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## PROTECTIONISM

# Will Agriculture Always Remain a Problem in GATT?

by Stefan Tangermann, Göttingen\*

**GATT has had extraordinarily scant "success" in the agricultural sphere up to now. To what extent is this due to the special status accorded to agriculture in GATT? Are trends discernible within GATT that might lead to an improvement in the situation? Might the Uruguay Round produce fundamentally new solutions?**

There is probably no field in which GATT has had as little success as it has had in agriculture. Farming is an outcrop of protectionism towering above the general landscape of trade policy. Rates of protection of a hundred per cent and more are not uncommon in the agricultural sector. Between 1979 and 1981, the total support that the governments of OECD countries allocated to farming by various measures averaged 32% of the value of their agricultural output at local prices;<sup>1</sup> the level of support was 43% in the EC, 56% in Scandinavia and 59% in Japan.<sup>2</sup> Protectionism in agriculture is a complex blend of domestic and foreign trade measures; non-tariff barriers, which are largely beyond the influence of GATT, play a particularly prominent role.

As a result, international trade in agricultural products does not reflect the comparative advantages of individual countries but more resembles a battlefield of national agricultural policies. The world market prices of farm products are not an indicator of relative scarcity but an expression of governments' ability to subsidise. In addition, trade flows and prices are liable to fluctuate sharply, because national markets are insulated not only against the level of world market prices but also against changes in that level. Trade flows are grotesquely distorted; some countries that ought to be importers are exporters, others with considerable cost advantages are being driven from the market and products for which there would not normally be a market are being traded in large quantities. Agricultural trade has repeatedly led to tensions and open conflicts between nations that would otherwise trade peacefully with one another.

Agriculture therefore still remains "an area which has obstinately resisted all attempts at rational treatment", as Sir Eric Wyndham White, the former Director General of GATT, said in 1967<sup>3</sup> and the observation that "it would be difficult to conclude that GATT's record in the sphere of temperate-zone agricultural commodities is other than one of failure"<sup>4</sup> still holds good as far as the results of GATT's efforts in this sector are concerned.

To what extent has GATT's failure in the agricultural sector been due to the special status accorded to agriculture within GATT? Are trends discernible within GATT that might lead to an improvement in the situation? Might the Uruguay Round produce fundamentally new solutions? These are the questions we shall attempt to answer.

### **Special Status of Agriculture**

Unlike trade in fibres and textiles, which is in effect exempted from the GATT rules and enjoys a special legal status under the Multi-Fibre Arrangement, trade in agricultural products is fully integrated into GATT from a legal point of view. All thirty-eight Articles of the GATT apply just as much to agricultural products as to industrial goods; only Articles VI, XI, XVI and XX make separate mention of agricultural products (and other raw materials). However, some of the exceptions for

<sup>1</sup> OECD: National Policies and Agricultural Trade, Paris, May 1987.

<sup>2</sup> Ibid.

<sup>3</sup> Sir Eric Wyndham White: International Trade Policy: The Kennedy Round and Beyond. Address to the Deutsche Gesellschaft für Auswärtige Politik, Bad Godesberg, 27th October 1967.

<sup>4</sup> K. Dam: The GATT - Law and International Economic Organization, Chicago and London 1970, p. 257.

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agricultural trade established in these Articles are highly significant, although not so far-reaching that they can in themselves fully explain the extent to which agricultural trade deviates from fundamental GATT principles. The specific exemptions for agricultural trade concern both market access (import regulation) and competition among agricultural exporters (export subsidies).

As far as the regulation of imports is concerned, agriculture enjoys special treatment under GATT in that the quantitative import restrictions generally prohibited for other goods are permissible in certain circumstances in the case of agricultural products. In particular, they are authorised by Article XI, section 2, if they are deemed necessary to prevent a curtailment of domestic production.

### Notorious Waiver

The possibility of applying quantitative import restrictions to agricultural products was written into GATT at the urging of the USA, but the Americans soon discovered that even this special treatment did not give them the freedom of action they considered necessary for their agricultural market policy. The US Government therefore sought and in 1955 obtained an exemption that gave the USA the exclusive right to impose quantitative restrictions on imports of agricultural products even if they did not harm domestic production. This notorious waiver in favour of the USA is still in force and is still applied.

The use of the waiver by the USA is admittedly no longer of great economic significance in the case of most of the products affected, since US producers would supply most of the domestic market's requirements in these products even without quantitative import restrictions (though not without the

other US agricultural and trade policy measures).<sup>5</sup> However, the impact the waiver has on the atmosphere for agricultural trade within GATT can hardly be overestimated. The fact that fundamental parts of GATT disciplines do not apply to a country as large as the USA, with all its economic might in international agricultural trade and performing what the USA at least sees as an important role as "guardian of the international economic order", must necessarily have far-reaching detrimental effects on international trade policy in the agricultural sphere as a whole.

Whereas these formalised special arrangements concerning import restrictions on agricultural products mainly affect the political climate, a number of loopholes in the GATT, in other words an absence of formal GATT disciplines, have very tangible effects in the agricultural sphere. We are referring here to so-called grey-area measures.

### Variable Import Levies

Variable import levies such as those applied by the EC to almost all important agricultural products are prominent in this respect. The legal status of measures of this kind, which are used very widely in agricultural trade, has never been defined in the GATT and it is surprising that none of the contracting parties has yet decided to test the legality of variable levies in GATT by using the complaints procedure under Article XXIII.

In concrete terms this means that the import regime of a second major participant in international agricultural trade, the European Community, is subject to no effective GATT disciplines. The EC can set its threshold

<sup>5</sup> Sugar is a significant exception, however, for in the recent past a progressive reduction in US import quotas for sugar has dramatically curtailed the volume imported.

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prices and hence its import levies as high as it likes – it will not run into difficulties with GATT in this respect. Since the two largest players in international agricultural trade, the USA and the EC, are beyond effective control by GATT as far as their import barriers against important agricultural products are concerned, it is no wonder that international agricultural trade is in such a lamentable state.

The activities of state trading enterprises, which in agricultural trade have a large share in the market, are also very important.<sup>6</sup> In addition, voluntary restraint agreements have assumed growing importance in agricultural trade;<sup>7</sup> the manioc agreement between the EC and Thailand is a particularly striking example.<sup>8,9</sup>

Finally, measures that must be described as plain "illegal" under GATT are being widely used to restrict agricultural imports. Such practices have occasionally led to complaints to GATT, but they have not received formal condemnation to any appreciable extent. Many governments clearly have particularly little compunction about deviating from the spirit and the letter of GATT as far as agriculture is concerned. Since so many countries are "sinners" in this respect, mutual recrimination has no effect.

### Export Subsidies

The special treatment given to the agricultural sector in GATT is even more evident in the handling of state export promotion than in measures on the import side. Agricultural trade is the only area in which GATT permits export subsidies (under Article XVI, section 3). Irrespective of the shape of domestic agricultural policy – and naturally regardless of any economic justification – any country that so wishes can therefore subsidise its agricultural exports. The only condition to be observed is that export subsidies "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".

How a country's "equitable share" of world trade in a particular product is to be determined has never been really clear, and may perhaps have been left

intentionally vague. Over the years a considerable number of disputes over export subsidies on agricultural products have been settled before the GATT, but even these GATT "judgements" have not managed to define the "equitable share" in concrete terms or to make it clearly applicable even to individual cases. GATT is therefore virtually powerless as regards subsidies on agricultural exports. Moreover, GATT permits domestic subsidies without any major restriction. From the economic point of view, however, there can be little justification for the asymmetrical treatment of domestic subsidies and those on exports. In the agricultural sector in particular, domestic subsidies (such as the deficiency payments on cereals in the USA) can easily be substituted for export subsidies.

In short, agricultural trade has been granted a far-reaching special status within GATT, either at the time of drafting the Agreement or in its practical application. Those in charge of agricultural policies have not hesitated to fashion their national agricultural and trade policies in such a way as to exploit this status to the full. Hence, if a discernible improvement is to be made in the conditions for world agricultural trade, the Uruguay Round must aim to bring about a fundamental change in the way in which agriculture is treated under GATT. The initial moves, however, hold out little hope that this can be achieved.

### Trends towards Reorganising Agriculture

In many of the discussions relating to the agricultural negotiations within GATT, such as those within the Committee on Trade in Agriculture established by the Ministerial Conference of 1982, the predominant tendency has been to advocate formulating the import regulations of Article XI and the provisions of Article XVI on the "equitable share" more stringently, making them more effective and applying them more widely. With regard to import restraints, for example, consideration has been given to applying the rules of Article XI not only to quantitative import restrictions but also to variable levies. The hope that the minimum import commitments under Article XI could then be applied to a greater number of cases obviously plays an important role here. As far as export subsidies are concerned, there has been much discussion on ways of formulating the concept of the "equitable share" of world export trade in operational terms so that countries that subsidise their exports are subject to stricter rules on the permitted volume of exports. There is therefore a trend towards defining "acceptable" volumes of trade and to committing contracting parties to GATT to respect these trade structures.

<sup>6</sup> A. F. McCalla, A. Schmitz: State Trading in Grains. Paper presented to the Conference on "State Trading in Industrialized and Developing Countries", Montreal, Canada, 18-20th April 1979.

<sup>7</sup> H.-J. Winterling: Selbstbeschränkungsabkommen im internationalen Agrarhandel – Eine qualitative sowie quantitative Analyse ihrer Bedeutung und Wirkungen am Beispiel des Tapiokaabkommens zwischen der Europäischen Gemeinschaft und Thailand, in: Agrarwirtschaft, special issue 111, Frankfurt 1986.

<sup>8</sup> B. Hartwig, S. Tangermann: Legal Aspects of Restricting Manioc Trade between Thailand and the EEC, Kiel 1987.

<sup>9</sup> H.-J. Winterling, S. Tangermann: Economic Implications of Restricting Manioc Trade between Thailand and the EEC, Kiel 1987.

However, the problem is that "acceptable" trade volumes cannot be defined in such a way that they would correspond to a sensible allocation of resources in world agriculture (or in any other sector). The GATT has attempted to define various concepts of "acceptable" trade volumes in a number of areas. In so doing, it has relied primarily on two concepts, the first being actual volumes of trade in a "previous representative period" (as in Article XVI, section 3) and the second the trade structures "which might reasonably be expected to rule . . . in the absence of restrictions" (as in Article XI, section 2). In practice, both concepts produce more or less the same result,<sup>10</sup> if only because it can never be ascertained what would have happened if a particular trade measure had not been taken, so that there is a natural predisposition to take past performance as the yardstick.

No matter how such rules may be framed in the future, they remain suspect from an economic point of view. A world agricultural trade order that relied heavily on the notion of "acceptable" trade volumes and allowed all countries a free hand to shape their agricultural and trade policies providing they adhered to such "acceptable" trade volumes would certainly not be a step towards more liberal world trade in agricultural products and a stronger orientation of trade flows according to comparative advantage. Rather, it would make the agricultural trading system resemble the "order" for trade in fibres and textiles under the Multi-Fibre Arrangement. Such a development would have little to do with fuller realisation of the basic principles of GATT in the agricultural sphere.

On the other hand, it is not clear what form better GATT rules for agriculture could take if they were not to amount to banning certain types of trade and agricultural policy measure (which would hardly be realistic politically) or prescribing the minimum amount that contracting parties had to import or the maximum they could export (which is not rational from an economic point of view). The main difficulty lies in drafting rules that can be applied to the non-tariff measures so widely prevalent in agricultural trade. This is particularly difficult, since non-tariff measures take

such a variety of forms, can be highly complex and their incidence is not always easy to measure.<sup>11</sup> Nevertheless, there is one conceivable approach that would be appropriate to agricultural trade.

### A New Approach for Agricultural Trade within GATT

An approach with the necessary characteristics involves the use of "support rates" for the agricultural negotiations within GATT. Such "support rates" are a monetary equivalent that expresses the overall effect of all agricultural and trade measures used in a particular country. They are thus related to the tariff equivalents, which have been used for some time in the literature on non-tariff measures. Given that many agricultural policy measures affect producers and consumers differently, support rates can be calculated separately for the two sides.

In simplified terms, support rates on the producer side (producer subsidy equivalents, or PSEs) indicate the amount of income producers would lose if all state measures affecting the product in question were eliminated.<sup>12</sup> They relate not only to policy instruments affecting output but also to the effects of measures applied to inputs. PSEs can therefore be regarded as yardsticks of nominal protection, corrected for the effects of input policies. Similarly, consumer subsidy equivalents (CSEs) measure the effects of state intervention on the consumers of the products in question.

Instead of drafting modified and new rules and disciplines along traditional lines, an attempt could be made within GATT to define all the commitments of contracting parties in the agricultural sphere by reference to PSEs, and possibly also CSEs. Ideally, this would be carried out in three stages. First, assuming prior fundamental agreement on the use of this approach, unanimity would have to be reached on the exact definition and empirical measurement of PSEs. In the second stage, a binding of the currently existing PSEs could be agreed on. They would then be registered in the schedules of individual contracting parties. The third stage would be to negotiate a step-by-step reduction in PSEs and hence a gradual liberalisation of international agricultural trade. Formulae for a multilateral reduction in PSEs across the entire range of agricultural products could be agreed, such as the "Swiss formula"<sup>13</sup> used for reducing customs tariffs in the Tokyo Round, or the negotiations could be conducted on a bilateral basis using the conventional "request and offer" procedure and the outcome extended to all contracting parties via the most-favoured-nation principle.

<sup>10</sup> S. Tangermann: Proposals for a "Rule-oriented" Liberalization of International Agricultural Trade. Paper prepared for the Conference on "The New GATT Round of Multilateral Trade Negotiations: Legal and Economic Problems" organised by the Zentrum für interdisziplinäre Forschung der Universität Bielefeld, 11-13th June 1987.

<sup>11</sup> H.-D. Jaeschke: Nicht-tarifäre Instrumente der Agrarhandelspolitik, in: *Angewandte Wissenschaft*, No. 326, Münster-Hiltrup 1986.

<sup>12</sup> In contrast to the concept of producer rents used in welfare analysis, the notion of PSEs as applied hitherto in policy analysis and applicable to negotiations within GATT is based on the assumption of constant input and output volumes.

### Combination with Traditional GATT Rules

The approach outlined here, entailing the complete replacement of existing GATT rules for the agricultural sector by binding and reducing PSEs, would be a very far-reaching departure from GATT's previous procedures in this sector. Less radical solutions are also conceivable, in which rules governing PSEs could be combined with traditional GATT rules on agricultural trade without completely replacing them.<sup>14</sup> That has its merits, since in view of the novelty of the approach many contracting parties may not wish to abandon traditional GATT rules, even though they have not proved particularly successful in the past.

Although such an approach would offer many advantages, it should not be overlooked that a number of conceptual and technical questions would have to be resolved before it could be used in the Uruguay Round of negotiations. Satisfactory answers can be found for most of these questions.<sup>15</sup> In particular, it should be stressed that the PSE concept is anything but rigidly fixed; it lends itself to extremely flexible use and can be tailored to suit the task in hand. On many issues the answers to be sought would be chiefly pragmatic political ones rather than ones based purely on economic principles, and they would have to be found by negotiation.

This itself poses a danger that should not be overlooked to the successful conclusion of the agricultural negotiations in the Uruguay Round. Much time, perhaps too much time, could be spent on the pre-negotiations on the applicability and shape of the PSE approach. Some contracting parties might even deliberately exploit such negotiations to gain time and avoid having to take serious decisions. It might therefore be wise to allocate right from the start a limited period of time for such pre-negotiations and to revert to GATT's traditional approaches if no positive agreement has been reached in the allotted time.

### Concluding Remarks

GATT has had extraordinarily scant "success" in the agricultural sphere up to now. Trade in agricultural products enjoys special status for the purposes of some important GATT rules governing both import restrictions and export subsidies. Broad areas of the agricultural

trade and market policies of important agricultural trading countries are subject to no effective GATT disciplines. Even in those areas of agricultural trade to which binding GATT rules apply, many governments show remarkably little willingness to respect the rules.

It is time to make serious efforts to apply the basic GATT principles more strongly in the agricultural sphere. The Uruguay Round offers a historical chance to do so. The situation in international agricultural trade has now become so critical that many governments have recognised that a change of course is imperative. Not all countries are yet sufficiently prepared to countenance serious reform, but the Punta del Este Declaration indicates that the will to modify the system is stronger than in earlier GATT rounds.

In view of the bad experience with previous methods of handling agricultural trade, there is little reason for not risking a totally new approach. The use of PSEs to define new commitments regarding agricultural trade within GATT could be the road to take. Even that approach is not without difficulties and dangers, but it affords so many potential advantages that there would have to be very sound reasons for it not to be tried. Some contracting parties now appear to have decided to give it a chance, so that in the months to come it might play some role in the agricultural negotiations of the Uruguay Round.

Like all other methods, however, this approach can ultimately succeed only to the extent that governments have the political will to make true progress in the agricultural sphere. This is particularly true of the USA and the EC. Individually and, especially, together they have such a decisive influence on the overall situation of international agricultural trade that no effective improvement can be achieved unless they modify their stance significantly. Both have managed to create considerable freedom of action for their agricultural policies within the GATT. They could make a correspondingly large contribution to the Uruguay Round by offering to change those policies. The USA could forego its waiver and the EC could make firm undertakings regarding variable levies (e.g. the binding of ceilings for variable levies). If both sides committed themselves voluntarily to such action, the negotiations on agricultural trade could enter a completely new stage and gain greatly in terms of substance and the prospects for success. The Uruguay Round, whose overall success will probably depend to a high degree on progress in the agricultural area, would then be remembered as a turning point in the history of international agricultural trade.

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<sup>13</sup> R. Senti: GATT – Allgemeines Zoll- und Handelsabkommen als System der Welthandelsordnung, Zurich 1986, pp. 85 ff.

<sup>14</sup> S. Tangermann, T. E. Josling, S. R. Pearson: Multilateral Negotiations on Farm Support Levels. The Role of PSEs, to be published in the September 1987 issue of *World Economy*.

<sup>15</sup> *Ibid.*