

**MULTILATERAL TRADE
NEGOTIATIONS
THE URUGUAY ROUND**

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DISCUSSION DOCUMENT ON SOME TECHNICAL ASPECTS
IN RELATION TO THE USE OF PSE IN THE
MULTILATERAL TRADE NEGOTIATIONS ON AGRICULTURE

Submitted by the European Communities

Introduction

Most of the contracting parties which have submitted a negotiating proposal pay a certain attention to the question of measuring the level of support to agriculture. The way in which the various approaches concerning the measurement of support are presented, clearly indicate that a number of technical issues need to be addressed before dealing with the question as to the possible use of this instrument as a negotiating tool.

It is recalled that the measurement needs to respond to the negotiating objectives of the Uruguay Round and might therefore have to differ to a certain degree from other measuring techniques developed hitherto.

The present document concerns mainly the issues raised in the Secretariat's document Spec (87)37 of 8 September 1987 and the considerations put forward are not prepared with a view to indicate political viewpoints on situations which might occur during the negotiations. The issues addressed are those which can be foreseen, taking into account the proposals for negotiations as presented by several Contracting Parties. Further development of these proposals may result in adjustments or reconsiderations.

Comments on the PSEs established by OECD

1. The correctness of the raw data used in PSE-calculations is crucial for the accuracy of the result. In some cases these data might be reasonably reliable when they originate in well established statistical or accounting systems, e.g. data on total production, producer prices and budgetary expenditures. However, problems arise where the data required are not traditionally compiled and where budgetary expenditures are not commodity specific, which would often be the case.
For the moment, for those Contracting Parties in respect of which OECD has calculated PSEs, it is nevertheless suggested not to launch an examination in GATT of these issues but simply to take over the figures used by OECD, unless specific need should arise.

2. The OECD has measured certain policies in different ways. Market price support policies, for example, are often assumed to be implicitly captured by the internal/external reference price gap, therefore individual measures are not quantified. Since each policy measure is not identified in the PSE, the quantified effect of individual measures cannot be compared. This leads to the result that specific policy measures cannot be selected for separate negotiation based on PSE measurement.

This situation should not create problems when the support level for a product is to be negotiated as a whole. If a contracting party in such a case undertakes commitments to reduce support measured in PSE, the party concerned would then have to decide in which way it wants to reduce its PSE.

However, some countries seem to consider a negotiation on a single PSE covering all agricultural products (or at least the most important agricultural products). Such a PSE may be too broad to be meaningful.

When a PSE is calculated for a given product or a given sector of products covering those which are substitutable or competing, the procedure used by OECD seems to be adequate. Should it be decided to determine PSEs for the agricultural sector as a whole, the existing OECD calculations must be extended to cover additional products.

II. Use of the PSE in the Multilateral Negotiations

1. Policy coverage

The question of policy coverage has been touched in the proposals submitted by the EC, the USA, the countries of the Cairns Group and the Nordic countries. The United States want for example to exclude payment decoupled from production, including those that provide a safety net against natural disaster or other extraordinary circumstances and bona fide foreign and domestic aid programs, while the countries of the Cairns Group specify in their proposal that exceptions to a general prohibition should be strictly defined and list four groups of measures.

The EC has indicated that only measures with a significant incidence on trade should be taken into consideration. It has, however, made it understood that in practice it would be difficult to establish a framework for this concept and has therefore invited the Negotiating Group on Agriculture to address this issue. The examination could, for example, be based on the measures listed in the OECD format.

2. Product coverage

The products for which PSEs must be determined depends on the way in which negotiations are conducted. As long as the negotiations are concentrated on major products, the products chosen by OECD are considered sufficient. It might be appropriate, at a later stage, to determine PSEs for other products but it does not seem appropriate at this moment to launch calculations of PSEs for non-major products.

In respect of processed agricultural products, where the raw material is covered by a PSE calculation, a specific calculation of PSE is not necessary.

3. Country coverage

Many important countries are covered by the calculations made by OECD but in order to reach an acceptable result of any commitments based on PSE, the largest possible number of countries should be involved in order to cover a substantial proportion of the production and trade of a given product. To that end, the procedure described by the Secretariat in doc. MTN.GNG/WG5/W34 seems appropriate.

III. Specific measurement issues

1. Production quotas

Production quotas applied by large countries will affect the supply/demand situation. Such measures have been introduced by several Contracting Parties and these Parties will therefore request "credit" for such measures. To that end it might be necessary to determine the specific effect of such quotas in a PSE calculation.

One solution could be simply to take the reduction of the total amount of PSE for each commodity into consideration. Such a calculation would be easy because the total amount of PSE would be reduced in proportion to the reduction of the production.

Other approaches which might be more accurate could also be foreseen, e.g. by simulating a future production, had the production quota not been introduced, and the reduction in producer prices which would have been necessary to ensure a production level equal to that introduced by quantitative restrictions. In that case it would be necessary to capture the elasticity of supply and demand in the calculation.

2. Quantitative import restrictions and voluntary export restraint arrangements

Quantitative import restrictions and voluntary export restraints arrangements will undoubtedly be addressed during the coming negotiations. It is therefore appropriate also to be able to cope with such measures in relation to PSE calculation.

Suppression of or a reduction in quantitative restrictions on import is supposed to lower the producer price in a country. When PSEs are calculated on historical figures, the effect can easily be measured but if the effect has to be estimated in advance the situation is more difficult. To appreciate price, production and consumption trends resulting from increased imports, the price elasticity of supply and demand should be taken into account and that elasticity would vary from country to country.

A simplified measurement could, however, be considered, where an appreciation in advance was desirable. For the purposes of such a calculation it could be assumed that imports enter at world market prices leading to a new equilibrium price (weighted average of domestic and import prices), that consumption remains unchanged and that production decreases by a quantity equal to the imported quantity. The possibility of measuring the effect by simulating future internal prices and taking into consideration the elasticity of supply and demand could also be considered.

Voluntary export restraints lead to higher import prices because of the existence of "quota rents". A similar situation would occur if an exporting country had agreed to respect a certain price level on exported products.

Where the import price is used as external reference price, the internal/external price differential - and hence the PSE - could in fact remain roughly constant. The effect on the PSE would in that case be disguised. It could therefore be necessary to adjust or replace the external reference price.

IV. External reference price

Within the overall PSE concept, the trade measures under "market price support" are normally captured as the difference between an internal price (producer price) and an external reference price. This price difference is considered to quantify border measures such as tariffs, levies, quotas, etc., as well as the operations of marketing boards, and the related internal measures such as stocking arrangements.

It follows from this procedure that a PSE may change when the external price changes, e.g. as a result of currency fluctuations. That situation is illustrated by the following figures used by OECD in calculating the PSE for wheat:

<u>EC</u>	<u>1983</u>		<u>1984</u>		<u>1985</u>	
	Ecu	\$	Ecu	\$	Ecu	\$
Producer price/t.	197,0	184,6	185,8	156,2	177,8	129,5
External price/t.	175,0	163,8	179,0	150,5	124,0	90,3
Price difference	22,0	20,8	6,8	5,7	52,8	39,2

USA

Adjusted producer price (1)	191,9	179,7	182,4	153,3	205,0	149,3
Producer price (2)	138,5	129,7	147,7	124,2	155,5	113,2

The purpose of these examples is not to interpret the trends of external reference prices during specific years but to demonstrate the differences of the price fluctuations, expressed in percentages, depending on the currency in which the fluctuations are expressed.

The figures in the table show that a producer in the EC during the period of three years has received 197 Ecu/t. as the highest price and 177,8 Ecu/t. as the lowest, i.e. a difference of roughly 10%. If the same amount is expressed in US\$, the highest price is 184,6 and the lowest 129,5 \$/t., i.e. a difference of 29,8%.

In the USA, the producer received an amount corresponding to the adjusted producer price. The highest price was 179,7 \$/t. and the lowest 149,3 \$/t., i.e. a difference of 16,9%. Expressed in Ecu, the highest price was 205,0 and the lowest 182,4 Ecu/t., i.e. a difference of 11%.

The external reference price for the EC differed by 31% when expressed in ECU and 45% when expressed in \$. In the USA, where the producer price is considered as corresponding to an external reference price, the latter differed by 13% when expressed in \$ and 11% when expressed in ECU.

- (1) For the USA, the adjusted producer price is equal to the producer price increased by direct payments. For the EC, producer price and adjusted producer price are identical.
- (2) For the USA, the producer price is considered equal to the external price (NB: this situation may be changed for the year 1985). The external prices used in the example also show the difficulties as to the choice of an appropriate external reference price.

It should also be noted that the years 1983 and 1985 did not always represent the highest or the lowest amount.

The above mentioned figures show clearly that comparison of national PSEs over time is not possible because currency fluctuations influence the calculation of PSE used by OECD. One solution to this problem could be to replace the "external reference price" used by OECD by a price which is not vulnerable in respect of currency fluctuations or by a mechanism which would ensure that the PSE measurement remains neutral in relation to currency fluctuations. Such a price or mechanism should also ensure that commitments expressed by reference to PSE would not lead to considerable changes in producer prices from one year to another. It is quite evident that had the EC or another contracting party for example made commitments based on the price difference for 1984 as shown in the table above, the producer price for 1985 had to fluctuate according to the gap between the internal and external price established for 1985, which could have required a reduction of the producer price of roughly 25%, expressed in Ecu.

The present method used by OECD for calculating PSEs would not ensure balanced commitment by reference to PSEs, but could even create further disparities unless a solution in respect of currency fluctuations could be found.

The EC is considering this problem and a possible solution could be:

- a fixed external reference price, expressed in the currency of the party concerned, and
- a mechanism making the measurement of support independent of currency fluctuations.

It should also be mentioned that any commitment made by reference to PSE would be influenced by the inflation in a given country. Therefore, it could be appropriate to adjust such commitments by a deflator which would ensure that the real amount of support stemming from a PSE-calculation would remain unchanged.

The EC would therefore appreciate an exchange of view on this subject as soon as possible.

V. Monitoring

Monitoring of commitments expressed by reference to PSEs cannot be done in respect of a single year. It would be impossible for the decision taking authorities to determine exactly the development in crops and internal prices; consequently, they cannot establish a correct PSE in advance. The PSE has to be calculated after the end of a marketing year and the level of PSE agreed upon could have been exceeded despite all

good intentions. In such a case the country concerned should not automatically be considered as not having respected its commitments but it should have the possibility to take measures for the following years to allow PSE commitments to be respected when determined over a longer period. The compliance with a commitment could therefore be determined as an average of the PSEs during e.g. the last three years and on a sliding scale.

The calculation of PSEs could be left to the GATT Secretariat and the Contracting Parties should undertake to notify GATT as regards their budgetary expenditures, producer prices, etc. The calculations should then be discussed and approved by a Committee established to that end.

The Contracting Parties need a certain period for compilation of data and the Committee discussing the correctness of the PSE could therefore, at the earliest, start their work 6 months after the end of a yearly reference period.

It could also be useful to monitor support measures which might be excluded from a PSE calculation for GATT purposes.

The EC wants to emphasize that the negotiating objective on agriculture should be obtained, inter alia, by improving market access and "improving the competitive environment by increasing discipline on the use of all direct and indirect subsidies and other measures affecting directly or indirectly agricultural trade, including the phased reduction of their negative effects and dealing with their causes".

The examination of the use of an adjusted PSE-measurement as a pertinent tool for a negotiation should therefore be conducted in such a way that the result of the examination would make it possible to decide on the appropriate measurement of support.