

**MULTILATERAL TRADE
NEGOTIATIONS
THE URUGUAY ROUND**

RESTRICTED

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A DISCUSSION PAPER ON ISSUES RELATED TO THE NEGOTIATIONS
SUBMITTED BY THE UNITED STATES

At its December 1987 meeting, the Negotiating Group on Agriculture agreed to consider a number of technical issues raised by the various proposals put before the group to date. Delegations were invited to submit papers with a view to furthering the discussion and work on these issues. It is for this purpose that the delegation of the United States submits this discussion paper.

Our purpose is to stimulate discussion. None of the ideas presented here should be interpreted as a change in the objectives or scope of the U.S. proposal submitted in July 1987. Our objective in these negotiations continues to be a phase out of all trade distorting measures, leading to free trade in agriculture.

The principle of free trade is both simple and powerful. The benefits of free trade can accrue in several ways. Free trade directly induces a more efficient use of resources which causes national output and consumption to rise. Over time, free trade can stimulate competition, increase employment, increase investment, and raise the rate of economic growth. Another important benefit of free trade, which is especially relevant to agriculture, is that it tends to reduce global price instability.

The benefits of trade liberalization are distributed broadly regardless of a country's size, availability of natural resources, or level of development.

While countries can benefit from unilateral trade liberalization, the benefits to all are greatly enhanced when trade liberalization occurs on a multilateral basis. Obviously, the extent of improvement in income, employment and growth rates are greatest when free trade replaces a previously, highly restricted or distorted trading environment such as currently exists for world agricultural trade. Also, because the potential for improvement is vastly larger, countries at lower levels of economic development can experience the greatest relative increases in economic growth from liberalization.

Substantial, multilateral liberalization of agricultural trade will provide all countries, developed and developing, the greatest opportunities for sustained economic growth. However, the process of liberalization can influence the pace and extent to which the benefits flow to participants. The transitional arrangements must take into account the variety of support measures used and the varying degrees of economic development of the participating countries.

The first paper contributes to the discussion on the use of an aggregate measure in the negotiations. It addresses some technical issues but more discussion will be necessary. The first question is not how to measure the effects of policies, but which policies need to be measured.

Work in the negotiating group also needs to move forward on the issue of eliminating the adverse effects on trade of health and sanitary regulations. Participants should explore possible approaches which will lead to more harmonization and provide a mechanism for reaching agreements and resolving differences on issues in this area.

Decoupling is a concept that has received considerable attention in the search for ways to support farmers that are not distortive of production, consumption and trade. A more detailed examination of decoupling and the role that it might play in agricultural policy reform is needed.

AGGREGATE MEASURES

INTRODUCTION

In order to facilitate discussion and enhance the work of this negotiating group, the United States submits the following discussion paper on the use of aggregate measures in the negotiations.

Proposals submitted to this negotiating group by the United States and other contracting parties have called for using a quantitative index to measure the support provided by governments to the agricultural sector. The aggregate index would provide assistance in comparing the large number and widely different policies protecting agriculture and distorting trade, and most important, in monitoring the steps taken by countries in the process of liberalization.

The Secretariat has prepared two useful and informative documents on the aggregate measure of support and specifically on the Producer Subsidy Equivalent (PSE) work of the OECD. The Secretariat's papers have described the background of the various type of measurements and have identified the specific shortcomings and problems which need to be addressed in order for the PSE, or another form of index, to be useful as a monitoring device. The purpose of this discussion paper is to comment on the issues raised in the Secretariat's papers and to promote further discussion on the remaining issues. Included is a discussion of the aggregate measurement techniques available.

While the use of an aggregate measure can facilitate the negotiations, it should not become an obstacle to, or a substitute for, substantive negotiations. The aggregate measure can be a tool to monitor and measure the process of liberalization and should not take on a more substantial role. However, the character and form of the measure will be dependent upon the nature of the final agreement in the negotiations. This is particularly true with regard to the issues of policy and commodity coverage.

COMMENTS ON MTN.GNG/NG5/W/34

The GATT Secretariat has contributed significantly to this negotiation through the distribution of working paper 34. The United States generally agrees with the suggestions and ideas on the subject of "Submission of Data". We support the development of a standardized format for the submission of information and the provision of technical assistance to facilitate the submission process. We believe that the Secretariat could play an active role in both of these activities.

COMMODITY COVERAGE

The draft format in the annex of working paper 34 is comprehensive and a suitable basis to begin calculation of the aggregate measure. For the calculation of an aggregate measure, the United States favors as broad a commodity coverage as practically and technically possible. However, the area of commodity coverage will need further technical discussions to refine the level of processing, classifications and grouping of commodities.

POLICY COVERAGE

Government policies and programs that isolate agricultural producers from the signals of the market, create trade distorting incentives and cause uncertainty, imbalances and instability in world agricultural markets should be the focus of these negotiations. A critical step, therefore, is the identification of those policies and programs which are most trade distortive.

While all policies have varying degrees of influence on production, consumption and trade, it is the trade distortions these policies cause which are of concern. However, the effects of trade distorting policies are not easy to measure precisely. The degree of production, consumption or trade effects created by different policies depends on several factors. These include:

- How extensive the program is;
- How responsive quantities supplied and demanded are to prices;
- How the policy restricts trade or subsidizes production; and
- How the policy operates in combination with other policies.

The policies which effect production, consumption and trade can be divided into seven categories (the examples provided are for illustrative purposes only). The categories include:

- 1) Border Measures-- tariffs, quotas, subsidies, variable levies;
- 2) Price Stabilization Schemes-- price support programs;
- 3) Domestic Income Support-- deficiency payments;
- 4) Input Subsidies-- for irrigation, fertilizer, seed and credit;
- 5) Marketing Subsidies-- transportation, inspection services;
- 6) Long Term Structural Measures-- infrastructure development, research and extension; and
- 7) Consumer Policies-- food stamps.

Generalizations about each of these categories may not apply to each policy within a category. However, it seems clear that border measures rank among the most trade distorting policies since they directly interfere with trade, affecting both producers and consumers. In addition, border measures can permit other policies to transfer income to agricultural producers which might be unsustainable in their absence. Domestic policies which raise producer prices above the world market levels would be untenable in a free trading environment. Even policies directed at consumers alone can have a trade distorting impact when used to promote import substitution to promote domestic industries.

The scope of policy coverage for programs which would be eliminated will be subject to negotiation. The United States' proposal calls for commitments from all countries participating in these negotiations to eliminate all subsidies and other measures that directly and indirectly impact on agricultural trade. The only policies which we believe should not be subject to negotiation are direct income payments not related to production and marketing in the form of a safety net and bona fide foreign and domestic food aid. The extent to which policies are quantified within an aggregate measure depends initially on which policies are to be reduced and eliminated.

The aggregate measure of support is a flexible tool which can incorporate a wide variety of policy instruments. If policies which do not distort trade are to be excluded, the index can be adjusted accordingly. The issue becomes one of deciding on the range or sub-set of policies to be covered in the aggregate measure.

CONTINUING WORK

A great deal of progress has been made through the contributions of the Secretariat. However, a number of issues remain to be discussed and resolved before the aggregate measure concept can play a significant role in the negotiations. Discussion of technical issues should not be allowed to delay or hinder substantive progress in the negotiations. The Secretariat could play an active role in addressing the remaining technical issues in cooperation with interested parties.

ATTACHMENT

Measurement Techniques

The traditional measures used by economists to estimate the effects of government policies are the Nominal Protection Rate (NRP) and the Effective Protection Rate (ERP). The NRP is usually calculated as the difference between the domestic producer price and the world price at the border. By definition, therefore, the Nominal Protection Rate encompasses policies which protect producers by providing them with a higher market price than would be the case under free trade. Since domestic prices cannot be kept above world prices without some type of border measure, the Nominal Protection Rate also encompasses most types of border policies. The Nominal Protection Rate can also include direct payments to farmers even though such payments are not incorporated directly into market prices. When direct payments are included, the Nominal Protection rate is identical to what has been called the Price Adjustment Gap.

Whereas the Nominal Protection Rate encompasses policies which affect a farmer's gross returns, the Effective Protection Rate encompasses policies which also affect input costs. The ERP is thus a more general measure. It is defined as the difference between value-added at domestic prices and value-added at world prices, where value-added is the difference between gross revenues and the cost of purchased inputs. Because the ERP uses the concept of value-added, it measures the effects of government policies on the returns to fixed factors of production rather than producers' gross revenues.

The measurement of the ERP is very data-intensive since it requires information on both input policies and input use. Such data are seldom broadly available. Thus, ERP's are usually calculated in studies covering either a single commodity or a single country. They have not been calculated in studies involving large groups of commodities or countries.

The Producer Subsidy Equivalent (PSE) is defined as the payment necessary to compensate producers for the removal of a policy. It is important to note that the PSE is a very flexible tool since the types of policies included in the calculation are a matter of choice. The definition of the PSE brings out the notion that it is an estimate of the income transfer to producers which results from government policies. For this reason, the calculation of the PSE relies partially on government budgetary data and it is often called a measure of assistance. But, if the effects of only those policies which are included in the Nominal Protection rate are to be measured, the PSE and the NPR are identical. They both measure the difference between the domestic and world prices. It is for other policies that budgetary data are generally used in calculating the PSE.

An alternative measure which keeps within the PSE framework is the Trade Distorting Equivalent(TDE). The difference between the PSE and the TDE is the policy coverage basis of the calculations.

HARMONIZATION OF HEALTH AND SANITARY REGULATIONS

A key element in the proposal submitted by the United States is recognition of the increasing influence of food, plant, and animal standards and regulations in international trade. The objectives in the U.S. proposal on health and sanitary regulations are to:

- (1) Harmonize health and sanitary regulations, in so far as it does not adversely affect health and safety;
- (2) Base domestic regulations on internationally agreed standards; and
- (3) Base processes and production methods on equivalent guarantees.

The U.S. proposal states that these objectives are to be implemented by expanding GATT rules and procedures governing technical trade barriers to:

- (1) Apply more explicitly to processes and production methods;
- (2) Give greater recognition to the principle of equivalency of laws and regulations; and
- (3) Provide procedures for early technical and policy consultations on legal and regulatory changes that have a high potential for disrupting trade.

Health and sanitary laws and national food control programs are major forces in world trade. Significant differences in these programs among importing and exporting countries can have wide ranging trade repercussions.

Harmonization of health and sanitary regulations, that are based on objective scientific review, could facilitate trade. The harmonization issue has been under consideration since the early preparatory stages of the negotiations. The GATT Committee on Trade in Agriculture recommended that negotiating approaches should be elaborated in order that "sanitary and phytosanitary regulations and other technical barriers to trade, including related administrative requirements, are brought within the ambit of improved procedures aimed at minimizing the adverse effects that these measures can have on trade in agriculture".

Subsequently, the Punta del Este Declaration stated that the negotiations shall aim to achieve greater liberalization through more operationally effective GATT rules and disciplines by "minimizing the adverse effect that sanitary and phytosanitary regulations and barriers can have on trade in agriculture, taking into account the relevant international agreements".

During the negotiations we should seek to develop new GATT procedures and rules to reflect the agreements we reach, and to improve and strengthen the existing GATT provisions. The following GATT provisions specifically address issues related to health and sanitary barriers:

-- GATT Article XX (b) permits the adoption and enforcement of measures necessary to protect human, animal or plant life or health. Such measures must be "necessary" and not applied in a manner which constitutes "a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade". The criteria and obligations of this Article are essentially undefined.

-- The Standards Code (The Agreement on Technical Barriers to Trade) embodies and elaborates on the same requirements as Article XX(b) with regard to product regulations, but its coverage of processes and production methods is less explicit. The Code principally provides a notification, consultation, and dispute settlement mechanism, and prohibits the use of standards that create unnecessary obstacles to trade. The Negotiating Group on MTN Agreements and Arrangements will address the need to strengthen standards disciplines applicable to Code signatories.

The United States recognizes that countries must maintain regulations that protect human, animal, or plant life or health. These regulations should be established based on a sound scientific rationale, and should not constitute arbitrary or unjustifiable restrictions on international trade.

A principal intent of the U.S. proposal is to seek an internationally agreed approach to the development and application of health and sanitary regulations to assure that they are harmonized, scientifically sound, and are not used as disguised trade barriers.

Harmonization is a broad concept that not only covers identical laws or uniform measures, but also includes acceptance of standards that provide substantially equivalent protection, standards that vary within technically reasonable limits, and standards that have been established by relevant international standards organizations.

A greater international consensus on acceptable standard levels would not only improve market access, but would also lead to fewer detentions of products at the border, lower costs to shippers, importers, and consumers, help maintain efficient technological practices, and assist developing countries in improving their food control systems.

The negotiations should encompass all health and sanitary laws and regulations that affect international trade including those applicable to such things as pesticide residues, food additives, food identity standards, processes and production methods, veterinary drugs, food hygiene, labeling, methods of analysis and sampling, foods for special dietary uses, animal health and quarantine, and plant health and quarantine. The negotiations should cover all agricultural commodities, food, beverages, forest products, and fish and fish products.

OBJECTIVES

To minimize the adverse trade effects of health and sanitary regulations, the negotiations could proceed by agreeing: (1) to establish formal links with appropriate international standards organizations regarding food and animal and plant health and enhance cooperation between the GATT and these institutions; and (2) to revise, improve or develop GATT rules and disciplines to meet our mutual commitment to harmonize health and sanitary regulations based on thorough scientific review.

International Standards Organizations: The Punta del Este Declaration states that relevant international agreements should be taken into account in the negotiations on sanitary and phytosanitary regulations and barriers. Agricultural standards writing organizations have a leading responsibility for coordinating work on standards, codes of practice, and guidelines undertaken by governments and non-government participating organizations. With rapid advances in technology

and changes in agricultural industries, the need for increasingly scientifically objective, comprehensive, carefully drafted, and effective standards has become more imperative. The marketability of internationally traded products depends on compliance with national standards. Therefore, harmonization of standards through closer coordination with international standards organizations can reinforce GATT efforts to facilitate and liberalize trade.

Uruguay Round participants could seek agreement that the GATT should formally recognize three scientific international standards-setting bodies, including the Codex Alimentarius Commission for food products, the International Office of Epizootics for zoo-sanitary issues, and the International Plant Protection Convention for phytosanitary issues (Attachment). Recognition should extend to the health and safety aspects of standards necessary for trade and would not include marketing (quality) factors. Procedures and cooperative arrangements could be established to link the standards determined by these bodies with the dispute settlement capabilities within the GATT. Such procedures could include:

- o Referring trade issues arising from restrictive health and sanitary laws and regulations to the appropriate international standards body for technical discussion, review of pertinent scientific data, or technical judgment on their scientific rationale
- o Requesting international standards organizations to make determinations regarding equivalency of standards.

GATT Disciplines: Negotiations could be undertaken to elaborate GATT principles and obligations by clarifying and strengthening the technical requirements governing the imposition of health and sanitary trade restrictions. The following objectives could be pursued:

- o Strengthen the GATT to require that measures taken to protect human, animal or plant health or life should be based on sound and verifiable scientific evidence.

- o Expand the GATT to recognize the principle of equivalency of standard laws and regulations, and to provide for early compulsory consultations on measures that have a high potential for disrupting trade. Technical consultations could be referred to international standards organizations under proposed procedures to enhance cooperation between the GATT and technical bodies.
- o Clarify that the GATT explicitly apply to processes and production methods.
- o Establish agreements to:
 - Base new technical requirements on existing international standards that were established by deliberation of the scientific issues.
 - Adopt international standards and codes of practice, and permit the import and distribution of foreign products conforming to appropriate international standards, to the maximum extent feasible.

Nullification or impairment of any benefits accruing from commitments undertaken should be redressed in accordance with GATT Article XXII and XXIII procedures providing for consultations, and in the absence of a mutually satisfactory adjustment, suspension of GATT concessions or obligations. The improved dispute settlement procedures currently being negotiated in the Uruguay Round would be the basis for enforcement.

ATTACHMENT

Several international commissions exist for the purpose of establishing commodity and health standards. Multilateral organizations of the United Nations either directly or indirectly coordinate activities of many of these commissions. Three international standard-setting bodies dominate in the development of codes regarding food products, animal health, and plant health. These are: (1) The Codex Alimentarius Commission (CAC) of the Food and Agriculture Organization (FAO) and the World Health Organization (WHO), (2) The International Office of Epizootics (OIE), and (3) The International Plant Protection Convention (IPPC) of the FAO.

There are other international and regional bodies which influence world trade of agricultural products, yet no other bodies have the capacity nor the international scientific reputation and credibility of these three organizations.

Regional organizations include the United Nations' five regional economic commissions, representing Europe, Latin America, Asia and the Pacific, Africa, and the Near East; and the Economic Commission for Europe (ECE). The ECE was established for the purpose of initiating and participating in concerted action for the economic reconstruction of post-World War II Europe. It includes a Commission on Agricultural Problems, which provides its members with a useful forum for discussion and an opportunity to work together on common technologic and economic problems.

Umbrella organizations for coordination of international food products, animal, and plant health and sanitary regulations principally include FAO, WHO, and OIE. Multilateral organizations under the auspices of FAO and/or WHO that exist for the purpose of international standard setting include the CAC and IPPC. The OIE is an international standard-setting organizations with independent status.

There are several other more specialized international groups that are administered by large multilateral intergovernmental organizations. One example is the International Technical Consultation on Veterinary Drug Registration; a group which is administered by OIE, but works in close concert with WHO. These groups arise in response to the commonly recognized need for development of a global database regarding issues, such as adverse reactions and residues in meat from veterinary drugs.

The Codex Commission was established in 1963 for the purpose of implementing the Joint FAO/WHO Food Standards Programme. The purpose of the CAC is to protect the health of consumers and to ensure fair practices in world food trade; to promote coordination of all foods standards developed by international governmental and non-governmental organizations; to determine priorities and to initiate and guide the preparation of draft standards through and with the aid of appropriate organizations; to finalize standards, and after acceptance by governments, publish them in a Codex Alimentarius either as regional or worldwide standards.

The Codex Alimentarius includes standards for all principle foods, whether raw, semi-processed, or processed, that are for distribution to consumers. Materials for further processing into food products are included to the extent necessary to achieve the purpose of the CAC. The Codex Commission is comprised of an Executive Committee and 25 subsidiary bodies. The subsidiary bodies, called the Codex Committees, can be divided into three broad groups:

- (1) Those dealing with food commodities;
- (2) Those dealing with general subject areas; and
- (3) Those dealing with regional matters.

The subject committees review provisions with respect to the hygienic and nutritional quality of food; including microbiological contamination, provisions for food additives, veterinary drug residues, other contaminants, labeling, and methods of sampling and analysis. The commodity committees focus on development of standards within a commodity group. The committees are forums of scientists who review technical data related to the development of product standards. Expert committees are convened by the Commission to provide additional review of the scientific data for particular issues. Currently, three Expert Committees are in operation. Codex standards exist to ensure that food available to consumers worldwide is safe and wholesome, free from adulteration, and is correctly labeled and presented.

The Codex Food Standards Programme has an advisory function in the worldwide efforts for harmonization of food standards. The Codex Commission is a powerful network for multilateral industries working to introduce new food products in international markets. In addition to its standard-setting function, it provides informal forums for discussion between international government and industry representatives. This informal network is an effective tool for promoting an understanding of each nations' regulatory policies related to foods. Although the objective of the Codex is for complete harmonization of international food laws, a prominent intermediate function is to promote international trade through an effective network of industry contacts.

While Codex is the prominent international system for development of food product standards, the OIE is its parallel regarding animal health and zoo-sanitary issues. The OIE is the oldest international veterinary organization, dating back to 1924. It was founded in Paris with 25 member countries. The OIE continues to operate from Paris, where it convenes its annual General Session meetings. Chief Veterinary Officers from the over 100 member countries attend the General Session.

The mission of the OIE is twofold: (1) to develop and maintain a worldwide livestock reporting system and (2) to expedite international trade without the risk of livestock diseases. A financial commitment is required from each member country, with the level of contribution depending on the countries' classification of involvement.

The OIE operations include four specialty commissions, including: (1) The International Animal Health Code Commission; (2) The Norms Commission; (3) The foot-and-mouth Disease Commission; and (4) The Fish Diseases Commission. Regional commissions also exist for (1) Africa; (2) the Americas; (3) Europe; and (4) Asia, the Far East, and Oceania.

The International Animal Health Code Commission was created to study and recommend sanitary regulations for the importation and exportation of animals and animal products. The Norm Commission studies and recommends the appropriate testing procedures relating to importation, exportation, and vaccine production. The Foot-and-Mouth Disease Commission monitors the occurrence of foot-and-mouth disease and makes recommendations relating to vaccine banks, research, regional control programs, and import/export regulations. The Fish Diseases Commission was created as a separate commission because of the unique reporting system and regulations relating to fish.

The four speciality commissions each meet on a semi-annual basis. Regional commissions, member countries, or the Director-General of OIE may select issues for review. The issues are sent to member countries for comments, after which the appropriate specialty commission proposes a new or revised regulation or testing procedure. Member countries may again comment before a final regulation is drafted by the specialty commission and presented at a general session for approval by the entire committee or member countries. Approved regulations and standards recommended for trade of animals and animal products are published as the "International Zoo-Sanitary Code". The OIE also publishes monthly disease bulletins, annual disease status reports from member countries, and a variety of scientific and technical reviews of animal diseases or other issues pertaining to animal health.

Member countries are expected to inform the OIE of outbreaks of 15 diseases classified as "List A Diseases." List A diseases are those that are highly contagious and pose particularly serious health threats to regional and/or national economies. This compilation of disease outbreaks is completed through a system of 24-hour, weekly, and monthly reports. Outbreaks and disease information for 40 other diseases, classified as List B Diseases", are reported on an annual basis. List B diseases are those that can have serious repercussions on farming or on animals, but do not represent as significant a threat as the List A diseases.

The function of the OIE is advisory in nature. Its recommendations, like those of the CAC, are based on a scientific evaluation of the issues. The OIE's monitoring and reporting function is of great service in providing information for world trading partners and in preventing the spread of economically-davastating animal diseases. The organization represents a well-established network of government officials responsible for ensuring animal health within their respective countries.

International standards for plant health and protection are developed predominantly by the IPPC. The IPPC was developed in the 1950's and is administered by the FAO. There are currently 88 signatory countries. The IPPC document is the general framework intended to prevent the international spread of plant pests and diseases.

The IPPC provides for (1) formation of national plant protection services; (2) conduct of plant pest surveys and reporting of plant pest conditions within member countries; (3) development of plant quarantine requirements which protect international resources with minimal restriction on trade and commerce; (4) control of plant pests within a country by internal quarantines; (5) issuance of prescribed certificates (the Phytosanitary Certificate") attesting that shipments of plants or plant product have been inspected, found to be free of quarantine plant pests, substantially free of injurious pests, and conforms with the plant quarantine import requirements of the designated destination country; and (6) formation of regional plant health organizations among countries sharing common geography, climate, plant species and resources, and pest concerns.

Regional plant health organizations are the core of the IPPC operations. These include the: (a) European and Mediterranean Plant Protection Organizations (EPPO), (b) North American Plant Protection Organization (NAPPO), (c) Caribbean Plant Protection Commission (CPPC), (d) Asia and Pacific Plant Protection Commission (APPPC), and (e) several loosely-knit organizations formed by African and Latin American countries.

Both EPPO and NAPPO are predominantly funded by their member countries or "contracting parties". Membership fees are assessed on the basis of agricultural production within a given country. The CPPC and APPPC are both largely funded by the FAO, due to their relative high percentage of developing-country members.

The FAO has played a relatively minor role in administering the IPPC. Their emphasis has been in providing training for developing country plant protection organizations and in leading the CPPC and the APPPC. The FAO publishes IPPC reports and bulletins that contain changes in plant health regulations. The FAO also serves as the dispute settlement body between the regional organizations, but they have been little utilized in this regard. However, even in dispute settlements, the decision by the FAO is non-binding.

DECOUPLING: A NEW APPROACH TO AGRICULTURAL POLICY

INTRODUCTION

Agricultural sectors are under stress around the world. Symptoms appear as burdensome inventories, depressed commodity prices, high prices to domestic buyers, large government expenditures, and uneconomic patterns of global resource use. Several of these symptoms have led to increased government intervention as political leaders have attempted to lower the level of farm financial stress.

A key factor in deepening and prolonging global agricultural stress and stifling progress is agricultural policies. The current set of global agricultural policies have many worthy goals, including farm income improvement, price stabilization, food security, environmental protection, and economic development. These policies also have serious side effects: they slow the sectoral adjustments toward market and technological realities, distort farmers' incentives and consumers' choices, aggravate problems of agricultural resource use, raise consumer costs and create barriers to trade of farm and food products, both internally and internationally.

DECOUPLING AND AGRICULTURAL POLICY REFORM

To stimulate global agricultural improvement, the United States has proposed global policy reform negotiated within the GATT. The proposal would eliminate trade-distorting subsidies and import barriers, allowing market signals to reach consumers and producers alike. Policy reform would let the market balance demand and supply, thus reducing surplus production and the burden of agricultural subsidies.

The United States proposal would completely phase-out over 10 years all agricultural subsidies which directly or indirectly affect trade. Certain policies would be permitted--those that are production and trade neutral or have such a small effect as to be inconsequential. Permitted policies are of two types: (1) direct income or other payments decoupled from production and marketing, including those that provide a safety net against natural disaster or other extraordinary circumstances; and (2) bona-fide foreign and domestic aid programs.

An income support policy of decoupled payments unrelated to production and marketing would remove direct government influence from markets and let market signals reach producers and consumers. At the same time, a policy of decoupled payments would support farmers' incomes during the transition period in which market-distorting policies are eliminated. It could also be used to provide a safety net to agricultural producers.

THE EFFECTS OF CURRENT POLICIES

Current agricultural policies generally attempt to support farmers' incomes by supporting commodity prices (through import quotas, state marketing systems, inventory programs, supply controls, and various other interventions), by making direct payments based on price and/or production levels, or by subsidizing the price of inputs. Being coupled to production and price levels, these policies directly affect farmers' decisions at three levels:

- (1) Decisions about marginal changes in the commodity mix or level of production and marketings--should a farmer produce an additional bushel of wheat?
- (2) Decisions about investment in additional production capacity--should a farmer buy another tractor or bring new land into production? and
- (3) Entry and exit decisions--should a farmer continue to farm or do something else?

By affecting farmers' decisions at all three levels, coupled programs influence production, consumption, and trade patterns, resource allocation, and farm structure.

Many countries, developed and developing, exporting and importing alike, have had extensive experience with coupled farm programs. The U.S. experience dating back to the 1930's illustrates the many problems countries face in using coupled price and income support programs. By raising the price (or lowering the cost) of each additional unit of production, U.S. farm programs encouraged U.S. farmers to expand production. To cope with the over production which resulted, limitations were placed on acreage. This led to more intensive cultivation,

decreasing the effectiveness of acreage controls and raising environmental concerns. Furthermore, the expectation of continued support attracted new investment and resources to U.S. agriculture, further stimulating output. The result has been almost continuous overproduction and repeated accumulation of price-depressing inventories. Unfortunately, the U.S. is not alone in the use of coupled policies. These policies are being used around the world by developed and developing countries, importing and exporting countries-all with the same results. The key problem with coupled support programs in the United States is that they have led U.S. farmers to make decisions based on program subsidy advantages rather than on market prices.

After more than 50 years of experience with coupled farm programs, the United States found itself in the 1980's with burdensome stocks, record government spending, large acreages retired from production, farm financial stress, and growing concern about the equitable distribution of farm program benefits. While some of these problems may have eased, coupled farm programs remain inconsistent with a market-oriented agricultural sector. Based on this experience, the United States reached the conclusion that a new direction in farm policy was required. The new direction is known as decoupling, and underlies the U.S. GATT proposal on agricultural reform.

THE GOALS OF DECOUPLING

The main goal of decoupling is to break the link between agricultural support programs and farmers' production, investment, and marketing decisions. To achieve this goal a decoupled payment must be independent of the current and future level of a farmer's production and marketings, input use, or commodity prices. This means that if more, less, or none of the commodity is produced, or if prices are low or high, a decoupled payment will not vary.

Decoupled payments would allow countries to pursue agricultural income support objectives without distorting international markets. While the principal reason for decoupled payments may be to provide transitional income support for farmers, decoupled payments could also be used in the context of a safety net. Decoupled payments should aim only at providing a safety net to farmers and not continuing current levels of government support.

ACHIEVING PRODUCTION NEUTRALITY

Ideally, a decoupled payment would be completely production neutral. In practical terms, however, payments to farmers could still have some effect on production and farmers' entry/exit decisions. This will generally be the case if eligibility for decoupled payments requires continuing employment in agriculture or the ownership of agricultural resources. For example, consider a government program that offers a fixed annual payment to any individual proven to be a farmer. While the payment would have no direct effect on a farmer's decision to produce 20 hogs rather than 10 hogs, it would affect the decision to remain a farmer. Thus payments tied to the employment of resources in agriculture could hold or possibly attract resources to agriculture.

This in turn could affect farmers' entry and exit decisions. For example, an individual who preferred farming over other occupations might choose to use a payment to remain in farming. That is, low-income farmers might prefer to remain in farming, rather than absorb the costs of finding new employment. By affecting individuals' decisions to enter or leave farming, such payments may affect farm structure.

Even though such payments may not be completely neutral, they would let market signals have a much greater influence on farmers' production and marketing decisions. The result would be global production and trade patterns based on comparative advantage and efficient resource use.

IMPLEMENTING DECOUPLED PROGRAMS

Decoupled income support payments to farmers have three important dimensions. Each country would have to address these dimensions in deciding on the design of decoupled support programs:

-- Eligibility Criteria. Eligibility could be determined by a means test, based on a producer's income and wealth, or payments could be made across-the-board to all producers or by other criteria that did not stimulate production.

-- Payment level. Payments based on a safety-net concept or minimum income support should neither attract additional resources to agriculture nor stimulate additional production, both of which should be functions of the market.

-- Program duration. Depending on the objective, decoupled payments could be made to a producer once or over a temporary period.

These dimensions of decoupling offer each country the flexibility to adopt its own approach to cutting the linkages between payments and production. Decoupled payments could be aimed at income support goals such as assisting farmers in a transition period. Or, on a one-time lump sum basis, decoupled payments could facilitate resource adjustment.

The potential market distortions created by a payment depend on these dimensions. In general, as both the program duration and level of payment increase, so will the potential for creating market and trade distortions. Similarly, the potential for distortions increases as the linkage between payments and resource ownership or employment strengthen.