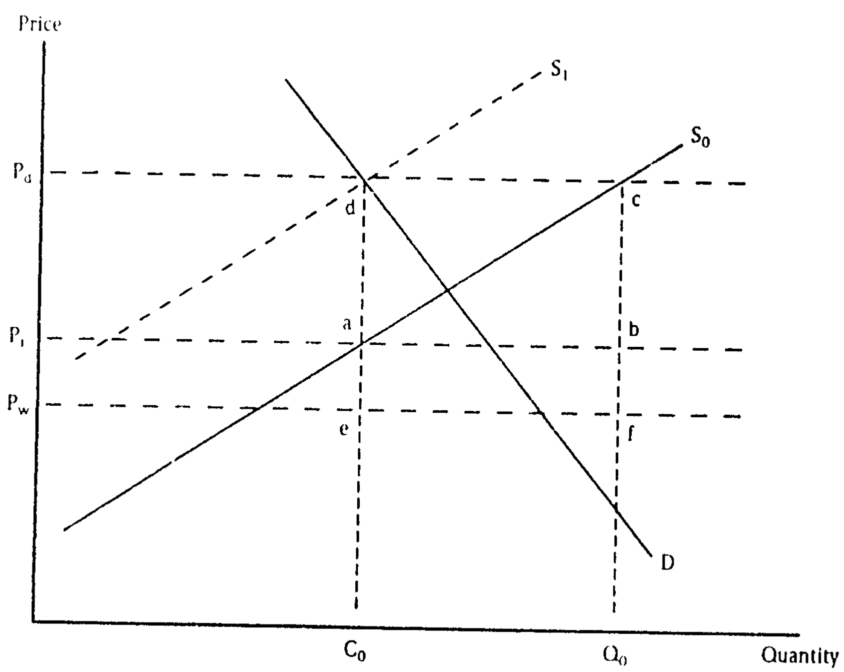
imports of the indirectly affected products would decline, either because of an increase in their import protection or because of government-induced changes in their relative prices.

Whether the rest of the world would be better off with or without such a policy response is unclear a priori. What is certain, however, is that the overall trade effect would be worse for pure demand-side policies than under a policy of reduced protection levels. It may also be noted that demand stimulation alone would probably not suffice to eliminate substantial excess supplies, for example, those experienced by the EC over the past decade in products such as beef and sugar. The reason is that domestic own-price or cross-price elasticities of demand are generally considered to be quite low for primary agricultural products.

Pure supply-side policies would attempt to curb production to eliminate excess supplies, leaving the nominal protection level constant. Input subsidies could be reduced for that purpose, tariffs could be raised on imported inputs, or production could be taxed. Either policy would shift the domestic supply curve up to the left, from $S_0$ to $S_1$ in Figure 3, assuming the implicit tax on producers equals distance ad. An implicit tax of that size would ensure that the domestic market clears without a reduction in the nominal protection level. The trade effects resemble those of a pure demand policy: subsidized exports cease, while imports remain zero. This is the partial equilibrium result. However, as in the case of pure demand-side policies, there may be unintended effects on related products. For example, restricting implicit taxation to product A may induce farmers to shift resources to product B. Even though the need for export subsidies is eliminated for product A, imports for product B may now be lower than before, thereby hurting the interests of countries exporting B. Hence, an implicit tax on isolated products may only shift, not eliminate, the problems caused by high domestic support prices and frontier barriers.

For domestic farmers, a pure supply-side policy based on implicit taxation is decidedly inferior to a pure demand-side policy. Their producer surplus, that is, the area between price line $P_d$

**Figure 3—Pure supply-side policy**



and the supply curve,[14] diminishes under implicit taxation, whereas it remains constant under a demand-side policy. Hence, closing the gap between supply and demand at support price $P_s$ through a policy of implicit taxation appears politically difficult. Probably the only way to achieve it is by compensating farmers for their losses through cash payments and, at the same time, building up strong support for a change in agricultural policy outside of agriculture. As discussed in Chapter 4, creating such support requires, among other things, embedding agricultural policy reform within the context of a multilateral trade agreement that encompasses all trade and is balanced across sectors.

Acreage reduction is an alternative to implicit production taxes if export subsidies are prohibited but support prices cannot be reduced for political reasons. Acreage reduction programs are certainly favored by farmers. Such programs have a long tradition in the United States, but they also appear to be gaining popularity in the EC. In fact, the agricultural policy in the EC seems to be drifting in this direction even without a ban on subsidies, because acreage reduction or set-aside is seen as a way to reduce the budgetary costs of farm support.[15] Set-aside programs can operate in a number of ways. A direct incentive system as practiced in the United States from 1956 to 1958 under the name of Acreage Reserve Program, or one similar to the diversion program in effect since the 1960s, involves paying farmers a specified premium per acre taken out of production. (The set-aside program presented by the EC Commission in early 1988 also falls into this category.) The predominant acreage reduction scheme in the United States since the 1960s works instead via indirect incentives. Rather than paying farmers for each acre taken out of production, the government subsidizes the remaining acreage used for continued production with deficiency payments. The deficiency system will be addressed later. For the moment, the discussion will be restricted to the direct incentive system.

Figure 3 helps to explain the basic idea behind the direct incentive form of set-aside programs. A premium equal to $(P_s - P^*)$ per production unit is paid to farmers in order to reduce domestic production from $Q_s$ to $C_s$ and hence eliminate the need for subsidized exports. Compared with the case of export subsidies in the amount of efcd, producers gain from the acreage reduction scheme. They are better off by triangle abc. The costs to the treasury are lower by rectangle efba. There are some practical problems, however. In reality, the premium is paid not for production units forgone, as assumed above, but per land unit taken out of production. Reducing acreage, though, does not necessarily imply that production diminishes by the intended amount $(Q_s - C_s)$. At least this has been the experience in the United States with acreage reduction programs. The simple reason is that farmers intensify production efforts on the remaining land. What happens to the land taken out of production also plays an important role. If it can be used to produce other agricultural commodities, acreage reduction for one product may simply lead to more exports or lower imports in another product. For all commodities taken together, then, there may be little gain to exporters of nonsubsidizing countries.

What remains to be discussed is policy responses that combine elements of a supply-side policy with changes in the nominal protection level. One such policy response would consist of substantially reducing or even eliminating import protection and at the same time raising input or production subsidies sufficiently. Figure 4 illustrates such a case. The level of protection is lowered so that the domestic price drops from $P_1^s$ to $P_2^s$. As partial compensation for farmers, a unit production subsidy of size ab is put in place, thereby shifting the domestic

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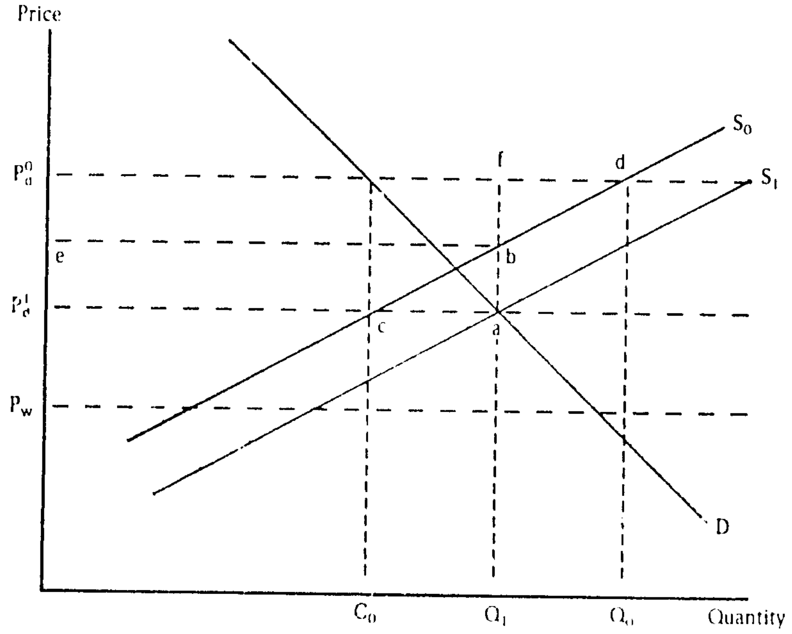
[14] $S_d$ is relevant before and $S_t$ after implicit taxes are imposed.

[15] See *Agra Europe*, January 22, 1988, P/1 - P/3. The EC Commission seems to endorse this shift. For example, it has drawn up an elaborate acreage reduction plan for cereals. See *Agra Europe*, January 15, 1988, P/1, for a summary of the plan's provisions.

## Figure 4—Partial replacement of import protection with domestic subsidies

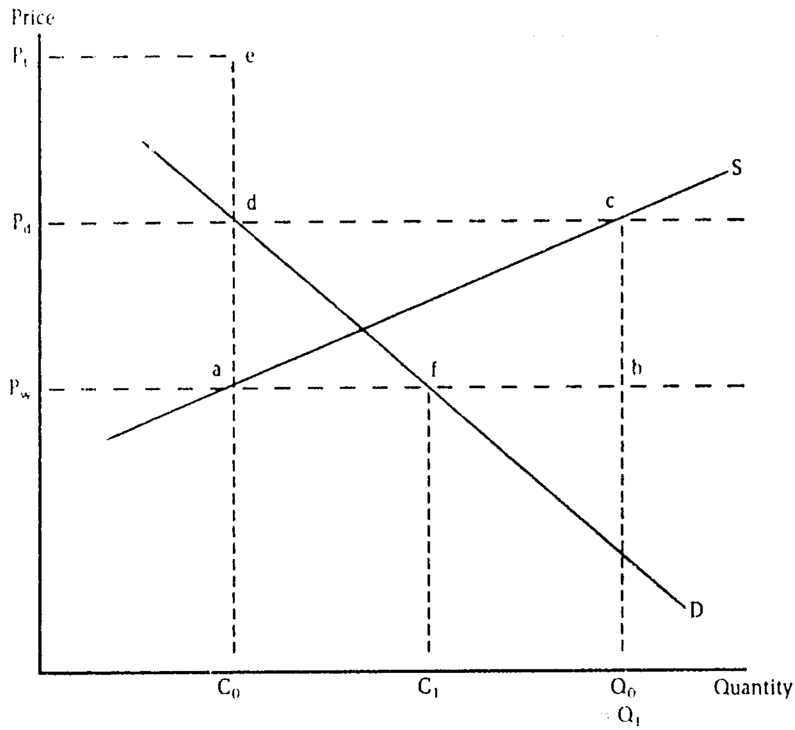



supply curve to the right. Domestic production declines from $Q_0$ to $Q_1$, and consumption rises from $C_0$ to $Q_1$.

The trade effect of such a policy parallels that resulting from a pure demand or supply policy: imports would remain at zero, and exports would decline to zero. The switch from a trade regime characterized by high protection and export subsidies to one of low protection and production subsidies affects the rest of the world only via a change in world export supply. Less will be exported at subsidized rates but no more will be imported. Whether such a policy response is found acceptable by farmers depends on the size of the subsidy relative to the reduction in nominal protection and the relevant demand and supply parameters. For example, a subsidy of size ab is clearly insufficient to compensate farmers fully for the reduction in market price support from $P_d^0$ to $P_d^1$. (As $S_0$ is linear, area abc equals area bdf, so farmers lose area bf$P_d^0$e as a result of this policy change.) Consumers clearly benefit because they face lower prices. Government expenditures are now in the form of production subsidies rather than export subsidies. Whether expenditures rise or fall is not clear a priori.

Instead of substituting domestic subsidies for export subsidies, a two-price system could be introduced. The essence of a two-price system can be explained by reference to Figure 5. Before the elimination of export subsidies, exports equal quantity ($Q_0$ - $C_0$) at domestic support price $P_d$. The domestic price is maintained at level $P_d$ through sufficiently stringent import restrictions (in the case depicted, this could be a zero import quota or a prohibitive tariff). The export subsidy amounts to area abcd. Switching to a two-price system has somewhat different implications depending on the way it is administered. Governments have two basic choices. Under the first option, the government restricts domestic sales to $C_0$ to keep the domestic price from falling below $P_d$. The size of the per unit deficiency payment to farmers ($P_t$ - $P_d$) is then determined by domestic supply conditions. Under the second option, the government fixes instead the per-unit deficiency payment ($P_t$ - $P_w$) and farmers respond by setting the quantity produced ($Q_t$).

**Figure 5—Two-price system**

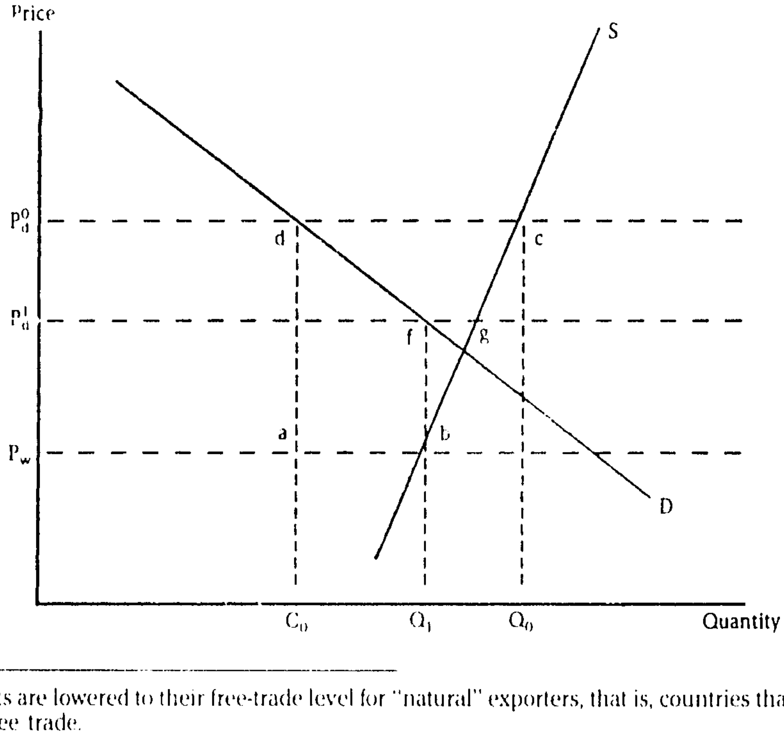



Some comments are in order on the first option. To restrict domestic sales to $C_0$ the government can intervene in a number of ways. One of the more efficient ways would be to distribute marketing certificates to farmers based on their production levels in some base period. Making these certificates freely tradable and tying their ownership to the deficiency payments would avoid production distortions characteristic of such schemes as equal percentage production cutbacks for all farmers or the U.S. version of deficiency payments (see Hathaway 1987). In particular, to be eligible for deficiency payments, inefficient farmers would not be required to continue producing, and efficient farmers would not have to idle productive land. Under the scheme, farmers would be free to produce as much for export as they want. The point is, though, that they face the world market price for any production beyond $C_0$. For all units up to $C_0$, farmers receive as deficiency payment the difference between the market-clearing price $P_d$ and some target price $P_t$. Price $P_t$ has to be sufficiently above $P_d$ to compensate farmers for the loss in producer surplus identified by area acd. Per-unit deficiency payments would have to be at least equal to distance $P_t$ - $P_d$. Productivity increases in combination with slow demand growth would enlarge area acd in Figure 5, thereby raising the price $P_t$ needed to compensate farmers. Compared with the system based on export subsidies that this version of a two-price system replaces, government expenditures diminish because the deficiency payments covering the loss in producer surplus ($deP_tP_d$) are lower than the former export refunds (abcd). The funds the government saves are equal to some share of the resource cost of the former level of production. (The switch to a two-price system is saving the government revenue equal to area abc in Figure 5.) Consumers are unaffected by the switch in support policies. They continue to pay price $P_d$ and thus continue to bear much of the cost of farm support.

Under the second option for deficiency payments, it is assumed that all frontier barriers to trade are dismantled. Hence consumers face the world price $P_w$ and consume quantity $C_1$. In contrast to the first case, they do not share in the costs of farm support. The burden is fully shifted to taxpayers. As a result, government expenditures exceed those realized under the first option discussed above by the implicit tax paid by consumers under that scheme ($adP_dP_w$). Another crucial difference is that deficiency payments are not limited to a particular quantity as they are under the first option. Rather they are paid on all production units, regardless of whether part of that production is exported or not.

The trade implications of the two types of deficiency payment schemes are different. Under the first option, imports remain below their free trade level for countries that would be importers under free trade ("natural" importers).[46] For example, in Figure 5, which depicts the case of a natural importer, free trade imports equal distance af. Under the two-price system no imports occur. Hence, for imports, there is no change compared with the situation that obtained under a system of price support cum export subsidies. In the case depicted in Figure 5 there would also be no exports under the deficiency payment scheme. It would simply not pay for farmers to produce in excess of $C_0$ because their production costs are in excess of the prevailing world price for units beyond $C_0$. This result is independent of the size of the deficiency payment per unit as long as deficiency payments are paid only on the domestically consumed quantity. Hence, for exports, the first option of the deficiency payment scheme appears to compare favorably with the price support cum export subsidy regime for which exports were of size $Q_0 - C_0$. However, there is a caveat. There could be cases for which exports would not cease under this option. Such a case is depicted in Figure 6.

## Figure 6—Two-price system with implicit export subsidization




[46] Exports are lowered to their free-trade level for "natural" exporters, that is, countries that would export under free trade.

At price $P^1_d$, consumption equals $C_0$ in Figure 6. In analogy to Figure 5, $C_0$ is the quantity supported by deficiency payments. (The deficiency payments for the case depicted in Figure 6 would amount to area abcd.) In contrast to Figure 5, though, total production ($Q_1$) will now exceed the quantity that receives deficiency payments ($C_0$). The difference ($Q_1$ - $C_0$) can be produced profitably at world price $P_w$ and exported without the help of explicit export subsidies.[17] Although exports are lower than under the price support cum export subsidy regime, thereby providing third-country exporters with somewhat better trading opportunities, there is still the peculiar situation that a natural importer is exporting, and this without any apparent explicit export subsidies. Exports are possible, however, only because the government is committed to deficiency payments that are related to a very high level of protection relative to the particular shapes of the domestic demand and supply curves. Deficiency payments serve the function of an indirect export subsidy in this case. The indirect subsidization of exports would not occur if the government were committed to deficiency payments only relative to a lower level of protection than indicated by $P^1_d$. In particular, exports would cease for a protection level corresponding to price $P^2_d$ or below and matching deficiency payments equal to area bgf or less. To sum up, the first option of implementing a deficiency payment scheme does not prevent countries that are natural importers from continuing to export the protected commodity in all possible cases. Indirectly subsidized exports can be prevented only if import protection is reduced at the same time that deficiency payments are limited to domestic consumption. The latter action alone is not sufficient to prevent indirect export subsidies.

Under the second option for deficiency payments, import protection is eliminated. Hence the type of indirect export subsidization described above cannot occur. However, there is still the possibility of indirect export subsidies. They can occur because the deficiency payments are not limited to domestic consumption but apply to all production. As per-unit deficiency payments ($P_s$ - $P_w$) are granted for quantities beyond $C_0$, domestic producers face an effective price of $P_s$ for any quantity they choose to produce (Figure 5).[18] Accordingly, they extend production to $Q_1$. As domestic consumption is considerably lower, at $C_1$, the difference, that is distance $Q_1$ - $C_1$, will be exported. Over time, as productivity increases and the supply curve shifts to the right at a more rapid rate than the demand curve, exports will even expand. In short, even in the absence of import protection, deficiency payments can have a trade effect that is very similar to the one that obtains in a system based on border protection and export subsidies. This can occur when fairly high deficiency payments are provided for all units of production, regardless of whether they are exported or not. This is basically what characterizes the U.S. deficiency payment system for grains, although its details are somewhat more complex. For instance, U.S. farmers receive deficiency payments only if they agree to restrict their acreage. This means that total production would be at a level below $Q_1$ in Figure 5. Also, total deficiency payments per farm are generally restricted. Finally, for most grains, Figure 5 would have to be changed somewhat to provide a more realistic description of the domestic U.S. market. In particular, the world price ($P_w$) would have to be set equal to the price level marked as $P_s$ in order to depict the case of a natural or efficient exporter.

To sum up, a ban on export subsidies could be expected to have the following benefits. (The main objections to a ban on export subsidies were discussed under "Some Theoretical Preliminaries" earlier in this chapter.) Efficient exporters, that is, countries that would be net

[17] Clearly, farmers will export only if the government can prevent them from selling $Q_1$ - $C_0$ in the domestic market, in which case the domestic market price would drop to $P^1_d$. Government enforcement is likely to be possible if the commodity has to go through a particular processing or marketing channel. This is the case, for example, with sugar.

[18] Distance ($P_s$ - $P_w$) equals distance ($P_s$ - $P_d$)

exporters under a free trade regime, would face less competition in their export markets from directly subsidized exports. Hence they would not have to support agriculture as much anymore to counteract foreign subsidies, thereby freeing resources for other purposes. For a given world demand curve, the world supply curve would move to the left, thereby raising world price. Efficient exporters would benefit from the resulting increase in both world price and export quantity, although not to the extent that would be expected under a free trade regime.

Avoidance behavior, however, is still possible if export subsidies are prohibited. If pure demand-side or supply-side policies are substituted for export subsidies, without any reduction in market support prices, nonsubsidizing exporters may experience worse market conditions for products connected by either demand or supply cross-effects to those formerly subject to export subsidies. Exports of those products may drop and their world price may fall because countries that formerly imported these products on a large scale now import less or even export. Unbound tariff levels may have gone up, or voluntary export restraints may have been introduced in addition.

Unwanted trade effects may also result in the case where a deficiency payment system is substituted for export subsidies. If the deficiency payments per unit are relatively high and are provided for all production units, they may end up subsidizing exports indirectly even if there are no import restrictions in effect. If there are import restrictions, deficiency payments may subsidize exports in an indirect way even if they are limited to the part of production that is consumed domestically. In the case of a natural importer, these indirect export subsidies are easily checked. All that needs to be monitored is the trade balance of the product in question. Evidence of any appreciable exports would signal that the ban on export subsidies, that is, indirect export subsidies, had been violated. For a competitive exporter that maintains no import restrictions, it is much more difficult to prove the existence of indirect export subsidies, especially if the exporter has a dominant influence on world price (this is typical of the United States in cereals). A pragmatic way to minimize these difficulties is to establish (for example, in the Subsidies Code) that deficiency payments shall under no circumstance be allowed on production not consumed domestically.

Policy responses along the lines of two-price systems are favored by many economists (see, for example, Paarlberg and Sharples 1984; Hathaway 1987). But as these systems generally involve the establishment of production quotas for farmers, some economists doubt their usefulness for countries other than the United States that do not have a tradition of such quotas (Henze 1985; Bergmann 1986). A system of production quotas makes considerable demands on the availability of statistical data at the farm level, and the more small-scale farming dominates agricultural production, the larger are administrative costs. These two points seem to be of some importance for the EC. (A discussion of the problems of applying acreage reduction schemes to European agriculture is given in Henze 1985, 332-333.) However, their importance should not be overstated: if there were indeed insuperable administrative difficulties, it is unlikely that the EC Commission would have come out with a detailed plan on acreage reduction.

Finally, some comments are required on the political-economy problems of a reform proposal that prohibits export subsidies. In all likelihood it would meet with some resistance, in particular from the EC, which is by far the main user of export subsidies.[19] After all, export subsidies are a central part of the EC's Common Agricultural Policy as it has evolved. But although their removal would require the restructuring of a number of commodity support programs, there may be some hope that the EC could agree to this, assuming it would get something in return, either inside or outside of agriculture. (The issue of compensation is discussed in Chapter 6.)

[19] Adjustments would also be required by some Nordic countries, Austria, and Japan. Details on protection methods by commodity are supplied in Organisation for Economic Co-operation and Development 1987.

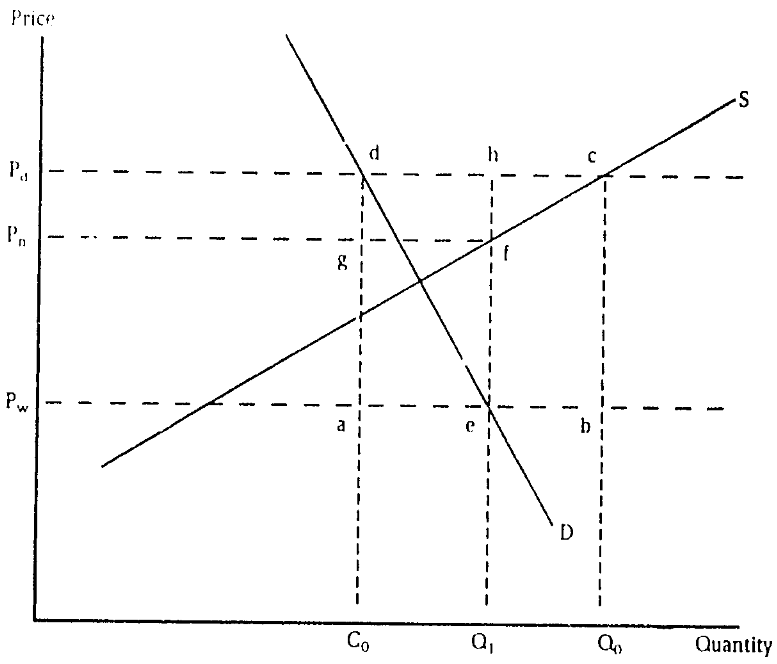
This guarded optimism stems from the EC's apparent leaning toward a system of acreage control. As shown in some detail above, however, acreage reduction can serve, in principle, as a substitute for export subsidies.

There is somewhat less need for the United States to adjust in the event of an export subsidy ban because export subsidies, although used more frequently since the 1985 Farm Act, are not central to most U.S. agricultural support programs. However, the U.S. system of deficiency payments for grains, for example, whereby payments extend to all production, would be in need of thorough reworking. Countries such as Japan or the Nordic countries, which operate highly restrictive import systems for much of agriculture but are not exporting, would of course not be required to adjust their farm support programs if export subsidies were prohibited for agricultural products. That is obviously why they have expressed essentially no objections to an export subsidy ban. (See the discussion in Chapter 3 of the reform proposals tabled by Japan and the Nordic countries at the Geneva talks in 1987.) Yet if the current disarray in agricultural trade is viewed as a result of import protection as much as of export subsidies, then a comprehensive reform proposal would have to encompass more than just a ban on export subsidies.

## Allowing Only Producer-Financed Export Subsidies

In its deliberations the Committee on Trade in Agriculture has apparently come to the conclusion that export subsidies could be permitted in the GATT system as long as they are financed by producers themselves rather than being paid for by the taxpayer. The idea behind these Producer-Financed Export Subsidies (PFES) can be understood best by referring to Figure 7. As depicted, the PFES scheme applies to countries that, although they are natural importers, are currently exporting the commodity in question. As the domestic market price ($P_d$) is supported at a level far in excess of the world price ($P_w$), these exports ($Q_0$ - $C_0$) require export

**Figure 7—Producer-financed export subsidies**



subsidies equal to rectangle abcd in value terms. To make producers pay for the export subsidy, an ad valorem tax of $(P_d/P_n) - 1$ is levied on them. As the tax reduces the net price received by producers from $P_d$ to $P_n$, they will cut production from $Q_0$ to $Q_1$. Consumers continue to pay price $P_d$, the official support price. (Note that PFES is at its heart also a two-price system, with a high price paid by consumers and a lower price received by farmers.) As a consequence of introducing PFES, the domestic surplus and, consequently, exports drop from $(Q_0 - C_0)$ to $(Q_1 - C_0)$. The amount of the required export subsidy falls from abcd to aehd. The tax revenue collected from producers amounts to rectangle $P_n$fh$P_d$. In equilibrium, it just suffices to cover export subsidies.

Compared with a ban on export subsidies, PFES results in a rather small trade effect. Exports diminish only marginally with PFES, whereas they would completely cease for a natural importer if export subsidies were banned. Consequently, any effect on world export supply and world price is going to be small. (See Valdés and Zietz 1987 for some numerical calculations of the effect of PFES for the case of sugar.) For a given supply curve, the larger the price elasticity of domestic demand, the more favorable the trade effect of PFES.[59] PFES has absolutely no trade effect if domestic production is unresponsive to price changes, that is, when supply curve S in Figure 7 is vertical. In this case, PFES is simply borne by farmers without inducing a change in behavior. Disregarding this special case, the main advantage of PFES lies in the link it establishes between fluctuations in world market price and domestic production decisions, even if a system of variable levies is used to support the domestic market price at level $P_d$ in Figure 7. This link has two positive trade effects. First, it moderates the effect on the volume of subsidized exports of both an increase in the domestic support price relative to the world price and an increase in productivity. Thereby it removes some of the uncertainty for nonsubsidizing exporters that is associated with government-financed, open-ended export subsidies. Second, PFES would diminish the adverse effect of a variable-levy system on world market instability.

The disadvantages of PFES can be summarized as follows. If implemented alone, PFES could never fully eliminate, only moderate, the possibility of subsidizing countries' raising their export volume. The EC's experience with a related system of producer levies demonstrates that subsidized exports could very well increase. (See Hubbard 1986 for a discussion of the coresponsibility levy as implemented in the EC.) It is important to point out in this context, however, that the EC's coresponsibility levies are not fully equivalent to PFES as illustrated in Figure 7. Not only are the levies not large enough to finance all export subsidies, but they are also established along with the domestic support price. Both differences operate to remove some vital functions of the PFES as intended, for example, by the Committee on Trade in Agriculture. Nevertheless, the EC's experience has shown that the introduction of the coresponsibility levies caused the farm lobby to exert great pressure on policymakers to also raise the domestic support price. This effectively kept the net price received by producers constant at its pretax level, thereby shifting the tax to consumers. (See Tangermann 1986 for a more detailed discussion and Tangermann 1984, 159-168.) Not surprisingly, consumption contracted further and the pressure to export increased rather than diminished.

PFES may also be objected to because it favors farmers of countries with a relatively small export share, for example, the EC as compared with Australasia. Having a small export share means that the tax per unit of production could be rather small, thereby causing little income loss to farmers and weakening the link between world market and domestic production

[59] In general, the larger the trade effect, the larger is the weighted sum of the elasticities of demand and supply.

decisions. A tax of negligible size also results in a small reduction in subsidized exports. Hence the trade effect of PFES would be small in countries with a large domestic consumption base and vice versa (see Hathaway 1987). For this reason, PFES may not be acceptable to nonsubsidizing exporters on equity grounds. However, the same reasoning, that is, the prospect of no fundamental change in trade flows, strongly favors PFES in terms of its political acceptability by the farm lobbies of populous countries such as the EC.

There is also a question of the extent to which PFES fits into the legal framework of the General Agreement. After all, PFES implies that the export price is below the price paid by domestic consumers. According to Article VI:1 of the General Agreement, this constitutes a case of dumping if the exports cause or threaten material injury to another country's producers. Hence, if one attaches some value to the legal consistency of the General Agreement, PFES does not appear worth further consideration. Rather than eliminating the special treatment of agricultural export subsidies, PFES would simply replace one special exception with another, although with one that is somewhat less objectionable from an economic standpoint.

In principle, PFES can moderate the negative trade effects on nonsubsidizing exporters of export subsidies by natural importers. In contrast to straight export subsidies, PFES is broadly consistent with the GATT's main principles as discussed in Chapter 4. It does not introduce discrimination among trading partners and, perhaps most important, it reactivates the price mechanism for protecting countries by forcing them, at least in theory, to vary the producer price in tandem with the world price. PFES, however, will not eliminate export competition from natural importers, nor will it turn them into actual importers. In other words, PFES in itself will not solve the problem of export subsidies. If a reversal of trade flows is desired, something has to be done to lower the level of domestic market price support from the prohibitive level that is at the root of export subsidies.

## Containing Quantitative Import Restrictions

### Minimum-Access Guarantees

As a complement to putting more disciplines on the behavior of agricultural exporters, either in the form of a ban on subsidized exports or by limiting them to PFES, import-protecting countries could also be made subject to firmer disciplines. Article XI:2(c) of the General Agreement currently gives countries the option to impose quotas on the importation of agricultural products to pursue certain domestic policy objectives (see Chapter 3 for more details). Import quotas are supposed to be accompanied by equivalent restraints on domestic production so that they will not result in a market share for imports that is lower than the one that could have been expected in the absence of import quotas. The idea of this provision is to safeguard traditional import shares and thereby ensure continued market access for exporters.[51]

The Committee on Trade in Agriculture has spent considerable time discussing ways to broaden this market-access provision of Article XI. Two ideas for an extension seem to have received the most support. The first would imply that the minimum-access rule of Article XI applies not only when a country imposes a quota but also when imports are restricted in any form other than through the bound tariffs written into a country's trade concessions. This would include, among other things, restrictions such as voluntary export restraints or a rise in the domestic support price. (Note that the minimum-access requirement would apply equally to

[51]Note that Article XI:2(c) does not guarantee the market share of a particular exporter—only that of all exporters. The provisions of Article XIII:2-4 on the nondiscriminatory administration of quantitative restrictions apply in this case.

all import-protecting countries regardless of whether they are currently importers or subsidizing exporters.) The second amendment of Article XI would require countries maintaining import restrictions other than bound tariffs to allow imports to reach a market share of at least X percent, regardless of the market share of imports in the recent past. This provision would add a new dimension to the minimum-access idea.

The minimum-access clause in its current form only safeguards a historical market share against rising levels of import protection or productivity changes over time, as discussed in Chapter 4. If the market share of imports happens to be close to or equal to zero because of historically very tight import restrictions,[52] the minimum-access guarantee has no economic consequences. It cannot induce a change in policy. Adding an X percent provision to the current minimum-access rule would, by contrast, require a policy response by heavily protecting countries. It would force them to open up their protected markets at least to the extent that imports reach X percent.

The X percent rule could be implemented by defining minimum access either as a percentage of domestic consumption or as a percentage of domestic production. The former will have a greater trade effect, that is, will shift the world demand curve further to the right, if import-protecting countries are supporting their market price at below the self-sufficiency level and imports have not entirely ceased.[53] For countries that support the market price above this level and hence probably use export subsidies to dispose of their domestic surplus,[54] the trade effect will clearly be larger if minimum access is defined in terms of domestic production. It follows that, under the latter definition, the trade effect of the X percent rule increases whenever the support price is raised, whereas it would decrease if minimum-access requirements were expressed in terms of domestic consumption. Therefore, expressing the X percent rule in terms of domestic production is likely to provide a better disincentive to raising domestic support prices and hence protection. This definition will be assumed for the remainder of this section.

Four cases are analyzed to illustrate, in a comparative static framework, the trade effect of adding an X percent provision to the minimum-access rule currently in force. The four cases correspond to parts (a) to (d) of Figure 8. Figure 8(a) pictures domestic demand and supply curves for a commodity subject to a relatively low level of protection, as indicated by the percentage difference between domestic price $P_d$ and world price $P_w$. Prior to minimum access, imports equal $C_d - Q_{d0}$. An X percent minimum-access requirement shifts the gross supply curve, that is, the horizontal sum of domestic production and minimum-access imports, from S to $S_X$. At price $P^0_d$, minimum-access imports equal distance ab, less than actual imports. Hence for case (a) the X percent provision has no trade effect. The world price remains unchanged.

Figure 8(b) depicts a case where minimum-access imports at support price $P^0_d$, distance ab, exceed actual imports at that price, $C - Q_d$. Without a change in the support price, minimum-access imports turn the market from one characterized by excess demand into one characterized by excess supply. In order to identify the trade effects of an X percent provision in this case, some assumptions are required on the set of policies that would be allowed under a reformed GATT treaty and that are consistent with the country's domestic policy objectives. Regarding the latter, it will be assumed that continuous stock accumulation is out of the question, as is the destruction of excess supplies. Under these assumptions, the discussion of export subsidies in the previous section applies in full. If export subsidies are not banned, domestic surplus

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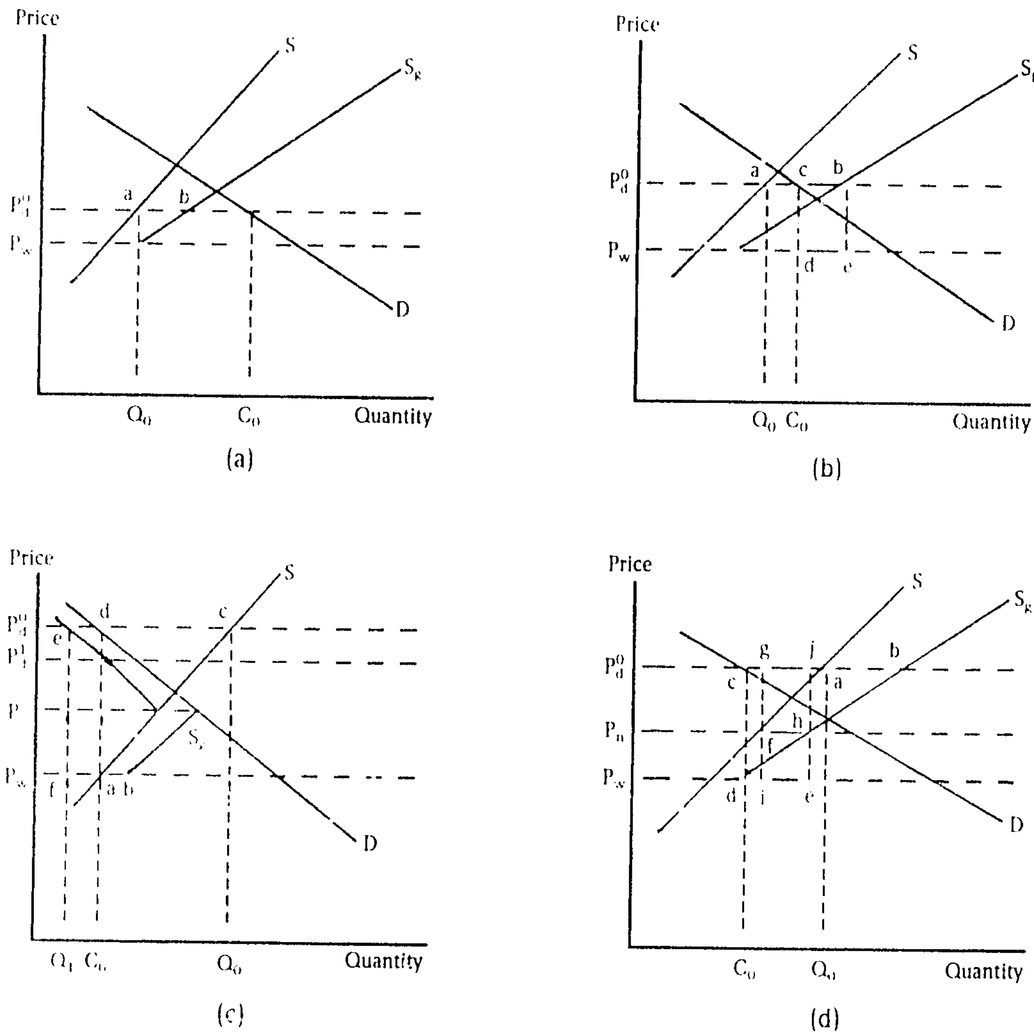
[52] Examples are the highly restrictive state trading practices Japan maintains for grains and the EC system of variable levies combined with export subsidies for wheat, beef, sugar, and other commodities.
[53] This description fits Japan for most agricultural products.
[54] The EC fits this description for a number of agricultural products, for example, beef.

## Figure 8—Minimum-access guarantees under alternative economic conditions




be could be exported, thereby avoiding any domestic adjustment and undoing any trade effect of the minimum-access imports. If protection is by tariffs or variable levies and minimum-access imports are not exempt, export subsidies could be fully financed out of tariff revenue. If import quotas or voluntary export restraints are used to raise the domestic price to $P_d^0$, the reexport would require government funds equal to rectangle bcde.

If it is assumed that export subsidies are prohibited, expansionary demand or contractionary supply policies could be adopted to clear the market at price $P_d^0$, that is, without a change in the level of protection. Either policy would cause minimum-access imports to have a positive effect on world demand, leading to an increase in world price. (In order to simplify the diagram, world price changes are not identified in Figure 8.) However, this applies only to the good in question. As explained in the section on export subsidies, it may well be that certain demand or supply policies have a negative trade impact on other goods, thereby partially canceling out the positive trade effect for the good examined. As an alternative to demand- or supply-side policies, the level of protection could be reduced sufficiently to clear the market. Minimum-access imports would be lower as a result because of reduced domestic production, causing a somewhat lower trade effect compared with policies that act on domestic demand or supply. From a general equilibrium perspective, however, such a policy response would have the advantage of reducing negative trade repercussions on other goods.

Figure 8(c) demonstrates the trade effects that result when minimum-access import requirements of X percent are combined with a two-price system. The $S_z$ curve identifying gross supply, the sum of domestic production and minimum imports, takes on a somewhat different shape in this case. For protection levels corresponding to prices below P, $S_z$ is identical to the curves shown in the other parts of Figure 8. Deficiency payments are based on the domestic production forthcoming at those prices. Minimum-access imports are less than or equal to the difference between domestic demand and production. The situation resembles that depicted in Figure 8(a). For higher levels of protection, for which the sum of domestic production and minimum-access imports exceeds domestic consumption, a two-price system would limit deficiency payments to a quantity equal to domestic consumption minus minimum imports. The quantity receiving deficiency payments diminishes with rising protection levels. In the case depicted in Figure 8(c), production reaches a maximum at domestic support price P. It falls for higher levels of the support price and reaches a minimum at price $P^1_d$.[55] This implies that minimum imports will never be smaller than indicated by distance ab. For domestic support prices between $P_w$ and $P^1_d$, minimum-access imports will be larger than ab, and for support prices above $P^1_d$, minimum imports will be exactly equal to distance ab (=ed).

To analyze the trade effects of superimposing an X percent provision on a two-price system, it is convenient to start with a protection level corresponding to price $P^*$. If a two-price system is in effect, the domestic market just clears at that price. Both production and consumption are at level $C_0$ and deficiency payments amount to area acd. Minimum-access import requirements of size ab (=ed) have a different trade effect depending on how the government reacts. Let us assume that pure demand- or supply-side policies, as discussed in the section on export subsidies, are considered infeasible. (If they are feasible, there is no reason to introduce a two-price system in the first place.) In this case, the government has to reduce the subsidized quota assigned to domestic farmers from $C_0$ to $Q_1$ if the domestic support price is kept constant. If deficiency payments are raised sufficiently, that is, by amount fade, farmers will be as well off as before minimum-access imports if they export quantity $C_0 - Q_1$. As exports happen to be exactly equal to minimum imports, world price will not change as a result of minimum access.

There is no positive trade effect of minimum access: all it does is raise the domestic tax burden. Farmers will be better off, however, if they can sell quantity $C_0 - Q_1$ in the domestic market rather than in the world market. (The government may not be able to prevent this from happening because the commodity does not pass through an easily controllable processing or marketing channel.) In this case the domestic price will drop to $P^1_1$ and minimum-access imports will have a positive trade effect. In short, superimposing minimum access on a two-price system can guarantee a positive trade effect only if there is a rule that prohibits importing countries from reexporting minimum-access imports or exporting an equivalent amount of domestic production. Without such a rule, minimum access may have a positive trade effect but it is not certain.

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[55] For a production quota below $C_0$, which corresponds to a support price above $P^1_d$, farmers could compete in the world markets. Hence they have a strong incentive to produce at least $C_0$, that is, in excess of their production quota. As it is more profitable for them to sell in the domestic market than to export, the domestic price will fall to $P^1_d$. See the discussion of deficiency payments earlier in this chapter.

Finally, Figure 8(d) illustrates the trade effects if an X percent minimum-access provision is combined with PFES. At price $P^w_d$ and prior to PFES and minimum imports, subsidized exports equal distance $Q_d$ - $C_d$. Without a change in support price, minimum-access imports of size ab would add to the existing surplus (ca). Introducing PFES would imply a levy on domestic production of size ($P^w_d$ - $P_n$), so that revenue from this levy, rectangle $P_n$fg$P^w_d$, just equals export restitutions, area jcde. At the production level corresponding to the net price received by farmers ($P_n$), minimum-access imports are equal to distance fh, whereas total subsidized exports correspond to de (= cj), implying that all required imports are reexported. Distance eg represents the part of subsidized exports that is not due to minimum-access imports.

Although minimum-access imports are reexported in full, they do have a positive trade effect when combined with PFES. This results from both the shift to the right of world import demand due to minimum-access imports and the shift to the left of world export supply. Note in this connection that subsidized exports are not simply rising by the amount of minimum-access imports, thereby canceling out any effect of minimum imports on world price. On the contrary, exports are falling, from ac to jc. This is due to a sizable decline in domestic production (ag) compared with the situation prior to PFES and minimum access. As a result of the production decline, the "homemade" surplus has shrunk to eg. If PFES were implemented alone, without being combined with minimum access, this homemade surplus would clearly be larger than eg, because the revenue of the producer tax depicted in Figure 8(d), area $P_n$fg$P^w_d$, would greatly exceed export subsidy requirements in the absence of minimum access, area iged. A larger homemade surplus, however, would imply, ceteris paribus, a smaller shift to the left of the world export supply curve, and hence less of a positive trade effect. Finally, it should be noted that adding minimum access to PFES will have an increasingly smaller effect on world price the less elastic domestic production reacts to price. In the section on PFES it was noted that a completely inelastic domestic supply schedule deprives PFES of any trade effect. Adding minimum access to PFES will not change this result.

To sum up, if an X percent minimum-access provision were introduced without combining it with restraint on export subsidies, either in the form of a complete ban or limiting them to PFES, it would be unlikely to have any appreciable positive trade effect. The introduction of or an increase in subsidized exports, either in explicit or implicit form, would be a natural avoidance strategy for import-protecting countries. Whether this is also affordable for a country depends largely on budgetary considerations. For countries with sufficient budgetary resources, no adjustment can be expected. For others, some reduction in the protection level and hence some positive trade effect could come forth. Basically, the choice for countries would be qualitatively the same as the one faced by any import-protecting country without minimum-access import obligations. Minimum-access imports just make the budgetary pressure more pronounced. But, clearly, they do not force upon a protecting country a particular internal response pattern. In particular, minimum-access imports do not manage by themselves to establish a link between domestic price and world price.

Without a ban on export subsidies, an X percent minimum-access provision can at most guarantee a quota rent for the exporter to the protected market. For the case depicted in Figure 8(b) the rent would amount to rectangle bcde, and for the case of Figure 8(d), to area ejgi. These rents, however, materialize in full only if quota imports are tariff-free. (Should traders in the importing country receive licenses for the amount of the quota imports, possibly as a result of a competitive bidding process, the quota rent, after subtraction of any tariff, would be reaped by importers rather than by exporting countries.) Should imports be subject to tariffs, then the quota rent is reduced accordingly by the tariff. Minimum-access rights would not give those countries that happen to fill the minimum import quota an increase in overall export quantity. Rather, their exports to the minimum-access countries would be just matched by an export decline in third-country markets that are not subject to minimum access. This occurs because the countries subject to minimum-access imports are likely to increase subsidized exports to these same third-country markets.

If export subsidies are prohibited, an X percent minimum-access provision can be expected to generate a one-time positive trade effect, as import-protecting countries that are self-sufficient or close to it are forced to import minimum-access quantities. Over time, as production increased relative to demand, minimum access imports would force the import-protecting country to lower the domestic support price to balance demand and supply. (This is true regardless of whether minimum access is defined in terms of production, as recommended, or in terms of consumption, as in Article XI.2(c).) Although the domestic price adjustment is a desirable result, the simultaneous freezing of import quantities or shares that would result is not. It effectively blocks the forces of comparative advantage from operating and hence contradicts the very spirit of the General Agreement.

An advantage of minimum-access import requirements is the relative ease with which they can be monitored. This is independent of the type of protection system used and applies to both the minimum-access rule of Article XI.2 and the suggested X percent minimum-import provision. Quantifying minimum access is hardly a problem for the minimum-access rule of Article XI. All that is required is a decision on the base period on which the market share reserved for imports is based. Quantifying the X percent rule, however, is far less straightforward. Should minimum-access imports amount to at least 10 percent of domestic production for a natural importer? Should that figure be the same for all commodities? These are difficult questions that would have to be resolved in the process of negotiation.

The minimum-access guarantee of Article XI is specific to agriculture. Restricting agricultural trade reform to tightening Article XI by adding an X percent provision and, possibly, a ban on export subsidies, would mean continuing to treat agriculture as a special case with its own rules of behavior. Treating agriculture as a special case in the GATT negotiations, though, has a number of distinct disadvantages from a political-economy perspective. (These were detailed in Chapter 4.) However, there is nothing about minimum access that makes it specific to agriculture on a priori grounds. A minimum-access rule like the one laid down in Article XI and amended by an X percent provision could very well apply to all trade, regardless of sector. If minimum access is interpreted in this more general form, it could be employed to condition the use of any type of trade-restricting measure apart from bound tariffs. This idea will be taken up again in Chapter 6, where it is incorporated as part of a trade reform proposal.

## Tariffication or Global Quotas

Bound tariffs are the principal exception to free trade envisioned by the GATT. The reason is that they preserve the main principles of the GATT, such as reliance on the price mechanism and nondiscrimination, as no other trade restriction can. In agriculture, however, nontariff barriers to trade play a more important role than tariffs, thereby excepting the sector from central GATT principles. Tariffication is a reform proposal that is intended to reverse this. Among economists this idea has a wide following.[56]

Tariffication has two objectives, one for the long run and the other for the short run. Its long-run objective is to replace all nontariff barriers and unbound tariffs with low bound tariffs. To minimize distortions of resource allocation, it is widely recognized that these bound tariffs should be uniform for broad commodity groups. In the short run, tariffication implies that the existing nontariff barriers would be converted into their respective tariff equivalents. This would clearly mean that, for many agricultural products and countries, the resulting tariff

[56] Advocates of this approach include, for example, Koester (1987), Patterson and Patterson (1986), and the cosigners of Institute for International Economics and The Institute for Research on Public Policy (1988).

equivalents would be far in excess of the bound tariff rates that may exist currently or that are envisioned to apply after the adjustment to a tariffs-only world has been completed.

In some form or other, then, countries have to be released temporarily from the obligations associated with bound tariffs. In order to avoid a permanent increase in tariff rates, however, the duration of this exception would have to be strictly limited. Preferably, a schedule of mandatory tariff reductions from the tariff equivalent down to the existing bound tariff rate, should be attached to a temporary waiver on the tariff concessions. To reduce the possibility of prohibitive tariffs during this adjustment period, countries could be obligated to abide by the minimum-access rule of Article XI 2, that is, importers would be required to preserve the historical market share of imports during the transition phase.

The trade effects of tariffication can be analyzed conveniently if it is pitted against a potential alternative trade reform: the conversion of all nontariff barriers into a global quota rather than tariffs (see Hufbauer and Schott 1985 for a discussion of this alternative). Gradual liberalization would then proceed in the form of increasingly larger quotas over time. Global quotas have features similar to those of tariffs. They are nondiscriminatory, easy to administer and monitor, and address only the problem of frontier barriers. A major difference lies in the fact that global quotas do not establish a link between domestic and world prices at a given quota level. Not only does this mean that an important GATT principle is violated, but it also has certain consequences for the development of trade.

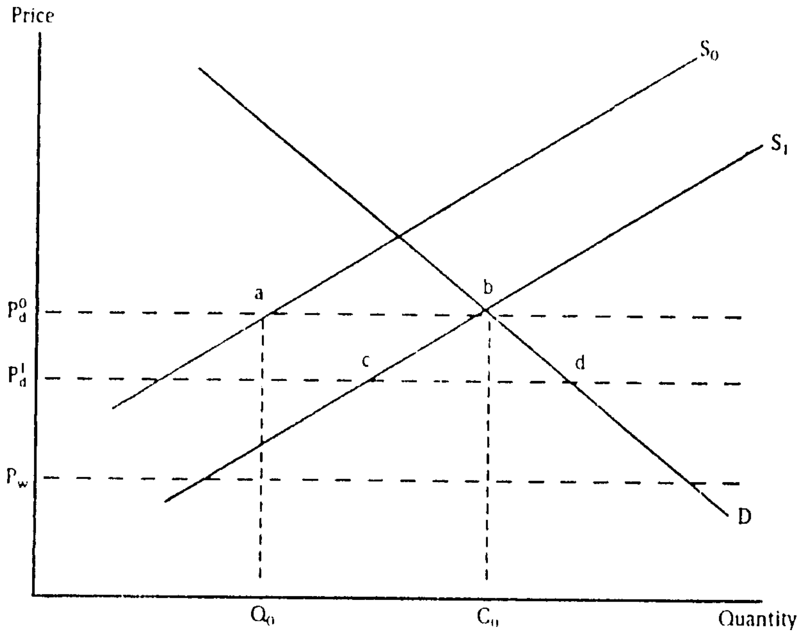
In the short run and for a given world price, replacing nontariff barriers with tariffs of the same restrictive effect changes neither domestic price nor the overall level of trade. However, the composition of imports, assuming the tariff equivalent is not prohibitive, may change if some of the nontariff barriers formerly discriminated trade by origin. A global quota would not differ from tariffication in this short-run respect. This ceases to be true if the assumption of a constant world price is relaxed. A lower (higher) world price increases (lowers) imports in the case of tariffs, but has no trade impact in a world of quotas. The trade effect resulting from tariffication moderates world price changes. Hence world price fluctuations should decline under such a system.

Over time, as domestic demand and supply curves shift, a constant tariff equivalent also has different consequences from a fixed quota. Take first the case that is usually quoted in this context: demand growth exceeds domestic production growth. A fixed import quota implies no growth in imports but rather an increase in the level of protection. For a bound tariff, in contrast, imports increase by the full amount of excess demand growth. Hence tariffs ensure a positive trade effect; quotas do not, unless the quotas are made adjustable upward, possibly through some automatic escalator system triggered on demand growth.

Take now the reverse case of production growth outstripping demand growth. For a constant tariff, imports decline; for a fixed import quota, this is not the case as long as export subsidies are prohibited and the domestic support price is above the world market price. The global quota will have an effect equivalent to minimum-access import guarantees under these conditions. This point is illustrated in Figure 9.

Before the domestic supply curve shifts to the right from $S_1$ to $S_2$, an ad valorem tariff of $(P^0_d/P_w) - 1$ percent and an import quota of size ab both establish a domestic price of $P^0_d$, with imports being equal to $C_1 - Q_1$. After the shift of the supply curve to $S_2$, imports cease under the tariff arrangement, whereas they remain constant for the case of the quota. If export subsidies are prohibited, the domestic price level declines from $P^0_d$ to $P^1_d$ under the quota arrangement (cd = ab) whereas it stays constant under the tariff regime. The price decline under the quota arrangement clearly assumes that the government follows a market-oriented policy. As was discussed at length in the section on export subsidies, any number of alternative reaction patterns is possible, from pure demand-stimulating policies to two-price systems. Any of these policies could avoid or moderate the decline in the domestic support price. In short, there

**Figure 9—Tariffs and global quotas with domestic production growth**




is nothing automatic about the price decline under the quota arrangement and the ban on export subsidies.

If export subsidies are not prohibited, then a country under the quota regime could choose to export quantity cd with the help of export subsidies rather than allow the support price to fall from $P_d^0$ to $P_d^1$. Although gross imports would not diminish in this case, as they would under the tariff arrangement, net imports would be zero, just as in the tariff case. From the perspective of nonsubsidizing exporters, then, there is little difference between the quota or tariff regime if export subsidies are allowed.[57] The world price would tend to drop in either case.

Tariffication gives rise to another concern that is absent in the case of a global quota. Countries may resort to gray-area measures such as voluntary export restraints or orderly marketing agreements. This is not a development one would expect immediately, as tariffs are set at their nontariff barrier equivalent, but only over time as these high tariff rates are lowered to their bound levels. This concern is not unfounded on an a priori basis, given the historical experience with tariff reductions in many segments of manufactures.

In numerous industries, tariff cuts negotiated in previous multilateral trade negotiations were subsequently reversed, at least partially, through the introduction of such gray-area measures. As new low-cost suppliers enter the market on a broader basis, this tendency seems to gain increasing momentum, spreading across more and more industries. In agriculture, however, this threat is probably of less concern for at least two reasons. First, new low-cost suppliers, such as the newly industrialized countries in industrial goods, are not as easily created in agriculture as in industry. Availability of fertile land and appropriate climate are strong constraining factors. Few if any new competitors can be expected to appear on agricultural markets, although some traditional ones, particularly in Latin America, still have considerable

[57] The case of a potential quota rent is disregarded here for simplicity.

growth potential. Second, voluntary export restraints and orderly marketing agreements are largely levied against developing countries, especially the newly industrialized countries. Compared with the major suppliers in agriculture, such as the United States, Canada, and Australasia, they have little political or economic clout to withstand trade restrictions.

Some comments are needed on the political-economy implications of tariffication versus global quotas. Quotas seem to be preferred over tariffication among farmers. The trade effect of quotas is considered more predictable because, unlike that of tariffs, it is not subject to the vagaries of estimating demand and supply functions. It is also independent of changes in relative costs. Predictable or unforeseen changes in comparative advantage, in other words, have no bearing on trade flows. Furthermore, high tariff levels for agriculture would be difficult to explain to voters as well as to industries not subject to similarly high protection levels. Quotas are not standardized in the way tariffs are and are thus harder to pin down in their restrictive effect for the uninitiated observer.

A system of global declining quotas also has a definite disadvantage from a political-economy point of view. It is generally agreed that zero tariffs or quotas at the free trade level are unrealistic for the foreseeable future. Hence, the end point of the process of tariffication would be realistically the establishment of a system of relatively low bound tariffs, not free trade. In terms of global quotas this would translate into quotas close to, but not equivalent to, the free-trade level. As demand and supply change over time, no government decision is required under the tariff system. The level of protection remains the same. Under a quota system, changes in demand and supply would require constant adjustments of the quota to keep its protective effect constant. This naturally gives rise to continual conflicts with the affected producers. It deprives governments of the protective shield against the demands of special interest groups for protection that is characteristic of a tariff. A tariff automates domestic price decision by linking the domestic price to the world price; a quota arrangement does not.

# Binding the Level of Protection

## Choices in Defining the Level of Protection

An alternative to restricting the use of specific instruments with a direct trade impact is to bind the level of protection, defined either separately for each commodity or jointly, that is, commodity-independent, for the country as a whole. Such a scheme would allow each country to decide on its own what trade-inhibiting measures to apply, as long as the level of protection stayed below a certain threshold as written into the country's GATT concessions. This threshold-protection level could be determined either by reference to a particular year or average of past years or by free negotiation among the GATT signatories. At any rate, once agreed upon, it could be bound in exactly the same way as a tariff.

Such an approach is not at all that new. Something rather similar was put on the negotiating table once before during multilateral trade negotiations. During the Kennedy Round the EC made such a suggestion in the form of the *montant de soutien* or "margin of support" strategy. The proposal was rejected by the United States at that time because it did not contain minimum-access guarantees to the EC market and endangered U.S. market access to the EC for products covered by bound tariffs. At present, there is again intense interest in the binding of protection levels as a way to halt the growth of protectionism in agriculture. The choice seems to boil down to one of the following three methods of measurement: nominal rates of protection (NRP), effective rates of protection (ERP), and the overall level of protection as measured by

Producer Subsidy Equivalent (PSE) or any of its derivatives, such as Trade Distortion Equivalent (TDE).[58]

The NRP is widely used in empirical analysis. Its popularity stems in part from its relative simplicity and the intuitive sense it makes. As the NRP is based on a comparison of domestic and world market prices, the data requirements are rather limited. All that is needed is information on two prices for each commodity. Despite its simplicity, the NRP measure has the advantage that it captures the most important protectionist measures quite adequately, making avoidance strategies on the part of protecting countries more difficult. The reason is that common protectionist measures, such as variable levies, tariffs, quotas, and the protectionist activities of state trading enterprises, directly affect the price differential between domestic and world market prices. Increases in the level of protection through these trade policy instruments generally show up in a greater differential between world price and domestic price.

However, there are some well-known cases for which the incentive effect of protection to producers, and hence the ultimate trade effect, is not fully captured by the NRP. One such case occurs when the inputs used in the production process are subject to levels of protection that are very different from those on the final product. In this case, the NRP on the final product underestimates the incentive effect to producers and, hence, the trade effect. The ERP is meant to correct for this shortcoming. It takes into account differences in the level of protection among inputs and final product.

Although the ERP better captures the true level of protection accorded to an economic activity, this measure also has its shortcomings. First and foremost, its calculation is far from easy. It requires a considerable amount of detailed information about input-output relationships—information that is simply not available in many cases. This is reflected in the limited number of empirical studies utilizing this measure for more than a few select products. Furthermore, it is unlikely that imported inputs play a large role for the majority of primary agricultural products that are being traded.[59] Finally, the ERP has one serious flaw in its use as a measurement concept that is of particular importance for heavily protected agricultural products, that is, the ERP is difficult or impossible to interpret when free-trade value added is low or negative. The ERP measure will assume very large positive or negative values under these circumstances, thereby rendering it ineffective for measurement purposes.

The NRP measure is a poor guide to the trade effects of government policies in a number of other instances apart from the case of differential rates of protection on inputs and final products. Examples are deficiency payments, input or production subsidies, and voluntary export restraints with the quota managed by the exporter.[60] In these cases the NRP may fail to establish a unique link between measured price difference or the lack thereof and the measure's trade impact. This has been illustrated for the case of deficiency payments in connection with Figures 5 and 6. If farmers receive deficiency payments only for the quantity they would produce in the absence of import barriers, these payments have no negative trade effect. This applies equally in the case where the country is an importer at the given world price and where it is an exporter. Hence an NRP of zero would correctly indicate the absence of negative trade effects, assuming consumers can buy at the world price. Deficiency payments beyond the

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[58] TDE is equivalent to PSE except that it intends to capture only government support measures that are explicitly trade-distorting. The Canadian proposal for agricultural trade reform at the Geneva talks is based on this measure.

[59] This is not to say that there are no cases in agriculture where the ERP is likely to be significantly above the NRP. One example would be the protection of the meat industry in the EC. Its NRP is high, but the low tariffs on feed imports, such as soybeans and citrus pulp, make its ERP even higher.

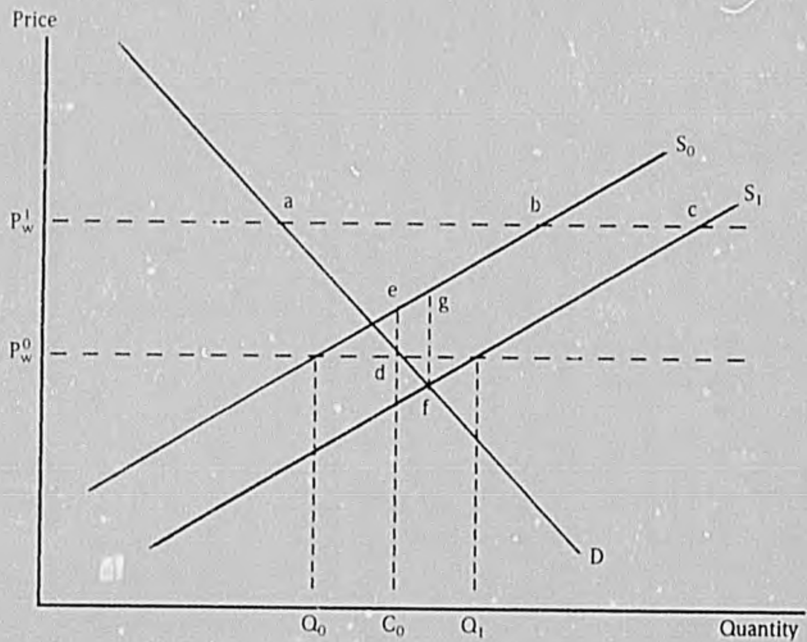
[60] The NRP will be affected by the voluntary export restraint only if a price other than the import price is used as a proxy for the world price for the purpose of comparison with the domestic price. A very similar argument holds for health and other standards that imports have to conform to.

quantities that would be produced in the absence of protection, however, do affect trade by either reducing imports or increasing exports. The NRP measure fails to show a negative trade effect in this case.

The NRP measure is even less useful in handling production subsidies than deficiency payments. It will never be able to identify the trade-distorting effects of subsidies. This is illustrated in Figure 10 for two alternative levels of the world price. To focus on the subsidy effect, the world price is assumed to be equal to the prevailing domestic price in each case. Before the introduction of production subsidies, the country is a net importer of quantity $C_0 - Q_0$ at the lower world price ($P_w^0$) and a net exporter of quantity ab at the higher world price. A per-unit production subsidy of sufficient size, that is, in excess of distance de, will make the country a net exporter even at price $P_w^0$. The subsidy identified by fg, for example, induces exports of size $Q_1 - C_0$. At price level $P_w^1$, a subsidy of this same size raises exports from ab to level ac. In neither case, however, is there a change in the NRP measure, yet negative trade effects certainly exist.

The latter two cases, that is, deficiency payments and domestic subsidies,[61] are typical examples of the rationale for extending the NRP measure into PSE. The overall level of protection as measured by PSE is a refinement or extension of the NRP measure in the sense that per-unit transfers received by farmers are added to the NRP measure if their effect on production is not already captured by the NRP.[62] Unlike the ERP, PSE does not rely on in-depth knowledge

**Figure 10—Trade impact of domestic subsidies at different levels of world price**




[61] Denaturing premiums that are paid to convert a surplus product into a product for which the domestic surplus is less acute can also be considered production subsidies, although not for the denatured product (for example, wine), but for the end product (for example, industrial alcohol).

[62] The idea of PSE originates with Josling, as developed in FAO 1975. In-depth discussions and practical applications can be found in Organisation for Economic Co-operation and Development 1987; Tangermann, Josling, and Pearson 1987; and U.S. Department of Agriculture 1987.

of technical input-output relationships. The measure is similar to the NRP in that the problems addressed by the ERP are not explicitly considered.[66] PSE's major advantage over the NRP is its more comprehensive coverage of governmental policies. PSE captures policies, such as subsidies, that have a potentially negative trade effect, yet do not change the differential between world price and domestic price and hence the NRP.

## Evaluating the Usefulness of Bound Protection Levels

Binding the protection level, whether in terms of the NRP or PSE, is fully consistent with the GATT's emphasis on the price mechanism. However, only if the protection level is defined in terms of PSE will world price fluctuations feed through to producers, either as changes in price or as transfers. This applies regardless of the intervention scheme that is applied by the government if PSE is defined in a very comprehensive manner. But given such a definition, PSE can dramatically reduce the possibilities open to governments to avoid the consequences of bound or reduced protection levels. For example, the substitution of domestic subsidies for export subsidies would be clearly impossible. PSE's advantage over the NRP lies in its ability to add up measures with direct and indirect trade effects in a consistent manner. This makes it appealing to anyone who thinks that the GATT's emphasis on measures with direct trade effect, that is, frontier barriers to trade, is in need of revision. PSE is flexible enough to allow the inclusion of only those government market interventions that have an actual or potential negative trade effect. As subsidies are constrained by PSE, both productivity increases and their expansionary effect on domestic supply or exports are curtailed. In that sense, PSE seems rather resilient to the trend in supply growth, whereas the NRP lacks that characteristic.

PSE also has a number of drawbacks. Probably its most serious disadvantage, one that it shares with the NRP, is that it keeps the door wide open for protecting countries to discriminate among trading partners. For example, nothing stands in the way of protectionist countries' continuing or switching to a system based on voluntary export restraints, discriminatory quotas, or selective tariffs. How this element of trade discrimination could be handled in a world of bound levels of protection is an open question. What is clear, however, is that the GATT principle of nondiscrimination is not enforced automatically through any such scheme. The only way nondiscrimination could be effected if overall protection levels were bound would be through some ancillary arrangement, such as increasing the monitoring capability of the GATT or some other organization, and possibly providing for the option to intervene when a case of trade discrimination becomes apparent.

Discrimination could be a particularly serious problem if the overall protection level is bound—not for each commodity individually, but for a group of commodities or for all agricultural commodities traded by a country. Under such a scheme, each country would be able to decide on its own how to allocate its protection allowance among individual products (such a possibility is suggested in Tangermann, Josling, and Pearson 1987). It would allow countries to extend protection for those commodities they consider most important for their farmers and resort to free trade for less important products. This flexibility probably has more negative consequences than positive ones. It would give politicians great latitude in supporting markets at levels far removed from levels consistent with comparative advantage. World markets could end up severely distorted for certain products on which a large share of the protection allowance is concentrated. This could be devastating for nonsubsidizing exporters

[66] Conceptually, however, it appears feasible to modify PSE to incorporate the information content of ERP. It would be necessary to calculate the value of the per-unit tariff concessions, relative to the product being analyzed, for those inputs that are subject to lower protection levels and add them to the NRP or other government outlays affecting the product.

that rely on these products but do not also trade in other products for which protection has declined at the same time.

Further, nonuniform protection could worsen existing negative trade effects or create new ones through its impact on the ERP. In short, the possibilities of negative trade effects through uninhibited trade discrimination are staggering. As always, discrimination and selectivity are going to hurt most those countries with less political or economic clout. In all likelihood, these will be developing countries. This makes PSE a questionable choice as the main theme of trade reform in agriculture, particularly if it is not intended to apply to each commodity separately but to groups of commodities on average.

A related disadvantage of fixing the overall protection level, in the form of the NRP or PSE, is the difficulty of exactly pinning down the resulting trade effect. Some examples may illustrate this point. Take the case of subsidies as pictured in Figure 10, a case that seems to be predestined for the application of PSE. Yet it is easy to see that a production subsidy of size de per unit does not have the same effect on trade at price $P_w$ as would raising the protection level and support price by the same amount. In the former case imports cease, whereas in the latter case not only do imports cease but subsidized exports are forthcoming, making for a much worse trade effect. Deficiency payments pose another serious problem for the NRP or PSE. Figure 5 can illustrate this. As per-unit payments of size $(P_s - P_d)$ are not incorporated in the measurement of the NRP because they have no additional trade effect, the NRP, as calculated from $P_d$ and $P_w$, would be the relevant measure of protection. Yet the NRP, if applied to domestic demand and supply curves, would predict exports of size de, although they have ceased altogether. Hence the NRP measure would vastly overestimate the negative trade effect of a two price system as pictured in Figure 5.

The above cases can equally well serve to demonstrate that the binding of protection levels, by the NRP or PSE, would allow a country to change over from a protection scheme with minimal negative trade effect (for example, a two-price system) to one with maximum negative trade effect (for example, a variable levy cum export subsidy system).[64] This example, although somewhat extreme, nevertheless reveals an inherent weakness of the binding of protection levels.

A number of measurement problems further weaken the case for the NRP or PSE as a basis for trade reform. One facet of this problem is the issue of quality differences. They are reflected in price differences the same way as protective measures. This is an important point for highly differentiated products, for which competition is at least to some extent based on quality. Beef, for example, is such a product. The problem of quality differences is of less importance for standardized products, such as refined sugar.

Another measurement problem—applicable only to PSE, not the NRP—relates to the identification of all subsidy expenditures on farm programs. It should come as no surprise that subsidy levels as reported by governments generally underestimate the true ex post levels.[65] Incomplete reporting, hiding of funds in other budget items, special mid-budget-year appropriations, and disbursements of funds from even less-clear budgets at other than the highest government level help to confuse the true magnitude of government support. The funds expended to support agriculture in the EC, for example, come only partially from the EC budget, although most international comparisons are based only on those figures. Disbursements by

[64] Note that export restitutions are not added to the NRP measure because this would involve double counting. The trade effect of a variable levy cum export subsidy scheme is fully captured by the simple NRP.
[65] It is not uncommon to find independent investigators uncovering levels of subsidization far in excess of those officially published. See, for example, Jüttemeier 1987 for details on the West German case.

national governments, however, probably double the true amount of financial support to the farming sector in the EC.

Finally, as the work of the OECD on PSE amply demonstrates (Organisation for Economic Co-operation and Development 1987), governments manage to complicate certain intervention schemes over time so that reliable estimates of their effects become extremely difficult. This is mainly because the initial interventions lead to unexpected results, such as steep unsustainable increases in program costs. As a reaction to budgetary pressures, "quick fixes" are added in an unsystematic manner, making the whole system ever more bureaucratic, less efficient, and harder to comprehend.

A further measurement problem relating to the fixing of overall protection levels derives from the strong dependence of the NRP and PSE on levels of exchange rates. Although exchange-rate fluctuations also affect other reform ideas, they are by far the most important for measures of overall protection that rely on price comparisons. (The exchange-rate issue is taken up again in Chapter 6.) Recent experience has shown that exchange rates can vary rather dramatically and over short periods of time. A depreciating dollar, for example, can increase the NRP both for goods quoted in dollar prices and for countries outside the dollar zone without there being a change in agricultural markets, import protection, or world prices. The reverse case, an appreciating dollar, would allow countries outside the dollar zone to raise domestic prices, and hence to upset trade relations, without violating the bound NRP. These problems are obviously serious, but how to handle them in actual measurement practice is far from clear. Simple three-year averages of exchange rates or similar schemes can dampen fluctuations; they do not eliminate the problem.

Bound overall protection levels would also cause problems for agricultural policy in times of wild fluctuations in world price. Averaging would again lessen the need for sharp policy adjustments. Yet major problems remain if world prices move in an unexpected direction at the end of a period whose average is compared with the bound level of protection. It has been suggested (Tangermann, Josling, and Pearson 1987) that countries be mandated to use price forecasts prepared by the GATT for guiding domestic policy, especially in the crucial last year or years of a measurement period.

Similar procedures are employed in connection with the compensatory financing facility of the International Monetary Fund (IMF) for export revenues of developing countries. It is unlikely, though, that the analogy is close enough to be meaningful. The crucial difference between the IMF's scheme and the one suggested above is the number and size of countries acting on the same price forecasts. For example, if the EC and the United States—both major players on the world market for numerous commodities—act on a given set of price forecasts, these forecasts are certain to turn out wrong ex post. They will be self-defeating. The situation is qualitatively different if a small developing country with moderate or no influence on the world price is involved, as is common for the IMF's compensatory financing scheme. Above all, however, the compensatory financing scheme does not require adjustments in policy to counteract the price forecasts, as would be the case if it were used to make countries abide by their pledges to bind their protection levels.

Based on political-economy considerations, the adoption of the NRP or PSE measures of overall protection are ambiguous at best. The main advantage of binding the protection level at this stage seems to be the stated unwillingness of the EC to link the trade talks with a discussion of reform of its internal agricultural policy regime. But as export subsidies, variable levies, or other trade-distorting measures are an integral part of domestic policies of farm support, any negotiating strategy that focuses on the removal of these measures could run into difficult problems at the negotiations.

The NRP or PSE, in contrast, would provide maneuvering room for governments, allowing them to choose those protective measures that are politically the most acceptable, within the obligations imposed by the NRP or PSE. But the considerable amount of discretion provided by the NRP and PSE also happens to be a potential problem: it subjects the government to constant pressure from the farm lobby. Finally, PSE or even the NRP cannot be seriously considered as a theme for the Uruguay Round in general. The problems of quality differences are too major for much of manufacturing to be ignored. As a result, adopting the NRP or PSE in agriculture, but going an entirely different route in manufacturing, would establish agriculture officially as a special case, with all the attendant problems outlined in detail in Chapter 4.

In sum, both the NRP and the PSE or any of its derivatives seem unsuitable as a basis for legal commitments by the GATT contracting parties. Binding the overall protection level cannot serve as the sought-after unifying theme of the Uruguay Round. However, this does not mean that PSE is useless for the GATT negotiations. Even if it should not be incorporated in any form into the General Agreement, PSE or any of its derivatives can serve a useful function as a measuring device during the negotiations to facilitate compromises and to set targets for liberalization, or as a monitoring device thereafter to check on the progress of trade liberalization over time.

# 6

# OUTLINE OF A TRADE REFORM PACKAGE

## The Basic Elements of the Reform Proposal and Its Rationale

The objective of multilateral trade negotiations under the aegis of the GATT has been and will continue to be the elimination of frontier barriers to trade, in agriculture as well as in other areas. Although political conditions make achieving this long-run objective highly unlikely in the short run or probably even in the medium run, it is important not to lose sight of it. Any idea for trade reform should, at a minimum, provide a smooth transition to this objective rather than obstruct its eventual achievement. The most important criteria by which to judge whether a reform proposal fits into this category were set out at the beginning of this study and have been applied subsequently in the evaluation of numerous ideas for trade reform. It is apparent from this analysis that all the criteria that have been established could probably not be satisfied by a single idea or element of trade reform. But an appropriate combination of reform ideas may achieve this end; the one favored by the author would consist of a strict ban on export subsidies combined with comprehensive tariffication.

The ban on export subsidies would eliminate the special treatment for agricultural, fishery, and forestry products in the General Agreement and the Subsidies Code. All goods would be subject to the same disciplines on export subsidies. In terms of the GATT code this implies the elimination of Article XVI:3 from the General Agreement and Article 10 from the Subsidies Code. The remainder of Article XVI of the General Agreement and Article 9 of the Subsidies Code would be changed to cover all products, regardless of sectoral origin. The Annex to the Subsidies Code (see Appendix 2) could also be amended to include some more pertinent examples of export subsidies that are specific to agriculture.[66] In this way, certain cases of indirect export subsidization that were mentioned in the context of deficiency payments schemes in Chapter 5 could be captured. As was concluded there, indirect export subsidies by countries that would be importers in the absence of import protection are easily identified by the existence of net exports despite positive rates of protection. Identifying indirect export subsidies for a competitive exporter that maintains no import restrictions was considered less clear-cut theoretically, although still possible if a pragmatic attitude is maintained. A simple solution would be to disallow deficiency payments on output levels in excess of domestic consumption. This would eliminate, among other things, the export subsidy problem associated with the current U.S. practice of disbursing deficiency payments on all domestic production, subject only to participation in acreage reduction programs.

Tariffication, the second element of the suggested trade reform package, consists of (1) replacing all unbound tariffs and nontariff barriers, such as variable levies, quotas, and voluntary export restraints, with bound base tariffs that are uniform across broad commodity groups for each country;[67] and (2) extending the tariffication idea to the safeguard Article XIX. The bound base tariff of part (1) is a country's basic tariff concession. It is the tariff level that would be applied

[66] Note in this context that numerous subsidy practices now common in agriculture would be clear violations of the Subsidies Code and its Annex even without its amendment. An example is the transportation subsidies granted to Canadian grain destined for export (see Organisation for Economic Co-operation and Development 1987, 282).

[67] Tariffs should certainly be uniform across commodities with significant cross-price elasticities; for example, grains and grain substitutes. Tropical products is another example.

uniformly across broad commodity groups by a given country after completion of the adjustment to a system based only on tariffs. Unless it invokes Article XIX, a country is bound to this tariff. Unbinding the tariff entails, as currently stipulated in the General Agreement, paying compensation to the affected trading partners or facing retaliation. The base tariff is, quite naturally, also the subject of subsequent multilateral trade negotiations on tariff reductions.

As it is probably politically impossible to shift from the current system of almost universal nontariff protection in agriculture to one of bound tariffs, and that at a relatively low uniform level, any agreement on tariffication will have to contain provisions for temporary import relief for the time period needed to restructure the industry or, at least, domestic support programs. Part (2) of the tariffication idea addresses this need. Once the adjustment period is over and a system of bound tariffs has been established, its major use would be to condition the response of importers to import surges according to Article XIX.

Extending tariffication to Article XIX implies that safeguard measures are limited to temporary tariff increases, applying by definition to all imports, regardless of source. Quotas are eliminated as safeguard measures, since they contradict the basic principles on which the GATT is founded. A revised safeguard Article XIX is envisioned to operate as follows. A country using a temporary tariff increase, here called an excess tariff, would bind itself to a timetable for lifting the safeguard measure. This timetable would specify the dates on which the excess tariff would be reduced as well as the step size of the individual reductions. Noncompliance of the country with this timetable would be a cause for compensation or retaliation by the affected trading partners. In accord with the current GATT rules relating to the unbinding of tariffs, a country would compensate its affected trading partners when it imposed a temporary excess tariff. Compensation payments should probably be automated to take the controversy out of them. A provision could be added to the safeguard article that would automatically transfer all tariff revenue on the product subject to an excess tariff, or a multiple thereof, to the governments of the affected exporting countries. To avoid the problem of prohibitive tariffs, the use of excess tariffs under the safeguard article could be conditioned on some minimum-access provision similar in spirit to that currently written into Article XI:2(c) of the General Agreement.

It is understood that Article XI:2(c) would be discarded in its present form, which limits it to agricultural or fishery products, because comprehensive tariffication implies that all special sectoral provisions are eliminated from the General Agreement. Article XI:2 could be rewritten so as to apply to all trade regardless of sector and whenever a country uses any import restriction other than its bound base tariffs. (In this context, "other import restrictions" means excess tariffs as applied under Article XIX, since this is the only legal escape mechanism under the suggested system of comprehensive tariffication.) A provision could be added to ensure that the market share reserved for imports would be distributed in a nondiscriminatory way. Reference could be made to Article XIII of the General Agreement for that purpose.

A question arising in this context relates to the conditions under which a country should be allowed to resort to excess tariffs. The criteria that currently apply for safeguard actions according to Article XIX could be extended to the revised safeguard article. Alternatively, the article could be modified along the lines of a more comprehensive definition of injury. For example, it has been suggested that the term "injury" be given an economy-wide perspective rather than limiting its interpretation to the producers of a particular range of products (Laird and Sampson 1987). In any case, the excess tariff provision would be applicable during the adjustment process from the current system of protection to one based solely on bound uniform tariffs. It is expected to be the primary means of achieving a system based only on bound uniform tariffs. Excess tariffs could provide temporary import relief for all products now protected by nontariff barriers with tariff equivalents much greater than the uniform base tariff that a country would adopt after adjusting to the new system.

Countries may resort to gray-area measures to reduce the adjustment pressure that grows from lowering excess tariffs to the level of the bound base tariff over time. In this context, four types of measures are particularly applicable to avoidance of tariffication disciplines: voluntary export restraints, state trading arrangements, domestic subsidies, and exchange-rate manipulations. Their likely significance will be discussed in turn, along with possible ways to contain their use.

In industry, voluntary export restraints could become the preferred way to circumvent the revised safeguard article, just as they have been the preferred mechanism to avoid the current safeguard article (see Sampson 1987 for quantitative evidence). Although voluntary export restraints are less likely to become a major problem in agriculture, they have to be addressed by any reform package that claims, as this one does, to be applicable for trade in general, not only for agricultural trade. Voluntary export restraints could be explicitly prohibited, with the GATT Secretariat actively supervising this prohibition. The Secretariat would have the right to initiate cases against any country that forced export restraint agreements on its trading partners, thus reducing the likelihood of government-sponsored voluntary export restraints. It would not be able, however, to contain export restraint agreements negotiated between companies of importing and exporting countries—an area for domestic cartel legislation, not for the GATT.

Currently, voluntary export restraints are less frequent in agriculture than they are in nonagriculture. One reason for this is the existence of another very popular escape mechanism in agriculture, state trading (see Article XVII). Examples of state trading arrangements just from the dairy sector include butter imports into Canada, butter and milk powder imports into Japan, Swiss butter imports, and dairy exports of New Zealand. Furthermore, most of the trade in wheat and coarse grains is channeled through state trading agencies (see Hathaway 1987). Although Article XVII of the General Agreement stipulates that state trading enterprises are to operate in a manner consistent with the General Agreement, little attention is paid to the relevant GATT rules in practice. In fact, state trading has been a convenient way to impose frontier barriers. It obviates the need to invoke official safeguard measures or provide explicit export subsidies. Yet no GATT dispute has ever been initiated that focused on the practices of state trading enterprises. This is probably because it is generally realized that official complaints are unlikely to bear any fruit, anyway. The rules of Article XVII are simply too loose to be of relevance.

To close this loophole, there is an urgent need for better disciplines on state trading arrangements. Treating export subsidies in agriculture the same way as elsewhere should go a long way in eliminating implicit export subsidies by state trading enterprises in agriculture. Implicit quantitative import restrictions, in contrast, are more difficult to prevent. An outright prohibition of state trading enterprises would be preferable and certainly would be the logical extension of comprehensive tariffication. But such a prohibition is unlikely to be politically feasible. Trying to discipline state trading enterprises through detailed rules on accounting may also be doomed because of the many diverse functions they can be assigned to fulfill. The only practical solution may be to restrict their operations on the import side indirectly through binding the NRP for all those goods under their control. In particular, a provision could be added to Article XVII to the effect that the price difference between the border price and the domestic wholesale price of products under the control of state trading enterprises should not exceed the equivalent of the bound base tariffs for those products.

Domestic subsidies are another possible way of circumventing the disciplines of tariffication. As the discussion in Chapter 5 has shown, they can, at least partially, undo the effect of a reduction in frontier barriers, including the elimination of export subsidies. A possible way of diffusing this potential problem is by adding a quantitative limit on domestic subsidies to the Subsidies Code's Article 11. Per-unit subsidies could, for example, be limited to a level equivalent to the prenegotiation nominal tariff level for the product in question. As an alternative, subsidy limits could be expressed in terms of a reduced version of the PSE measure, that is, a PSE stripped of its NRP component.[68] The subsidy equivalent could be expressed as a percent of value added for a given industry or product and limited to a maximum value for all countries. The attraction of such a scheme is twofold. Not only would it limit the influence of domestic subsidies on trade flows, it would also give governments a measure of independence from special interest groups and their ever-present demands for handouts. To put it differently, quantitative limits on subsidies would make rent-seeking less profitable and subsidy-cutting easier to implement—a very important point in light of the rather unsuccessful attempts at subsidy reductions observed in many countries. The possible damage that strict quantitative limits on domestic subsidies could impose on well-thought-out plans for correcting market failures should not be overestimated. In reality, a great many subsidies relating to tradable goods are neither well thought through nor do they attack true market failures.

A quantitative limit on domestic subsidies also has certain disadvantages. As discussed in detail in Chapter 5, domestic subsidies are inherently difficult to identify and quantify. Also, countries differ widely in their attitude toward them. Both points could waste a lot of time and goodwill at the negotiating table relative to the expected benefit of a subsidy limit. If a comprehensive tariffication plan is adopted, the subsidy issue will probably lose much of its importance. Indeed, apart from agriculture, there are few areas where domestic subsidies play a major role in trade. (One distinct exception is the civil aircraft industry in the EC.).

Even in agriculture, domestic subsidies with trade effects are likely to be much less of an issue if rates of protection are made uniform across broad commodity groups in agriculture.[69] This is the main reason that the above tariffication proposal calls for *uniform* tariffs. Furthermore, as argued at some length in Chapter 4, relatively low frontier barriers to trade imply a relatively high budgetary cost of domestic subsidies to governments. This cost argument contributes to making domestic subsidies less attractive once tariffication has converted the present trading system into one characterized by uniform, relatively low, bound tariffs. Finally, although numerically fixed subsidy levels or ratios would indeed give governments a protective shield with which to ward off demands for handouts in excess of those limits, there is the danger that governments will not be able to resist demands to raise subsidies at least to the levels allowed.

When the arguments for and against a quantitative limit on domestic subsidies are weighed, doubts may arise as to the value of striving for a general solution to the domestic subsidy issue in the Uruguay Round. If domestic subsidies are not believed to present a major issue under a system of uniform tariffs, a case-by-case resolution of domestic subsidies issues may be more efficient and could be accomplished either in negotiations outside of the GATT or by dispute settlement inside the GATT. For successful dispute settlement within the GATT, current procedures would have to be made much more responsive.[70] This would especially benefit developing countries, whose lack of political or economic influence weakens their position in direct negotiations outside of the GATT.

Government attempts to manipulate exchange rates in order to circumvent the disciplines of tariffication and an export subsidy ban could be handled in the same way as domestic

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[68] The NRP component of PSE, that is, the need to compare border price and domestic price for like products, stands in the way of applying PSE for all products, regardless of sector. This is discussed in more detail in Chapter 5.

[69] It may be conjectured that the vast differences between the protection rates accorded to grains and those for grain substitutes in the EC are the root cause for a good number of vexing subsidy disputes between the United States and the EC. This applies most apparently to the production and processing subsidies that the EC has given to oilseeds since the late 1970s.

[70] Some suggestions on revising the GATT's current dispute-settlement procedures are contained, for example, in Institute for International Economics and the Institute for Research on Public Policy 1988.

subsidies, that is, without adding new provisions to the General Agreement or its subsidiary codes law. This is not to deny that consistent currency undervaluations or depreciations that aim at gaining a competitive trade advantage can severely distort trade flows. They can indeed reduce imports on a massive scale and at the same time provide decisive advantages in export markets. For all practical purposes, they are functionally equivalent to a combination of import taxes and export subsidies applied uniformly across sectors. (In this context note that nothing about the exchange rate makes it unique to agriculture.) Exchange-rate undervaluation is not only of theoretical interest. It has been practiced in the past by West Germany and Japan among others, and is currently used by such countries as Taiwan and Korea.

In contrast to currency undervaluation, currency overvaluation is of less concern to the GATT (though it is of major concern to the World Bank and the IMF). Currency overvaluation does not displace exports of other countries that would be competitive otherwise, nor does it translate directly into lower imports and reduced market access.[71] Currency overvaluation plays a role for the GATT system only insofar as it may make developing countries less inclined to endorse tariffication. After all, high tariffs are used by many developing countries to compensate for the implicit tax on importables that results from an overvalued exchange rate. Lowering these tariffs would even increase this implicit tax on importables, thereby putting heavy pressure on governments to reduce the degree of exchange-rate misalignment.[72]

Leaving aside the problem that overvalued exchange rates can pose in getting developing countries to accept the idea of tariffication, the GATT has to be mainly concerned with currency undervaluation. But as there are only a few countries in the world with undervalued exchange rates, this area seems to be ideally suited for a bargaining solution rather than an approach based on complex rules that may be impossible to enforce in practice. Political pressure to adjust the exchange rate, similar to that applied to Korea and Taiwan by the United States in recent times, appears to be the proper way to handle the trade problems resulting from undervalued currencies. Besides, it has to be remembered that an undervalued currency is difficult to maintain in real terms over a prolonged period. Consistent currency undervaluation will eventually lead to higher rates of inflation, with a consequent reduction in international competitiveness. In addition, domestic output growth will increase the demand for imported raw materials and intermediate goods. Eventually, imports will also get a boost from rising personal consumption unless high domestic taxes are levied on imported goods. (This appears to be the case for Korea with regard to foreign-made automobiles, for example.) If such taxes are levied, GATT signatories may file a complaint with the GATT under the provisions of Article XXIII.[73] In short, there does not appear to be a compelling reason to settle the exchange-rate issue through amendments to the General Agreement or the addition of a new code.

To summarize, the reform proposal suggested in this study consists of two basic elements: comprehensive tariffication and a prohibition of export subsidies.[74] In order to keep countries

[71]Market access can become restricted indirectly over time, as the import-competing industries in a country with an overvalued exchange rate will lobby for import protection—a phenomenon recently observed in the United States.

[72] Krueger, Schiff, and Valdés (1988) show that the importables of many developing countries are subject to high positive rates of protection at the official exchange rate, but receive negative protection, that is, they are implicitly taxed, at the corrected exchange rate.

[73] It may be added that multiple currency practices as opposed to an undervalued exchange rate for all trade is captured by Article VI of the GATT. Such practices can in principle be countervailed. See the text of Article VI and the clarifying interpretations in Appendix 1.

[74] The approach suggested here is close to, though not identical to, the one proposed in Resources for the Future 1988.

from circumventing the disciplines of this reform package, a ban on voluntary export restraints and more effective rules of behavior for state trading enterprises seem necessary.

The above package has several advantages over such alternative suggestions for trade reform as fixing overall protection levels. The reform proposal relies on well-known GATT instruments and principles rather than untried policy instruments or measurement techniques. This should ease the transition for trade in agriculture and other industries toward the final objective of little or no government interference. The effort to incorporate a completely new approach such as PSE into the GATT framework could not only deadlock negotiations over measurement concepts and problems, but also establish a special case for agriculture, with all the negative consequences that have already been discussed. In contrast, opting for the reform proposal outlined above would fully integrate agriculture into the GATT framework. In fact, a major strength of the proposal's core element, tariffication, is that it could easily form the basis of trade reform within the GATT for all goods-producing sectors, not just agriculture.[75] It could be the sought-after unifying theme of the Uruguay Round and hence play a role similar to the "across-the-board" tariff-reduction idea of the Tokyo Round. (See Chapters 3 and 4 for a discussion of the importance of finding such a unifying theme for the Uruguay Round.)

Tariffication has one characteristic that may lessen its appeal to agriculture: it does not by itself guarantee domestic price stability. Unlike the exchange-rate issue, the question of price stability is unique to agricultural products. It also appears to be of considerable importance to both farmers and agricultural policymakers. For example, even sharp critics of the EC's Common Agricultural Policy concede that it has performed well in achieving the stabilization objective. The question arises as to whether the objective of stable prices warrants giving agriculture some special exemptions from the disciplines of tariffication.

Incomplete markets due to adverse selection and moral hazard prevent farmers from obtaining comprehensive insurance against the output and price risks they face. If this is acknowledged as a market failure, government intervention can be justified. (See a complete discussion of price stabilization in Newberry and Stiglitz 1981.) However, it is questionable whether government intervention should take the form of border measures. Probably the only reason to favor border measures to stabilize prices is their low transaction costs compared with some of the alternatives; otherwise, such measures do not seem a good choice. First, the history of the GATT clearly questions the wisdom of special sectoral exemptions. Indeed, most of the problems with agricultural trade have resulted exactly because of such special exemptions. Second, it is far from certain that the extent of price variability that may still be expected in a system based only on tariffs would be large enough to warrant the costs of government intervention.[76] Although the degree to which world price variability will be less than at present is uncertain, there appears to be no reason to doubt the direction of change. (See Schiff 1985 for a discussion of price variability.) Third, stabilizing domestic price may actually worsen the fluctuations in income if price and quantity are negatively correlated. Fourth, by partially or fully insulating the domestic market from price fluctuations in the world market, border measures worsen the price instability in the world market. This, in turn, tends to raise the problem of price instability for all countries. Price stabilization through border measures has, in other words, negative externalities for other countries. This does not appear to be a desirable outcome from the point of view of global welfare maximization.

Domestic or international insurance schemes that compensate for income losses resulting from price instability seem to be preferable to border measures from the perspective of the

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[75] The ban on export subsidies for agricultural products only serves to bring agriculture up to the same level of GATT disciplines that applies to nonagriculture.

[76] Quota-like variable levies or similar schemes to insulate domestic farmers from world price fluctuations incur the cost of preventing a country from taking full advantage of its comparative advantage.

General Agreement. Certain mechanisms are already in place to deal with such cases. A number of countries have futures markets, others have insurance schemes for selective risks (crop insurance). (See Stiglitz 1987 for a short discussion of alternative responses to the risk of price instability.) Domestic credit programs or special income tax provisions could alleviate the problems of income fluctuations even further. Developing countries can draw on the IMF's compensatory financing scheme or the EC's Stabex system. If so desired, these mechanisms could certainly be improved. They could even serve as a model for domestic schemes of income averaging.

## On the Proposal's Realism

Whether a proposal has a realistic chance of being adopted during the Uruguay Round depends ultimately on its ability to garner enough domestic political support in the major trading nations. It has already been argued at some length in this report that domestic acceptability hinges on a favorable political constellation. It is particularly important that the political power of the groups that stand to lose from a trade reform proposal in the short run be kept in check by a sufficient amount of countervailing power. This means there have to be other special interest groups, apart from consumers, that are strongly in favor of a trade reform and, at the same time, have enough political clout to counter the influence of those groups that oppose the reform.

The influence of special interest groups on the negotiations is greatly increased by sector-specific, commodity-based reform proposals that lead to piecemeal trade arrangements one commodity at a time. Negotiations on this basis are likely to break down or lead the agricultural sector closer to a system of managed trade. The political power needed to counter these special interest groups can be generated to some extent by the aggregate negotiating approach advocated by the United States in the Negotiating Group on Agriculture. If all agricultural support programs for all commodities are negotiated in one package, it is at least possible to trade a country's losses in one commodity group, such as oilseeds, for gains in another commodity group, such as grains. The political influence of a commodity group that is losing can be counteracted by the influence of a commodity group that stands to gain. However, this negotiating approach runs into a problem with countries such as Japan, the Nordic countries, and the EC, which have few or no commodity groups that would gain from a given reform package. This can be solved by negotiating not only agriculture, but all sectors, in one package. Losses in agriculture can thus be compensated for by gains in industry, or vice versa,[77] and countervailing power is established across sectors and industries. But negotiations across sectors require a unifying principle just as a package deal in agriculture alone needs a unifying negotiating and measurement concept like PSE. Tariffication as defined above, applicable for all sectors and fully compatible with the basic principles of the GATT, could be this unifying theme.

If the negotiations of the Uruguay Round extend across sectors and are based on the idea of tariffication, then their success depends on whether it is possible to find an overall balance of gains and losses for the major trading nations—the United States, the EC, Japan, and the Cairns Group countries. In the remainder of this chapter some of these possible gains and losses are outlined to show that the Uruguay Round could indeed reach an overall agreement. The discussion will center on agriculture.

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[77] Australia, for example, is a country where protection in industry could be more easily reduced if industry were negotiated in a package deal with agriculture, which can expect to gain significantly from a trade reform that opens up domestic markets in all countries.

The trade reform proposal outlined above would mean considerable adjustment pressure for the farmers of countries that are importers of agricultural products but have significant frontier barriers. Japan and the Nordic countries fall into this category. The suggested ban on agricultural export subsidies is probably the least controversial part of the proposal, because export subsidies are used seldom or not at all. Japan, for example, employs export subsidies for rice only sporadically, hence their elimination would not cause much political resistance from farming groups. This is reflected in the trade reform proposals that Japan and the Nordic countries tabled in the Negotiating Group on Agriculture in 1987.

Comprehensive tariffication, including uniformity of tariffs and the dismantling of state trading, poses much more of a threat to farmers in these countries because it would require a substantive restructuring of domestic support policies. The incomes of certain sections of the agricultural sector, that is, producers of particular crops or firms upstream or downstream of agricultural producers, could shrink as a result. Expected income losses, however, or simply uncertainty about future income will cause resistance to reform ideas in the farm community. As there is little or nothing for Japan and the Nordic countries to request as compensation from their trading partners in the area of agriculture, the agricultural sector will be solidly united against reform. Plenty of compensation possibilities exist, however, outside of agriculture. Japanese cars, electronics, and other manufactures, for example, face numerous nontariff barriers in the United States, Australasia, and many developing countries that are actual or potential exporters of agricultural products to Japan. A cross-sectoral reform package that promises new opportunities for industry balanced by concessions in agriculture, could be of sufficient interest to industry to take on the farm lobby and hence to allow the government some room for compromise at the multilateral trade negotiations.

The case of the EC differs somewhat from that of Japan or the Nordic countries because it is a large and growing net exporter of agricultural products. As export subsidies are an integral part of the Common Agricultural Policy, the EC could and does assert that a ban on export subsidies would be equivalent to fundamentally changing the nature of its internal agricultural policy regime, whereas this would apply to no other country to that extent. In addition, comprehensive tariffication would mean an end to the system of variable levies, another keystone of the Common Agricultural Policy. Hence it seems clear that marginal adjustments of the type implemented by the Common Agricultural Policy in past years would not suffice this time. (The introduction of coresponsibility levies for milk, production quotas for sugar, and decreasing market price support for cereals are examples of these adjustments.)

In order to maintain the incomes of farmers, the Common Agricultural Policy would probably have to be changed over to a system based on direct income support or deficiency payments, possibly along the lines of a combination of production controls and marketing certificates, as outlined in Chapter 5. Although this might not necessarily lower the incomes of farmers in the short run (Koester and Nuppenau 1987), it would certainly cause considerable uncertainty among farmers. In addition, there would be adjustment costs for many vested interests with strong links to farm production. For example, landowners would incur capital losses and the industries upstream and downstream of agricultural production would face a structural adjustment problem, with income losses highly probable in the short to medium run.

Even if certain commodity groups within agriculture could gain from a trade reform as suggested above, it is far from clear who would gain in the end. The many complex distortions introduced by the Common Agricultural Policy make any predictions highly uncertain. Given this high degree of uncertainty, it is unlikely that much support for trade reform will be forthcoming from agriculture. The political power of those groups with a strong vested interest in the status quo can be counteracted only with sufficient pressure from outside of agriculture. In this sense, the situation in the EC is not very different from that in Japan and the Nordic countries.

In another sense, the EC differs from Japan in agriculture because trade reform, as outlined above, would give the EC something in agriculture that it has long desired, tariff harmonization. It has to be remembered in this context that tariffication, as defined above, rests on relatively low base tariffs that are uniform within broad commodity groups. (The base tariffs will prevail after an adjustment period during which countries will use excess tariffs according to a revised safeguard Article XIX to ease the transition to the new system based solely on tariffs.) Uniformity of tariffs is a means of minimizing distortions that are generated by differences in effective protection rates; thus it removes one strong incentive for domestic subsidies. For example, even without changing the current system of the Common Agricultural Policy, there would be no EC subsidy program for oilseeds if the EC could raise the tariffs for oilseeds and the feed substitutes manioc (cassava), corn gluten, and citrus pellets from close to zero to a level that matches the protection level for grains. (This is not to say that harmonizing protection levels for feed substitutes upward to the level currently pertaining to grains is, per se, a good idea.)

Harmonization of EC tariffs would have considerable effects on other countries, even if the uniform base tariffs were fixed at a level much lower than those rates of protection now common for most agricultural commodities produced by the EC. Strong opposition by the oilseed and feed-substitute commodity groups would have to be overcome in the United States, Thailand, Argentina, and Brazil, to name only a few countries. Comprehensive tariffication, then, if applied to the EC case, clearly invalidates the argument that only the EC—not the United States—would have to accede in agriculture.

Is there anything worthwhile that the United States and other affected countries would gain from uniform base tariffs in the EC? If the answer is yes, there is a chance that sufficient countervailing power can develop against the strong opposition of those commodity groups that stand to lose. Before turning to the various repercussions of tariff harmonization, though, it seems worthwhile to mention briefly a basic point relating to negotiation strategy.

In the absence of some form of tariff harmonization, the EC is not going to let the feed-substitute issue rest in peace. The budgetary pressure is simply too high. Domestic subsidies will continue, and production will increase and gradually displace a growing quantity of imports. Countries with less political and economic power than the United States, such as Thailand, will have to cut back their exports because of tighter voluntary export restraints. (The EC has already concluded a voluntary export restraint on manioc with Thailand that reduced Thai exports to the EC from about 8 million tons to 5 million tons.) What all this means is that the economic value of the zero-tariff binding for feed substitutes will diminish over time. (This fear is behind the U.S. initiative to bring the feed subsidies of the EC before a GATT panel.) If present trends continue, its economic value is likely to be zero in a few years, unless two unknowns are assumed: a clear decision by a GATT panel against the EC oilseed subsidy program and the willingness of the EC to abide by it.

The basic idea of tariffication is that relatively low uniform tariffs replace the current system of protection after some period of adjustment. Lower rates of protection in the EC for all agricultural products and the absence of export subsidies will mean much better market conditions for many traded commodities, particularly grains, beef, and sugar. The keystone commodity group for U.S. agriculture consists of grains. Better market conditions here are likely to translate into considerable political support for trade reform that could more than compensate for the negative attitude of feed-substitute and oilseed producers.

It is certain that the producers of feed substitutes and oilseeds are going to lose from tariffication. It would mean an end to the rents they now receive by being able to sell at zero duty in the EC market that is otherwise highly protected. The following changes can be anticipated. The drop in the price of citrus pellets would lower, ceteris paribus, the profits of the producers of citrus juices and its derivatives. However, since tariffication would also mean lower frontier barriers for the latter products, particularly in Japan, the benefits of an expanding market would probably compensate for the drop in profits resulting from higher production costs.

The virtual loss of the corn gluten market in the EC would raise the production costs of the wet-corn milling industry in the United States, thereby pushing down profits on high-fructose sweeteners, ethanol, and a range of other products made from corn. A further drop in profits would result from the likely world price increase in corn, the industry's basic input. As tariffication would also end U.S. quotas on sugar, the U.S. sugar price would fall considerably. Since sugar is the industry's basic competing product, corn sweetener production would become even less profitable. As a result, sugar might regain some of its lost ground or at least not lose much more in the United States because of trade reform.

Lower prices for all feed substitutes relative to coarse grains might displace some grain from use for feed. Hence the production costs in the United States for pork, poultry, beef, and dairy products might not go up, despite a likely price increase in grains, so there would not be a squeeze on profits from the cost side. Lower protection rates on dairy products, however, could reduce profits from the output side.

High protection rates on feedgrains, together with zero-tariff bindings on feed substitutes in the EC, have made Thailand a large exporter to the EC of the feedgrain substitute manioc. Similarly, Brazil and Argentina supply oilseed meals to the EC. Tariff harmonization in the EC would mean sharply reduced EC imports of both types of feeds. As this translates into immediate income losses for feed-substitute producers in these countries, the question of compensation becomes of crucial importance. Internal support for a trade reform based on tariffication can be mobilized only if large enough gains through better market access can be expected in other products, inside or outside of agriculture. Such gains are indeed very likely. Better export opportunities, in both the EC and third markets, are certain in a number of products that are both heavily subsidized by the EC and of particular interest to Argentina, Brazil, and Thailand. These products are grains for Argentina, beef for Argentina and Brazil, and sugar for Brazil, to name only the most important agricultural products. Apart from that, tariffication would translate into better market access for textiles and clothing for both Brazil and Thailand. Thailand could also expect to benefit in other products. Since tariffication also applies to the United States and Japan, Thai rice producers could expect significant gains, as the United States would stop subsidizing its rice exports and Japan would lower its barriers for rice imports.[78]

In short, those countries that are negatively affected by tariff harmonization between grains and grain substitutes in the EC would be expected to get sizable economic benefits from tariffication. As the economic gains would be reaped to a large extent by agricultural commodity groups with considerable domestic clout, it is unlikely that comprehensive tariffication will fail because of the opposition of producers of feedgrain substitutes.

Comprehensive tariffication, however, would also affect other commodity groups. In particular, it would imply that the trade preferences the EC is granting under the Lomé Agreement to ACP countries would lose much of their value. This issue was examined at some length earlier, hence it is sufficient to point out here the similarity between ACP tariff preferences and the zero-tariff binding for feedgrain substitutes. Tariffication would mean an end to quota rents in both cases. But as all countries switch to tariffication, export opportunities open up in other markets, not only in the particular product where quota rents are lost, but in general. Export opportunities are likely to improve, not worsen, when market access in selected products and countries is exchanged for improved market access in all products and all countries. This point

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[78] The Japanese rice policy is analyzed in Otsuka and Hayami 1985. The world rice market and Thailand's role in it is detailed in Siamwalla and Haykin 1983.

applies not only to developing countries that fear for their quota rents, but with equal force to others that think tariff increases due to tariffication (tariff harmonization) will do them more harm than good. In this context, it should be remembered that low tariffs alone do not guarantee market access. Seasonal quotas, tariff quotas, and a host of other schemes are currently used to nullify low tariffs. The idea of tariffication is to eliminate these import barriers and along with them the high degree of uncertainty about market access.

A switch to a tariffs-only system would require significant adjustments in the agricultural sector of the United States that would extend far beyond the structural adjustment problems faced by oilseed producers mentioned above. For example, export subsidies would have to stop. Since the 1985 U.S. Farm Bill was passed, export subsidies have been used for numerous commodities ranging from beef and dairy to grains—although not to the extent common in the EC (see cases cited in Chapter 5). Further, the current system of deficiency payments, by which payments are made for all production regardless of domestic or export use, would have to be revised. Seasonal import restrictions on fruit and vegetables would have to be phased out. Above all, the section 22 waiver, granting the right to impose quotas at will without compensation, would have to be given up by the United States and would affect beef, sugar, and dairy producers. It is unlikely that they will be easily convinced of the merits of trade reform. However, the lobby that is in favor of trade reform can be expected to be strong in the United States. Within agriculture, grain producers can be counted on for support because their potential gains from worldwide tariffication are the most obvious. The strongest support for trade reform, however, is likely to come from outside of agriculture, that is, from industry and the services. The concessions in agriculture—tariff harmonization and the elimination of the section 22 waiver—could be used to obtain compensating concessions in areas outside of agriculture. In practice, this would mean that LDCs compromise in industrial goods, intellectual property rights, trade-related investment measures, and services.[79] It would also imply a commitment by the Cairns Group countries (particularly Australasia), which gain from trade reform in agriculture more than any other country or country group, to open up their markets for industrial goods and services.

[79] The willingness of LDCs and, in particular, the newly industrialized countries to compromise in these areas could be reinforced considerably if the United States as well as all other industrial countries could agree to extend tariffication unconditionally to light industries such as textiles and clothing, that is, industries that are of particular interest to LDCs.

# APPENDIX 1: SELECTED ARTICLES OF THE GENERAL AGREEMENT

## Article VI

*Anti-dumping and Countervailing Duties*

1. The contracting parties recognize that dumping, by which products of one country are introduced into the commerce of another country at less than the normal value of the products, is to be condemned if it causes or threatens material injury to an established industry in the territory of a contracting party or materially retards the establishment of a domestic industry. For the purposes of this Article, a product is to be considered as being introduced into the commerce of an importing country at less than its normal value, if the price of the product exported from one country to another

(*a*) is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country, or,

(*b*) in the absence of such domestic price, is less than either

(i) the highest comparable price for the like product for export to any third country in the ordinary course of trade, or

(ii) the cost of production of the product in the country of origin plus a reasonable addition for selling cost and profit.

Due allowance shall be made in each case for differences in conditions and terms of sale, for differences in taxation, and for other differences affecting price comparability.*

2. In order to offset or prevent dumping, a contracting party may levy on any dumped product an anti-dumping duty not greater in amount than the margin of dumping in respect of such product. For the purposes of this Article, the margin of dumping is the price difference determined in accordance with the provisions of paragraph 1.*

* refers to interpretative notes at the end of this appendix.

3. No countervailing duty shall be levied on any product of the territory of any contracting party imported into the territory of another contracting party in excess of an amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation, including any special subsidy to the transportation of a particular product. The term "countervailing duty" shall be understood to mean a special duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly or indirectly, upon the manufacture, production or export of any merchandise.*

4. No product of the territory of any contracting party imported into the territory of any other contracting party shall be subject to anti-dumping or countervailing duty by reason of the exemption of such product from duties or taxes borne by the like product when destined for consumption in the country of origin or exportation, or by reason of the refund of such duties or taxes.

5. No product of the territory of any contracting party imported into the territory of any other contracting party shall be subject to both anti-dumping and countervailing duties to compensate for the same situation of dumping or export subsidization.

6. (*a*) No contracting party shall levy any anti-dumping or countervailing duty on the importation of any product of the territory of another contracting party unless it determines that the effect of the dumping or subsidization, as the case may be, is such as to cause or threaten material injury to an established domestic industry, or is such as to retard materially the establishment of a domestic industry.

(*b*) The CONTRACTING PARTIES may waive the requirement of sub-paragraph (*a*) of this paragraph so as to permit a contracting party to levy an anti-dumping or countervailing duty on the importation of any product for the purpose of offsetting dumping or subsidization which causes or threatens material injury to an industry in the territory of another contracting party exporting the product concerned to the territory of the importing contracting party. The CONTRACTING PARTIES shall waive the requirements of sub-paragraph (*a*) of this paragraph, so as to permit the levying of a countervailing duty, in cases in which they find that a subsidy is causing or threatening material injury to an industry in the territory of another contracting party exporting the product concerned to the territory of the importing contracting party.*

(*c*) In exceptional circumstances, however, where delay might cause damage which would be difficult to repair, a contracting party may levy a countervailing duty for the purpose referred to in sub-paragraph (*b*) of this paragraph without the prior approval of the CONTRACTING PARTIES; *Provided* that such action shall be reported immediately to the CONTRACTING PARTIES and that the countervailing duty shall be withdrawn promptly if the CONTRACTING PARTIES disapprove.

7. A system for the stabilization of the domestic price or of the return to domestic producers of a primary commodity, independently of the movements of export prices, which results at times in the sale of the commodity for export at a price lower than the comparable price charged for the like commodity to buyers in the domestic market, shall be presumed not to result in material injury within the meaning of paragraph 6 if it is determined by consultation among the contracting parties substantially interested in the commodity concerned that:

(*a*) the system has also resulted in the sale of the commodity for export at a price higher than the comparable price charged for the like commodity to buyers in the domestic market, and

(*b*) the system is so operated, either because of the effective regulation of production, or otherwise, as not to stimulate exports unduly or otherwise seriously prejudice the interests of other contracting parties.

## Article XI *

### *General Elimination of Quantitative Restrictions*

1. No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party.

2. The provisions of paragraph 1 of this Article shall not extend to the following:

(*a*) Export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party;

(*b*) Import and export prohibitions or restrictions necessary to the application of standards or regulations for the classification, grading or marketing of commodities in international trade;

(*c*) Import restrictions on any agricultural or fisheries product, imported in any form,* necessary to the enforcement of governmental measures which operate:

(i) to restrict the quantities of the like domestic product permitted to be marketed or produced, or, if there is no substantial domestic production of the like product, of a domestic product for which the imported product can be directly substituted; or

(ii) to remove a temporary surplus of the like domestic product, or, if there is no substantial domestic production of the like product, of a domestic product for which the imported product can be directly substituted, by making the surplus available to certain groups of domestic consumers free of charge or at prices below the current market level; or

(iii) to restrict the quantities permitted to be produced of any animal product the production of which is directly dependent, wholly or mainly, on the imported commodity, if the domestic production of that commodity is relatively negligible.

Any contracting party applying restrictions on the importation of any product pursuant to sub-paragraph (*c*) of this paragraph shall give public notice of the total quantity or value of the product permitted to be imported during a specified future period and of any change in such quantity or value. Moreover, any restrictions applied under (i) above shall not be such as will reduce the total of imports relative to the total of domestic production, as compared with the proportion which might reasonably be expected to rule between the two in the absence of restrictions. In determining this proportion, the contracting party shall pay due regard to the proportion prevailing during a previous representative period and to any special factors* which may have affected or may be affecting the trade in the product concerned.

## Article XIII *

*Non-discriminatory Administration of Quantitative Restrictions*

1. No prohibition or restriction shall be applied by any contracting party on the importation of any product of the territory of any other

contracting party or on the exportation of any product destined for the territory of any other contracting party, unless the importation of the like product of all third countries or the exportation of the like product to all third countries is similarly prohibited or restricted.

2. In applying import restrictions to any product, contracting parties shall aim at a distribution of trade in such product approaching as closely as possible the shares which the various contracting parties might be expected to obtain in the absence of such restrictions, and to this end shall observe the following provisions:

(*a*) Wherever practicable, quotas representing the total amount of permitted imports (whether allocated among supplying countries or not) shall be fixed, and notice given of their amount in accordance with paragraph 3 (*b*) of this Article;

(*b*) In cases in which quotas are not practicable, the restrictions may be applied by means of import licences or permits without a quota;

(*c*) Contracting parties shall not, except for purposes of operating quotas allocated in accordance with sub-paragraph (*d*) of this paragraph, require that import licences or permits be utilized for the importation of the product concerned from a particular country or source;

(*d*) In cases in which a quota is allocated among supplying countries, the contracting party applying the restrictions may seek agreement with respect to the allocation of shares in the quota with all other contracting parties having a substantial interest in supplying the product concerned. In cases in which this method is not reasonably practicable, the contracting party concerned shall allot to contracting parties having a substantial interest in supplying the product shares based upon the proportions, supplied by such contracting parties during a previous representative period, of the total quantity or value of imports of the product, due account being taken of any special factors which may have affected or may be affecting the trade in the product. No conditions or formalities shall be imposed which would prevent any contracting party from utilizing fully the share of any such total quantity or value which has been allotted to it, subject to importation being made within any prescribed period to which the quota may relate.*

3. (*a*) In cases in which import licences are issued in connection with import restrictions, the contracting party applying the restrictions shall provide, upon the request of any contracting party having an interest in

the trade in the product concerned, all relevant information concerning the administration of the restrictions, the import licences granted over a recent period and the distribution of such licences among supplying countries; *Provided* that there shall be no obligation to supply information as to the names of importing or supplying enterprises.

(*b*) In the case of import restrictions involving the fixing of quotas, the contracting party applying the restrictions shall give public notice of the total quantity or value of the product or products which will be permitted to be imported during a specified future period and of any change in such quantity or value. Any supplies of the product in question which were *en route* at the time at which public notice was given shall not be excluded from entry; *Provided* that they may be counted so far as practicable, against the quantity permitted to be imported in the period in question, and also, where necessary, against the quantities permitted to be imported in the next following period or periods; and *Provided* further that if any contracting party customarily exempts from such restrictions products entered for consumption or withdrawn from warehouse for consumption during a period of thirty days after the day of such public notice, such practice shall be considered full compliance with this sub-paragraph.

(*c*) In the case of quotas allocated among supplying countries, the contracting party applying the restrictions shall promptly inform all other contracting parties having an interest in supplying the product concerned of the shares in the quota currently allocated, by quantity or value, to the various supplying countries and shall give public notice thereof.

4. With regard to restrictions applied in accordance with paragraph 2 (*d*) of this Article or under paragraph 2 (*c*) of Article XI, the selection of a representative period for any product and the appraisal of any special factors * affecting the trade in the product shall be made initially by the contracting party applying the restriction; *Provided* that such contracting party shall, upon the request of any other contracting party having a substantial interest in supplying that product or upon the request of the CONTRACTING PARTIES, consult promptly with the other contracting party or the CONTRACTING PARTIES regarding the need for an adjustment of the proportion determined or of the base period selected, or for the reappraisal of the special factors involved, or for the elimination of conditions, formalities or any other provisions established unilaterally relating to the allocation of an adequate quota or its unrestricted utilization.

5. The provisions of this Article shall apply to any tariff quota instituted or maintained by any contracting party, and, in so far as applicable, the principles of this Article shall also extend to export restrictions.

## Article XVI *

*Subsidies*

### Section A—Subsidies in General

1. If any contracting party grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory, it shall notify the CONTRACTING PARTIES in writing of the extent and nature of the subsidization, of the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory and of the circumstances making the subsidization necessary. In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, or with the CONTRACTING PARTIES, the possibility of limiting the subsidization.

### Section B—Additional Provisions on Export Subsidies *

2. The contracting parties recognize that the granting by a contracting party of a subsidy on the export of any product may have harmful effects for other contracting parties, both importing and exporting, may cause undue disturbance to their normal commercial interests, and may hinder the achievement of the objectives of this Agreement.

3. Accordingly, contracting parties should seek to avoid the use of subsidies on the export of primary products. If, however, a contracting party grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory, such subsidy shall not be applied in a manner which results in that contracting party having more than an equitable share of world export trade in that product, account being taken of the shares of the contracting parties in such trade in the product during a previous representative period, and any special factors which may have affected or may be affecting such trade in the product.*

4. Further, as from 1 January 1958 or the earliest practicable date thereafter, contracting parties shall cease to grant either directly or indirectly any form of subsidy on the export of any product other than a primary product which subsidy results in the sale of such product for export

at a price lower than the comparable price charged for the like product to buyers in the domestic market. Until 31 December 1957 no contracting party shall extend the scope of any such subsidization beyond that existing on 1 January 1955 by the introduction of new, or the extension of existing, subsidies.*

5. The CONTRACTING PARTIES shall review the operation of the provisions of this Article from time to time with a view to examining its effectiveness, in the light of actual experience, in promoting the objectives of this Agreement and avoiding subsidization seriously prejudicial to the trade or interests of contracting parties.

## Article XVII

### *State Trading Enterprises*

1.* (*a*) Each contracting party undertakes that if it establishes or maintains a State enterprise, wherever located, or grants to any enterprise, formally or in effect, exclusive or special privileges,* such enterprise shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders.

(*b*) The provisions of sub-paragraph (*a*) of this paragraph shall be understood to require that such enterprises shall, having due regard to the other provisions of this Agreement, make any such purchases or sales solely in accordance with commercial considerations,* including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of the other contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.

(*c*) No contracting party shall prevent any enterprise (whether or not an enterprise described in sub-paragraph (*a*) of this paragraph) under its jurisdiction from acting in accordance with the principles of sub-paragraphs (*a*) and (*b*) of this paragraph.

2. The provisions of paragraph 1 of this Article shall not apply to imports of products for immediate or ultimate consumption in governmental use and not otherwise for resale or use in the production of goods * for sale. With respect to such imports, each contracting party shall accord to the trade of the other contracting parties fair and equitable treatment.

3. The contracting parties recognize that enterprises of the kind described in paragraph 1 (*a*) of this Article might be operated so as to create serious obstacles to trade; thus negotiations on a reciprocal and mutually advantageous basis designed to limit or reduce such obstacles are of importance to the expansion of international trade.*

4. (*a*) Contracting parties shall notify the CONTRACTING PARTIES of the products which are imported into or exported from their territories by enterprises of the kind described in paragraph 1 (*a*) of this Article.

(*b*) A contracting party establishing, maintaining or authorizing an import monopoly of a product, which is not the subject of a concession under Article II, shall, on the request of another contracting party having a substantial trade in the product concerned, inform the CONTRACTING PARTIES of the import mark-up * on the product during a recent representative period, or, when it is not possible to do so, of the price charged on the resale of the product.

(*c*) The CONTRACTING PARTIES may, at the request of a contracting party which has reason to believe that its interests under this Agreement are being adversely affected by the operations of an enterprise of the kind described in paragraph 1 (*a*), request the contracting party establishing, maintaining or authorizing such enterprise to supply information about its operations related to the carrying out of the provisions of this Agreement.

(*d*) The provisions of this paragraph shall not require any contracting party to disclose confidential information which would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises.

## Article XIX

### *Emergency Action on Imports of Particular Products*

1. (*a*) If, as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement, including tariff concessions, any product is being imported into the territory of that contracting party in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products, the contracting party shall be free, in respect of such product, and to the extent and for such time as may be necessary to prevent or remedy such injury, to suspend the obligation in whole or in part or to withdraw or modify the concession.

(*b*) If any product, which is the subject of a concession with respect to a preference, is being imported into the territory of a contracting party in the circumstances set forth in sub-paragraph (*a*) of this paragraph, so as to cause or threaten serious injury to domestic producers of like or directly competitive products in the territory of a contracting party which receives or received such preference, the importing contracting party shall be free, if that other contracting party so requests, to suspend the relevant obligation in whole or in part or to withdraw or modify the concession in respect of the product, to the extent and for such time as may be necessary to prevent or remedy such injury.

2. Before any contracting party shall take action pursuant to the provisions of paragraph 1 of this Article, it shall give notice in writing to the CONTRACTING PARTIES as far in advance as may be practicable and shall afford the CONTRACTING PARTIES and those contracting parties having a substantial interest as exporters of the product concerned an opportunity to consult with it in respect of the proposed action. When such notice is given in relation to a concession with respect to a preference, the notice shall name the contracting party which has requested the action. In critical circumstances, where delay would cause damage which it would be difficult to repair, action under paragraph 1 of this Article may be taken provisionally without prior consultation, on the condition that consultation shall be effected immediately after taking such action.

3. (*a*) If agreement among the interested contracting parties with respect to the action is not reached, the contracting party which proposes to take or continue the action shall, nevertheless, be free to do so, and if such action is taken or continued, the affected contracting parties shall then be free, not later than ninety days after such action is taken, to suspend, upon the expiration of thirty days from the day on which written notice of such suspension is received by the CONTRACTING PARTIES, the application to the trade of the contracting party taking such action, or, in the case envisaged in paragraph 1 (*b*) of this Article, to the trade of the contracting party requesting such action, of such substantially equivalent concessions or other obligations under this Agreement the suspension of which the CONTRACTING PARTIES do not disapprove.

(*b*) Notwithstanding the provisions of sub-paragraph (*a*) of this paragraph, where action is taken under paragraph 2 of this Article without prior consultation and causes or threatens serious injury in the territory of a contracting party to the domestic producers of products affected by the action, that contracting party shall, where delay would cause damage difficult to repair, be free to suspend, upon the taking of the action and throughout the period of consultation, such concessions or other obligations as may be necessary to prevent or remedy the injury.

## Article XX

### *General Exceptions*

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

(*a*) necessary to protect public morals;

(*b*) necessary to protect human, animal or plant life or health;

(*c*) relating to the importation or exportation of gold or silver;

(*d*) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices;

(*e*) relating to the products of prison labour;

(*f*) imposed for the protection of national treasures of artistic, historic or archaeological value;

(*g*) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;

(*h*) undertaken in pursuance of obligations under any intergovernmental commodity agreement which conforms to criteria submitted to the CONTRACTING PARTIES and not disapproved by them or which is itself so submitted and not so disapproved;*

(*i*) involving restrictions on exports of domestic materials necessary to ensure essential quantities of such materials to a domestic processing industry during periods when the domestic price of such materials is held below the world price as part of a governmental stabilization plan; *Provided* that such restrictions shall not operate to increase the exports of or the protection afforded to such domestic industry, and shall not depart from the provisions of this Agreement relating to non-discrimination;

(*j*) essential to the acquisition or distribution of products in general or local short supply; *Provided* that any such measures shall be consistent with the principle that all contracting parties are entitled to an equitable share of the international supply of such products, and that any such measures, which are inconsistent with the other provisions of this Agreement shall be discontinued as soon as the conditions giving rise to them have ceased to exist. The CONTRACTING PARTIES shall review the need for this sub-paragraph not later than 30 June 1960.

## Article XXII

*Consultation*

1. Each contracting party shall accord sympathetic consideration to, and shall afford adequate opportunity for consultation regarding, such representations as may be made by another contracting party with respect to any matter affecting the operation of this Agreement.

2. The CONTRACTING PARTIES may, at the request of a contracting party, consult with any contracting party or parties in respect of any matter for which it has not been possible to find a satisfactory solution through consultation under paragraph 1.

## Article XXIII

*Nullification or Impairment*

1. If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as the result of

(*a*) the failure of another contracting party to carry out its obligations under this Agreement, or

(*b*) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement, or

(*c*) the existence of any other situation,

the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be concerned. Any coı tracting party thus approached shall give sympathetic consideration to tl representations or proposals made to it.

2. If no satisfactory adjustment is effected between the contractir parties concerned within a reasonable time, or if the difficulty is of tl type described in paragraph 1 (*c*) of this Article, the matter may be referre to the CONTRACTING PARTIES. The CONTRACTING PARTIES shall promptl investigate any matter so referred to them and shall make appropria recommendations to the contracting parties which they consider to l concerned, or give a ruling on the matter, as appropriate. The CONTRACTIN PARTIES may consult with contracting parties, with the Economic and Soci Council of the United Nations and with any appropriate inter-governmenta organization in cases where they consider such consultation necessary. If tl CONTRACTING PARTIES consider that the circumstances are serious enoug to justify such action, they may authorize a contracting party or parti to suspend the application to any other contracting party or parties c such concessions or other obligations under this Agreement as they dete mine to be appropriate in the circumstances. If the application to an contracting party of any concession or other obligation is in fact suspende that contracting party shall then be free, not later than sixty days after suc action is taken, to give written notice to the Executive Secretary [1] to th CONTRACTING PARTIES of its intention to withdraw from this Agreemer and such withdrawal shall take effect upon the sixtieth day following th day on which such notice is received by him.

## Article XXVIII *

*Modification of Schedules*

1. On the first day of each three-year period, the first period beginnin on 1 January 1958 (or on the first day of any other period * that may b specified by the CONTRACTING PARTIES by two-thirds of the votes cast) contracting party (hereafter in this Article referred to as the "applican contracting party") may, by negotiation and agreement with any contractin party with which such concession was initially negotiated and with an other contracting party determined by the CONTRACTING PARTIES to have a principal supplying interest* (which two preceding categories of contractin

[1] Since changed to Director General.

parties, together with the applicant contracting party, are in this Article hereinafter referred to as the "contracting parties primarily concerned"), and subject to consultation with any other contracting party determined by the CONTRACTING PARTIES to have a substantial interest* in such concession, modify or withdraw a concession* included in the appropriate Schedule annexed to this Agreement.

2. In such negotiations and agreement, which may include provision for compensatory adjustment with respect to other products, the contracting parties concerned shall endeavour to maintain a general level of reciprocal and mutually advantageous concessions not less favourable to trade than that provided for in this Agreement prior to such negotiations.

3. (*a*) If agreement between the contracting parties primarily concerned cannot be reached before 1 January 1958 or before the expiration of a period envisaged in paragraph 1 of this Article, the contracting party which proposes to modify or withdraw the concession shall, nevertheless, be free to do so and if such action is taken any contracting party with which such concession was initially negotiated, any contracting party determined under paragraph 1 to have a principal supplying interest and any contracting party determined under paragraph 1 to have a substantial interest shall then be free not later than six months after such action is taken, to withdraw, upon the expiration of thirty days from the day on which written notice of such withdrawal is received by the CONTRACTING PARTIES, substantially equivalent concessions initially negotiated with the applicant contracting party.

(*b*) If agreement between the contracting parties primarily concerned is reached but any other contracting party determined under paragraph 1 of this Article to have a substantial interest is not satisfied, such other contracting party shall be free, not later than six months after action under such agreement is taken, to withdraw, upon the expiration of thirty days from the day on which written notice of such withdrawal is received by the CONTRACTING PARTIES, substantially equivalent concessions initially negotiated with the applicant contracting party.

4. The CONTRACTING PARTIES may, at any time, in special circumstances, authorize* a contracting party to enter into negotiations for modification or withdrawal of a concession included in the appropriate Schedule annexed to this Agreement subject to the following procedures and conditions:

(*a*) Such negotiations* and any related consultations shall be conducted in accordance with the provisions of paragraphs 1 and 2 of this Article.

(*b*) If agreement between the contracting parties primarily concerned is reached in the negotiations, the provisions of paragraph 3 (*b*) of this Article shall apply.

(*c*) If agreement between the contracting parties primarily concerned is not reached within a period of sixty days* after negotiations have been authorized, or within such longer period as the CONTRACTING PARTIES may have prescribed, the applicant contracting party may refer the matter to the CONTRACTING PARTIES.

(*d*) Upon such reference, the CONTRACTING PARTIES shall promptly examine the matter and submit their views to the contracting parties primarily concerned with the aim of achieving a settlement. If a settlement is reached, the provisions of paragraph 3 (*b*) shall apply as if agreement between the contracting parties primarily concerned had been reached. If no settlement is reached between the contracting parties primarily concerned, the applicant contracting party shall be free to modify or withdraw the concession, unless the CONTRACTING PARTIES determine that the applicant contracting party has unreasonably failed to offer adequate compensation.* If such action is taken, any contracting party with which the concession was initially negotiated, any contracting party determined under paragraph 4 (*a*) to have a principal supplying interest and any contracting party determined under paragraph 4 (*a*) to have a substantial interest, shall be free, not later than six months after such action is taken, to modify or withdraw, upon the expiration of thirty days from the day on which written notice of such withdrawal is received by the CONTRACTING PARTIES, substantially equivalent concessions initially negotiated with the applicant contracting party.

5. Before 1 January 1958 and before the end of any period envisaged in paragraph 1 a contracting party may elect by notifying the CONTRACTING PARTIES to reserve the right, for the duration of the next period, to modify the appropriate Schedule in accordance with the procedures of paragraphs 1 to 3. If a contracting party so elects, other contracting parties shall have the right, during the same period, to modify or withdraw, in accordance with the same procedures, concessions initially negotiated with that contracting party.

## Interpretative Notes to the Articles

Ad *Article VI*

*Paragraph 1*

1. Hidden dumping by associated houses (that is, the sale by an importer at a price below that corresponding to the price invoiced by an exporter with whom the importer is associated, and also below the price in the exporting country) constitutes a form of price dumping with respect to which the margin of dumping may be calculated on the basis of the price at which the goods are resold by the importer.

2. It is recognized that, in the case of imports from a country which has a complete or substantially complete monopoly of its trade and where all domestic prices are fixed by the State, special difficulties may exist in determining price comparability for the purposes of paragraph 1, and in such cases importing contracting parties may find it necessary to take into account the possibility that a strict comparison with domestic prices in such a country may not always be appropriate.

*Paragraphs 2 and 3*

1. As in many other cases in customs administration, a contracting party may require reasonable security (bond or cash deposit) for the payment of anti-dumping or countervailing duty pending final determination of the facts in any case of suspected dumping or subsidization.

2. Multiple currency practices can in certain circumstances, constitute a subsidy to exports which may be met by countervailing duties under paragraph 3 or can constitute a form of dumping by means of a partial depreciation of a country's currency which may be met by action under paragraph 2. By " multiple currency practices " is meant practices by governments or sanctioned by governments.

*Paragraph 6* (b)

Waivers under the provisions of this sub-paragraph shall be granted only on application by the contracting party proposing to levy an anti-dumping or countervailing duty, as the case may be.

Ad *Articles XI, XII, XIII, XIV and XVIII*

Throughout Articles XI, XII, XIII, XIV and XVIII, the terms " import restrictions " or " export restrictions " include restrictions made effective through state-trading operations.

## Ad *Article XI*

*Paragraph 2 (c)*

The term " in any form " in this paragraph covers the same products when in an early stage of processing and still perishable, which compete directly with the fresh product and if freely imported would tend to make the restriction on the fresh product ineffective.

*Paragraph 2, last sub-paragraph*

The term " special factors " includes changes in relative productive efficiency as between domestic and foreign producers, or as between different foreign producers, but not changes artificially brought about by means not permitted under the Agreement.

## Ad *Article XVI*

The exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.

*Section B*

1. Nothing in Section B shall preclude the use by a contracting party of multiple rates of exchange in accordance with the Articles of Agreement of the International Monetary Fund.

2. For the purposes of Section B, a " primary product " is understood to be any product of farm, forest or fishery, or any mineral, in its natural form or which has undergone such processing as is customarily required to prepare it for marketing in substantial volume in international trade.

*Paragraph 3*

1. The fact that a contracting party has not exported the product in question during the previous representative period would not in itself preclude that contracting party from establishing its right to obtain a share of the trade in the product concerned.

2. A system for the stabilization of the domestic price or of the return to domestic producers of a primary product independently of the movements of export prices, which results at times in the sale of the product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market, shall be considered not to involve a subsidy on exports within the meaning of paragraph 3 if the CONTRACTING PARTIES determine that:

(*a*) the system has also resulted, or is so designed as to result, in the sale of the product for export at a price higher than the comparable price charged for the like product to buyers in the domestic market; and

(*b*) the system is so operated, or is designed so to operate, either because of the effective regulation of production or otherwise, as not to stimulate exports unduly or otherwise seriously to prejudice the interests of other contracting parties.

Notwithstanding such determination by the CONTRACTING PARTIES, operations under such a system shall be subject to the provisions of paragraph 3 where they are wholly or partly financed out of government funds in addition to the funds collected from producers in respect of the product concerned.

*Paragraph 4*

The intention of paragraph 4 is that the contracting parties should seek before the end of 1957 to reach agreement to abolish all remaining subsidies as from 1 January 1958; or, failing this, to reach agreement to extend the application of the standstill until the earliest date thereafter by which they can expect to reach such agreement.

## Ad *Article XVII*

*Paragraph 1*

The operations of Marketing Boards, which are established by contracting parties and are engaged in purchasing or selling, are subject to the provisions of sub-paragraphs (*a*) and (*b*).

The activities of Marketing Boards which are established by contracting parties and which do not purchase or sell but lay down regulations covering private trade are governed by the relevant Articles of this Agreement.

The charging by a state enterprise of different prices for its sales of a product in different markets is not precluded by the provisions of this Article, provided that such different prices are charged for commercial reasons, to meet conditions of supply and demand in export markets.

*Paragraph 1* (a)

Governmental measures imposed to ensure standards of quality and efficiency in the operation of external trade, or privileges granted for the exploitation of national natural resources but which do not empower the government to exercise control over the trading activities of the enterprise in question, do not constitute " exclusive or special privileges ".

*Paragraph 1* (b)

A country receiving a " tied loan " is free to take this loan into account as a " commercial consideration " when purchasing requirements abroad.

*Paragraph 2*

The term " goods " is limited to products as understood in commercial practice, and is not intended to include the purchase or sale of services.

*Paragraph 3*

Negotiations which contracting parties agree to conduct under this paragraph may be directed towards the reduction of duties and other charges on imports and exports or towards the conclusion of any other mutually satisfactory arrangement consistent with the provisions of this Agreement. (See paragraph 4 of Article II and the note to that paragraph.)

*Paragraph 4* (b)

The term " import mark-up " in this paragraph shall represent the margin by which the price charged by the import monopoly for the imported product (exclusive of internal taxes within the purview of Article III, transportation, distribution, and other expenses incident to the purchase, sale or further processing, and a reasonable margin of profit) exceeds the landed cost.

## Ad *Article XX*

*Sub-paragraph* (h)

The exception provided for in this sub-paragraph extends to any commodity agreement which conforms to the principles approved by the Economic and Social Council in its resolution 30 (IV) of 28 March 1947.

## Ad *Article XXVIII*

The CONTRACTING PARTIES and each contracting party concerned should arrange to conduct the negotiations and consultations with the greatest possible secrecy in order to avoid premature disclosure of details of prospective tariff changes. The CONTRACTING PARTIES shall be informed immediately of all changes in national tariffs resulting from recourse to this Article.

*Paragraph 1*

1. If the CONTRACTING PARTIES specify a period other than a three-year period, a contracting party may act pursuant to paragraph 1 or paragraph 3 of

Article XXVIII or the first day following the expiration of such other period and, unless the CONTRACTING PARTIES have again specified another period, subsequent periods will be three-year periods following the expiration of such specified period.

2. The provision that on 1 January 1958, and on other days determined pursuant to paragraph 1, a contracting party "may ... modify or withdraw a concession" means that on such day, and on the first day after the end of each period, the legal obligation of such contracting party under Article II is altered; it does not mean that the changes in its customs tariff should necessarily be made effective on that day. If a tariff change resulting from negotiations undertaken pursuant to this Article is delayed, the entry into force of any compensatory concessions may be similarly delayed.

3. Not earlier than six months, nor later than three months, prior to 1 January 1958, or to the termination date of any subsequent period, a contracting party wishing to modify or withdraw any concession embodied in the appropriate Schedule, should notify the CONTRACTING PARTIES to this effect. The CONTRACTING PARTIES shall then determine the contracting party or contracting parties with which the negotiations or consultations referred to in paragraph 1 shall take place. Any contracting party so determined shall participate in such negotiations or consultations with the applicant contracting party with the aim of reaching agreement before the end of the period. Any extension of the assured life of the Schedules shall relate to the Schedules as modified after such negotiations, in accordance with paragraphs 1, 2 and 3 of Article XXVIII. If the CONTRACTING PARTIES are arranging for multilateral tariff negotiations to take place within the period of six months before 1 January 1958, or before any other day determined pursuant to paragraph 1, they shall include in the arrangements for such negotiations suitable procedures for carrying out the negotiations referred to in this paragraph.

4. The object of providing for the participation in the negotiations of any contracting party with a principal supplying interest, in addition to any contracting party with which the concession was initially negotiated, is to ensure that a contracting party with a larger share in the trade affected by the concession than a contracting party with which the concession was initially negotiated shall have an effective opportunity to protect the contractual right which it enjoys under this Agreement. On the other hand, it is not intended that the scope of the negotiations should be such as to make negotiations and agreement under Article XXVIII unduly difficult nor to create complications in the application of this Article in the future to concessions which result from negotiations thereunder. Accordingly, the CONTRACTING PARTIES should only determine that a contracting party has a principal supplying interest if that contracting party has had, over a reasonable period of time prior to the negotiations, a larger share in the market of the applicant contracting party than a contracting party with which the concession was initially negotiated or would, in the judgment of the CONTRACTING PARTIES, have had such a share in the absence of discriminatory quantitative restrictions

maintained by the applicant contracting party. It would therefore not be appropriate for the CONTRACTING PARTIES to determine that more than one contracting party, or in those exceptional cases where there is near equality more than two contracting parties, had a principal supplying interest.

5. Notwithstanding the definition of a principal supplying interest in note 4 to paragraph 1, the CONTRACTING PARTIES may exceptionally determine that a contracting party has a principal supplying interest if the concession in question affects trade which constitutes a major part of the total exports of such contracting party.

6. It is not intended that provision for participation in the negotiations of any contracting party with a principal supplying interest, and for consultation with any contracting party having a substantial interest in the concession which the applicant contracting party is seeking to modify or withdraw, should have the effect that it should have to pay compensation or suffer retaliation greater than the withdrawal or modification sought, judged in the light of the conditions of trade at the time of the proposed withdrawal or modification, making allowance for any discriminatory quantitative restrictions maintained by the applicant contracting party.

7. The expression "substantial interest" is not capable of a precise definition and accordingly may present difficulties for the CONTRACTING PARTIES. It is, however, intended to be construed to cover only those contracting parties which have, or in the absence of discriminatory quantitative restrictions affecting their exports could reasonably be expected to have, a significant share in the market of the contracting party seeking to modify or withdraw the concession.

*Paragraph 4*

1. Any request for authorization to enter into negotiations shall be accompanied by all relevant statistical and other data. A decision on such request shall be made within thirty days of its submission.

2. It is recognized that to permit certain contracting parties, depending in large measure on a relatively small number of primary commodities and relying on the tariff as an important aid for furthering diversification of their economies or as an important source of revenue, normally to negotiate for the modification or withdrawal of concessions only under paragraph 1 of Article XXVIII, might cause them at such a time to make modifications or withdrawals which in the long run would prove unnecessary. To avoid such a situation the CONTRACTING PARTIES shall authorize any such contracting party, under paragraph 4, to enter into negotiations unless they consider this would result in, or contribute substantially towards, such an increase in tariff levels as to threaten the stability of the Schedules to this Agreement or lead to undue disturbance of international trade.

3. It is expected that negotiations authorized under paragraph 4 for modification or withdrawal of a single item, or a very small group of items, could normally be brought to a conclusion in sixty days. It is recognized, however, that such a period will be inadequate for cases involving negotiations for the modification or withdrawal of a larger number of items and in such cases, therefore, it would be appropriate for the CONTRACTING PARTIES to prescribe a longer period.

4. The determination referred to in paragraph 4 *(d)* shall be made by the CONTRACTING PARTIES within thirty days of the submission of the matter to them, unless the applicant contracting party agrees to a longer period.

5. In determining under paragraph 4 *(d)* whether an applicant contracting party has unreasonably failed to offer adequate compensation, it is understood that the CONTRACTING PARTIES will take due account of the special position of a contracting party which has bound a high proportion of its tariffs at very low rates of duty and to this extent has less scope than other contracting parties to make compensatory adjustment.

# APPENDIX 2: SELECTED ARTICLES OF THE SUBSIDIES CODE

*Article 8 Subsidies—General Provisions*

1. Signatories recognize that subsidies are used by governments to promote important objectives of social and economic policy. Signatories also recognize that subsidies may cause adverse effects to the interests of other signatories.
2. Signatories agree not to use export subsidies in a manner inconsistent with the provisions of this Agreement.
3. Signatories further agree that they shall seek to avoid causing, through the use of any subsidy
   (a) injury to the domestic industry of another signatory,
   (b) nullification or impairment of the benefits accruing directly or indirectly to another signatory under the General Agreement, or
   (c) serious prejudice to the interests of another signatory.
4. The adverse effects to the interests of another signatory required to demonstrate nullification or impairment or serious prejudice may arise through
   (a) the effects of the subsidized imports in the domestic market of the importing signatory,
   (b) the effects of the subsidy in displacing or impeding the imports of like products into the market of the subsidizing country, or
   (c) the effects of the subsidized exports in displacing the exports of like products of another signatory from a third country market.

*Article 9 Export Subsidies on Products Other than Certain Primary Products*

1. Signatories shall not grant export subsidies on products other than certain primary products.
2. The practices listed in points (a) to (l) in the Annex are illustrative of export subsidies.

*Article 10 Export Subsidies on Certain Primary Products*

1. In accordance with the provisions of Article XVI:3 of the General Agreement, signatories agree not to grant directly or indirectly any export subsidy on certain primary products in a manner which results in the signatory granting such subsidy having more than an equitable share of world export trade in such product, account being taken of the shares of the signatories in trade in the product concerned during a previous representative period, and any special factors which may have affected or may be affecting trade in such product.

2. For purposes of Article XVI:3 of the General Agreement and paragraph 1 above:
   (a) "more than equitable share of world export trade" shall include any case in which the effect of an export subsidy granted by a signatory is to displace the exports of another signatory bearing in mind the developments on world markets;
   (b) with regard to new markets traditional patterns of supply of the product concerned to the world market, region or country, in which the new market is situated shall be taken into account in determining "equitable share of world export trade";
   (c) "a previous representative period" shall normally be the three most recent calendar years in which normal market conditions existed.
3. Signatories further agree not to grant export subsidies on exports of certain primary products to a particular market in a manner which results in prices materially below those of other suppliers to the same market.

*Article 11 Subsidies Other than Export Subsidies*

1. Signatories recognize that subsidies other than export subsidies are widely used as important instruments for the promotion of social and economic policy objectives and do not intend to restrict the right of signatories to use such subsidies to achieve these and other important policy objectives which they consider desirable. Signatories note that among such objectives are:
   (a) the elimination of industrial, economic and social disadvantages of specific regions,
   (b) to facilitate the restructuring, under socially acceptable conditions, of certain sectors, especially where this has become necessary by reason of changes in trade and economic policies, including international agreements resulting in lower barriers to trade,
   (c) generally to sustain employment and to encourage re-training and change in employment,
   (d) to encourage research and development programmes, especially in the field of high-technology industries,
   (e) the implementation of economic programmes and policies to promote the economic and social development of developing countries,
   (f) redeployment of industry in order to avoid congestion and environmental problems.
2. Signatories recognize, however, that subsidies other than export subsidies, certain objectives and possible form of which are described, respectively, in paragraphs 1 and 3 of this Article, may cause or threaten to cause injury to a domestic industry of another signatory or serious prejudice to the interests of another signatory or may nullify or impair benefits accruing to another signatory under the General Agreement, in particular where such subsidies would adversely affect the conditions of normal competition. Signatories shall therefore seek to avoid causing such effects through the use of subsidies. In particular, signatories, when drawing up their policies and practices in this field, in addition to evaluating the essential internal objectives to be achieved, shall also weigh, as far as practicable, taking account of the nature of the particular case, possible adverse effects on trade. They shall also consider the conditions of world trade, production (e.g. price, capacity utilization etc.) and supply in the product concerned.

3. Signatories recognize that the objectives mentioned in paragraph 1 above may be achieved, *inter alia*, by means of subsidies granted with the aim of giving an advantage to certain enterprises. Examples of possible forms of such subsidies are: government financing of commercial enterprises, including grants, loans or guarantees; government provision or government financed provision of utility, supply distribution and other operational or support services or facilities; government financing of research and development programmes; fiscal incentives; and government subscription to, or provision of, equity capital.

Signatories note that the above form of subsidies are normally granted either regionally or by sector. The enumeration of forms of subsidies set out above is illustrative and non-exhaustive, and reflects these currently granted by a number of signatories to this Agreement.

Signatories recognize, nevertheless, that the enumeration of forms of subsidies set out above should be reviewed periodically and that this should be done, through consultations, in conformity with the spirit of Article XVI:5 of the General Agreement.

4. Signatories recognize further that, without prejudice to their rights under this Agreement, nothing in paragraphs 1–3 above and in particular the enumeration of forms of subsidies creates, in itself, any basis for action under the General Agreement, as interpreted by this Agreement.

## *Article 12 Consultations*

1. Whenever a signatory has reason to believe that an export subsidy is being granted or maintained by another signatory in a manner inconsistent with the provisions of this Agreement, such signatory may request consultations with such other signatory.
2. A request for consultations under paragraph 1 above shall include a statement of available evidence with regard to the existence and nature of the subsidy in question.
3. Whenever a signatory has reason to believe that any subsidy is being granted or maintained by another signatory and that such subsidy either causes injury to its domestic industry, nullification or impairment of benefits accruing to it under the General Agreement, or serious prejudice to its interests, such signatory may request consultations with such other signatory.
4. A request for consultations under paragraph 3 above shall include a statement of available evidence with regard to (a) the existence and nature of the subsidy in question and (b) the injury caused to the domestic industry or, in the case of nullification or impairment, or serious prejudice, the adverse effects caused to the interests of the signatory requesting consultations.
5. Upon request for consultations under paragraph 1 or paragraph 3 above, the signatory believed to be granting or maintaining the subsidy practice in question shall enter into such consultations as quickly as possible. The purpose of the consultations shall be to clarify the facts of the situation and to arrive at a mutually acceptable solution.

## *Article 13 Conciliation, Dispute Settlement and Authorized Countermeasures*

1. If, in the case of consultations under paragraph 1 of Article 12, a mutually acceptable solution has not been reached within thirty days[30] of the request for consultations,

any signatory party to such consultations may refer the matter to the Committee for conciliation in accordance with the provisions of Part VI.

2. If, in the case of consultations under paragraph 3 of Article 12, a mutually acceptable solution has not been reached within sixty days of the request for consultations, any signatory party to such consultations may refer the matter to the Committee for conciliation in accordance with the provisions of Part VI.

3. If any dispute arising under this Agreement is not resolved as a result of consultations or conciliations, the Committee shall, upon request, review the matter in accordance with the dispute settlement procedures of Part VI.

4. If, as a result of its review, the Committee concludes that an export subsidy is being granted in a manner inconsistent with the provisions of this Agreement or that a subsidy is being granted or maintained in such a manner as to cause injury, nullification or impairment, or serious prejudice, it shall make such recommendations[31] to the parties as may be appropriate to resolve the issue and, in the event the recommendations are not followed, it may authorize such countermeasures as may be appropriate, taking into account the degree and nature of the adverse effects found to exist, in accordance with the relevant provisions of Part VI.

## Notes

23. Injury to the domestic industry is used here in the same sense as it is used in Part I of this Agreement.

24. Benefits accruing directly or indirectly under the General Agreement include the benefits of tariff concessions bound under Article II of the General Agreement.

25. Serious prejudice to the interests of another signatory is used in this Agreement in the same sense as it is used in Article XVI:1 of the General Agreement and includes threat of serious prejudice.

26. Signatories recognize that nullification or impairment of benefits may also arise through the failure of a signatory to carry out its obligations under the General Agreement or this Agreement. Where such failure concerning export subsidies is determined by the Committee to exist, adverse effects may, without prejudice to paragraph 9 of Article 18 below, be presumed to exist. The other signatory will be accorded a reasonable opportunity to rebut this presumption.

27. The term "displacing" shall be interpreted in a manner which takes into account the trade and development needs of developing countries and in this connection is not intended to fix traditional market shares.

28. The problem of third country markets so far as certain primary products are concerned is dealt with exclusively under Article 10 below.

29. For purposes of this Agreement "certain primary products" means the products referred to in Note Ad Article XVI of the General Agreement, Section B, paragraph 2, with the deletion of the words "or any mineral".

30. Any time periods mentioned in this Article and in Article 18 may be extended by mutual agreement.

31. In making such recommendations, the Committee shall take into account the trade, development and financial needs of developing country signatories.

## Annex Illustrative List of Export Subsidies

(a) The provision by governments of direct subsidies to a firm or an industry contingent upon export performance.

(b) Currency retention schemes or any similar practices which involve a bonus on exports.

(c) Internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments.

(d) The delivery by governments or their agencies of imported or domestic products or services for use in the production of exported goods, on terms or conditions more favourable than for delivery of like or directly competitive products or services for use in the production of goods for domestic consumption, if (in the case of products) such terms or conditions are more favourable than those commercially available on world markets to their exporters.

(e) The full or partial exemption, remission, or deferral specifically related to exports, of direct taxes[1] or social welfare charges paid or payable by industrial or commercial enterprises.[2]

(f) The allowance of special deductions directly related to exports or export performance, over and above those granted in respect to production for domestic consumption, in the calculation of the base on which direct taxes are charged.

(g) The exemption or remission in respect of the production and distribution of exported products, of indirect taxes[1] in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption.

(h) The exemption, remission or deferral of prior stage cumulative indirect taxes[1] on goods or services used in the production of exported products in excess of the exemption, remission or deferral of like prior stage cumulative indirect taxes on goods or services used in the production of like products when sold for domestic consumption; provided, however, that prior stage cumulative indirect taxes may be exempted, remitted or deferred on exported products even when not exempted, remitted or deferred on like products when sold for domestic consumption, if the prior stage cumulative indirect taxes are levied on goods that are physically incorporated (making normal allowance for waste) in the exported product.[3]

(i) The remission or drawback of import charges[1] in excess of those levied on imported goods that are physically incorporated (making normal allowance for waste) in the exported product; provided, however, that in particular cases a firm may use a quantity of home market goods equal to, and having the same quality and characteristics as, the imported goods as a substitute for them in order to benefit from this provision if the import and the corresponding export operations both occur within a reasonable time period, normally not to exceed two years.

(j) The provision by governments (or special institutions controlled by governments) of export credit guarantees or insurance programmes, of insurance or guarantee programmes against increases in the costs of exported products[4] or of exchange risk programmes, at premium rates, which are manifestly inadequate to cover the long-term operating costs and losses of the programmes.[5]

(k) The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and denominated in the same currency as the export credit), or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.

Provided, however, that if a signatory is a party to an international undertaking on official export credits to which at least twelve original signatories[1] to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original signatories), or if in practice a signatory applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.

(l) Any other charge on the public account constituting an export subsidy in the sense of Article XVI of the General Agreement.

## Notes

1. For the purpose of this Agreement:

The term "direct taxes" shall mean taxes on wages, profits, interest, rents, royalties, and all other forms of income, and taxes on the ownership of real property;

The term "import charges" shall mean tariffs, duties, and other fiscal charges not elsewhere enumerated in this note that are levied on imports;

The term "indirect taxes" shall mean sales, excise, turnover, value added, franchise, stamp, transfer, inventory and equipment taxes, border taxes and all taxes other than direct taxes and import charges;

"Prior stage" indirect taxes are those levied on goods or services used directly or indirectly in making the product;

"Cumulative" indirect taxes are multi-staged taxes levied where there is no mechanism for subsequent crediting of the tax if the goods or services subject to tax at one stage of the production are used in a succeeding stage of production;

"Remission" of taxes includes the refund or rebate of taxes.

2. The signatories recognize that deferral need not amount to an export subsidy where, for example, appropriate interest charges are collected. The signatories further recognize that nothing in this text prejudges the disposition by the CONTRACTING PARTIES of the specific issues raised in GATT document L/4422. The signatories reaffirm the principle that prices for goods in transactions between exporting enterprises and foreign buyers under their or under the same control should for tax purposes be the prices which would be charged between independent enterprises acting at arm's length. Any signatory may draw the attention of another signatory to administrative or other practices which may contravene this principle and which result in a significant saving of direct taxes in export transactions. In such circumstances the signatories shall normally attempt to resolve their differences using the facilities of existing bilateral tax treaties or other specific international mechanisms, without prejudice to the rights and obligations of signatories under the General Agreement, including the right of consultation created in the preceding sentence.

Paragraph (e) is not intended to limit a signatory from taking measures to avoid the double taxation of foreign source income earned by its enterprises of the enterprises of another signatory.

Where measures incompatible with the provisions of paragraph (e) exist, and where major practical difficulties stand in the way of the signatory concerned bringing such measures promptly into conformity with the Agreement, the signatory concerned shall, without prejudice to the rights of other signatories under the General Agreement or this Agreement, examine methods of bringing these measures into conformity within a reasonable period of time.

In this connexion the European Economic Community has declared that Ireland intends to withdraw by 1 January 1981 its system of preferential tax measures related to exports, provided for under the Corporation Tax Act of 1976, whilst continuing nevertheless to honour legally binding commitments entered into during the lifetime of this system.

3. Paragraph (h) does not apply to value-added tax systems and border-tax adjustment in lieu thereof; the problem of the excessive remission of value-added taxes is exclusively covered by paragraph (g).

4. The signatories agree that nothing in this paragraph shall prejudge or influence the deliberations of the panel established by the GATT Council on 6 June 1978 (C/M/126).

5. In evaluating the long-term adequacy of premium rates, costs and losses of insurance programmes, in principle only such contracts shall be taken into account that were concluded after the date of entry into force of this Agreement.

6. An original signatory to this Agreement shall mean any signatory which adheres *ad referendum* to the Agreement on or before 30 June 1979.

# APPENDIX 3: MINISTERIAL DECLARATION ON THE URUGUAY ROUND

*PART I*

## NEGOTIATIONS ON TRADE IN GOODS

. . .

*A. OBJECTIVES*

Negotiations shall aim to:

(i) bring about further liberalization and expansion of world trade to the benefit of all countries, especially less-developed contracting parties, including the improvement of access to markets by the reduction and elimination of tariffs, quantitative restrictions and other non-tariff measures and obstacles;

(ii) strengthen the role of GATT, improve the multilateral trading system based on the principles and rules of the GATT and bring about a wider coverage of world trade under agreed, effective and enforceable multilateral disciplines;

. . .

*B. GENERAL PRINCIPLES GOVERNING NEGOTIATIONS*

(i) Negotiations shall be conducted in a transparent manner, and consistent with the objectives and commitments agreed in this Declaration and with the principles of the General Agreement in order to ensure mutual advantage and increased benefits to all participants.

(ii) The launching, the conduct and the implementation of the outcome of the Negotiations shall be treated as parts of a single undertaking. However, agreements reached at an early stage may be implemented on a provisional or a definitive basis by agreement prior to the formal conclusion of the Negotiations. Early agreements shall be taken into account in assessing the overall balance of the negotiations.

(iii) Balanced concessions should be sought within broad trading areas and subjects to be negotiated in order to avoid unwarranted cross-sectoral demands.

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(iv) CONTRACTING PARTIES agree that the principle of differential and more favorable treatment embodied in Part IV and other relevant provisions of the General Agreement and in the Decision of the CONTRACTING PARTIES of 28 November 1979 on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries applies to the negotiations. In the implementation of standstill and rollback, particular care should be given to avoiding disruptive effects on the trade of less-developed contracting parties.

(v) The developed countries do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of developing countries, i.e., the developed countries do not expect the developing countries, in the course of trade negotiations, to make contributions which are inconsistent with their individual development, financial and trade needs. Developed contracting parties shall therefore not seek, neither shall less-developed contracting parties be required to make, concessions that are inconsistent with the latter's development, financial and trade needs.

(vi) Less-developed contracting parties expect that their capacity to make contributions or negotiated concessions or take other mutually agreed action under the provisions and procedures of the General Agreement would improve with the progressive development of their economies and improvement in their trade situation and they would accordingly expect to participate more fully in the framework of rights and obligations under the General Agreement.

(vii) Special attention shall be given to the particular situation and problems of the least-developed countries and to the need to encourage positive measures to facilitate expansion of their trading opportunities. Expeditious implementation of the relevant provisions of the 1982 Ministerial Declaration concerning the least-developed countries shall also be given appropriate attention.

### *C. STANDSTILL AND ROLLBACK*

Commencing immediately and continuing until the formal completion of the Negotiations, each participant agrees to apply the following commitments:

*Standstill*

(i) not to take any trade restrictive or distorting measure inconsistent with the provisions of the General Agreement or the Instruments negotiated within the framework of GATT or under its auspices;

(ii) not to take any trade restrictive or distorting measure in the legitimate exercise of its GATT rights, that would go beyond that which is necessary to remedy specific situations, as provided for in the General Agreement and the Instruments referred to in (i) above;

(iii) not to take any trade measures in such a manner as to improve its negotiating positions.

*Rollback*

(i) that all trade restrictive or distorting measures inconsistent with the provisions of the General Agreement or instruments negotiated within the framework of GATT or under its auspices, shall be phased out or brought into conformity within an agreed time frame not later than by the date of the formal completion of the negotiations, taking into account multilateral agreements, undertakings and understandings, including strengthened rules and disciplines, reached in pursuance of the Objectives of the Negotiations;

. . .

## *D. SUBJECTS FOR NEGOTIATIONS*

*Tariffs*

Negotiations shall aim, by appropriate methods, to reduce or, as appropriate, eliminate tariffs including the reduction or elimination of high tariffs and tariff escalation. Emphasis shall be given to the expansion of the scope of tariff concessions among all participants.

*Non-tariff Measures*

Negotiations shall aim to reduce or eliminate non-tariff measures, including quantitative restrictions, without prejudice to any action to be taken in fulfillment of the rollback commitments.

*Tropical Products*

Negotiations shall aim at the fullest liberalization of trade in tropical products, including in their processed and semi-processed forms and shall cover both tariff and all non-tariff measures affecting trade in these products.

. . .

*Natural Resource-Based Products*

. . .

*Textiles and Clothing*

. . .

*Agriculture*

CONTRACTING PARTIES agree that there is an urgent need to bring more discipline and predictability to world agricultural trade by correcting and preventing restrictions and distortions including those related to structural surpluses so as to reduce the uncertainty, imbalances and instability in world agricultural markets.

Negotiations shall aim to achieve greater liberalization of trade in agriculture and bring all measures affecting import access and export competition under strengthened and more operationally effective GATT rules and disciplines, taking into account the general principles governing the negotiations, by:

(i) improving market access through, *inter alia*, the reduction of import barriers;

(ii) improving the competitive environment by increasing discipline on the use of all direct and indirect subsidies and other measures affecting directly or indirectly the phased reduction of their negative effects and dealing with their causes;

(iii) minimizing the adverse effects that sanitary and phytosanitary regulations and barriers can have on trade in agriculture, taking into account the relevant international agreements.

In order to achieve the above objectives, the negotiating group having responsibility for all aspects of agriculture will use the recommendations adopted by the CONTRACTING PARTIES at their Fortieth Session, which were developed in accordance with the GATT 1982 Ministerial Programme and take account of the approaches suggested in the work of the Committee on Trade in Agriculture without prejudice to other alternatives that might achieve the objectives of the Negotiations.

*GATT Articles*

Participants shall review existing GATT articles, provisions and disciplines as requested by interested contracting parties, and, as appropriate, undertake negotiations.

*Safeguards*

(i) A comprehensive agreement on safeguards is of particular importance to the strengthening of the GATT system and to progress in the MTNs.

(ii) The agreement on safeguards:

— shall be based on the basic principles of the General Agreement;

— shall contain, *inter alia*, the following elements: transparency, coverage, objective criteria for action including the concept of serious injury or threat thereof, temporary nature, degressivity and structural adjustment, compensation and retaliation, notifications, consultation, multilateral surveillance and dispute settlement; and

— shall clarify and reinforce the disciplines of the General Agreement and should apply to all contracting parties.

*MTN Agreements and Arrangements*

Negotiations shall aim to improve, clarify, or expand, as appropriate, agreements and arrangements negotiated in the Tokyo Round of Multilateral Negotiations.

*Subsidies and Countervailing Measures*

Negotiations on subsidies and countervailing measures shall be based on a review of Articles VI and XVI and the MTN agreement on subsidies and countervailing measures with the objective of improving GATT disciplines relating to all subsidies and countervailing measures that affect international trade. A negotiating group will be established to deal with these issues.

*Dispute Settlement*

In order to ensure prompt and effective resolution of disputes to the benefit of all contracting parties, negotiations shall aim to improve and strengthen the rules and the procedures of the dispute settlement process, while recognizing the contribution that would be made by more effective and enforceable GATT rules and disciplines. Negotiations shall include the development of adequate arrangements for overseeing and monitoring of the procedures that would facilitate compliance with adopted recommendations.

*Trade Related Aspects of Intellectual Property Rights, including Trade in Counterfeit Goods*

. . .

*Trade-Related Investment Measures*

. . .

## *E. FUNCTIONING OF THE GATT SYSTEM*

Negotiations shall aim to develop understandings and arrangements:

(i) to enhance the surveillance in the GATT to enable regular monitoring of trade policies and practices of contracting parties and their impact on the functioning of the multilateral trading system;

(ii) to improve the overall effectiveness and decision-making of the GATT as an institution, including, *inter alia*, through involvements of ministers;

(iii) to increase the contribution of the GATT to achieving greater coherence in global economic policy-making through strengthening its relationship with other international organizations responsible for monetary and financial matters.

## *F. PARTICIPATION*

. . .

## *G. ORGANIZATION OF THE NEGOTIATIONS*

A Group of Negotiations on Goods (GNG) is established to carry out the programme of negotiations contained in this part of the Declaration. The GNG shall, *inter alia:*

. . .

(iii) establish negotiating groups as required. . . .

. . .

(v) coordinate the work of the negotiating groups and supervise the progress of the negotiations. As a guideline, not more than two negotiating groups should meet at the same time;

. . .

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