

**MULTILATERAL TRADE  
NEGOTIATIONS  
THE URUGUAY ROUND**

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of Support and Related Matters

OPTIONS FOR THE USE OF AN AGGREGATE MEASUREMENT OF SUPPORT  
IN THE NEGOTIATIONS ON TRADE IN AGRICULTURE

Informal Background Paper Prepared by the Secretariat at the Request  
of the Technical Group at its Meeting on 24 March 1988

Introduction

1. In the secretariat note Spec(87)37 (paragraphs 46 to 50), four options for using a PSE-based aggregate measurement of support were outlined. One option (I) would involve using the PSE itself as a medium for expressing commitments to progressively phase down protection and support. Another option (II) would involve using the PSE as a yardstick or unit of account to measure or assess the value of specific commitments to reduce protection and support. A third option (III) would involve using the PSE as a monitoring device, either as an adjunct to Options I and II, or as a device for monitoring the general shape and direction of domestic agricultural policies. A fourth option (IV) would involve using the PSE as an ingredient in strengthened and more operationally effective GATT rules and disciplines. The object of the present paper is to comment in somewhat greater detail on each of these options with a view to facilitating consideration of whether an aggregate measurement of support should be used in the negotiations and, if so, how.

Option I: Commitments to reduce protection and support expressed in terms of PSE

2. Under this Option, the objective would be to reach agreement on a base reference PSE for a given product or sector and on a transition period for the progressive reduction of this base reference PSE in accordance with an agreed formula. Thus, for example, if the base reference aggregate monetary PSE is 10,000 units of national currency and the agreed reduction is 50 per cent implemented in equal tranches over ten years, the commitment would be to ensure that the mix of domestic support measures does not result in a PSE of more than 9,500 units in Year 1 of the transition period, of more than 9,000 units in Year 2 and so on until Year 10 when the ceiling binding would be 5,000 units. In this scenario, each participant would decide for itself how the annual PSE reduction would be implemented. The specific measures taken to reduce direct or indirect support would be notified and would be subject to monitoring by other participants in the agreement to check that they brought about the annual reduction.

3. The selection of the base reference period and the measure coverage as well as the length of the transition period and the reduction formula would not as such appear to raise particular technical issues. Product coverage that extended beyond the major traded commodities would give rise to technical, logistical or conceptual issues, particularly in the case of processed products. The selection of the form in which PSE commitments would be expressed (e.g., per unit of production, percentage of total value of production at world or domestic prices, or the aggregate monetary PSE) could have technical or operational implications. For the purpose of discussion it is assumed that the aggregate monetary PSE expressed in national currencies, which is relatively less insensitive to certain policy changes, would be employed as the medium for expressing commitments.

4. An issue that would involve technical implications, and certainly operational implications, would be the impact of fluctuations in world prices on PSE commitments. Such fluctuations can occur because of exchange rate changes, as a result of domestic policy changes, as a result of policy changes in other countries, and because of changes in supply/demand conditions in world markets. Since a PSE commitment constitutes a ceiling binding only where a certain relationship between external and internal reference prices is maintained, a rising world reference price could result in a temporary suspension of obligations to reduce direct and indirect support measures, and could indeed create a margin for increasing support. Conversely where the external reference price declines there would be an obligation to make appropriate reductions in domestic support to offset the impact of exogenous changes on PSE commitments. On the one hand, it can be argued that such adjustments would lead to greater market orientation of domestic policies and, on the other, that such adjustments would introduce a degree of instability into domestic policy that would be inimical to progressive multilateral reform.

5. From a technical point of view a number of possibilities could be considered in order to moderate or exclude the impact of short-term or erratic world price fluctuations. A multi-year moving average PSE would in principle reduce the amplitude of fluctuations in external reference prices and focus the adjustment process on medium-term trends in world markets. Another possibility would consist in the adoption of the exchange rates implicit in the base reference period for the calculation of PSEs in subsequent years, with adjustments being made at intervals of, say, three years. A variant of this approach would consist in fixing the external reference price implicit in the base period in national currencies and adjusting this at intervals of, say, three or five years. One important effect would be that PSE reductions, although subject to review after three or five years as the case may be, would not be contingent on annual or averaged movements in world prices, but would be implemented in regular stages in accordance with an agreed reduction formula.

6. The PSE would play a particularly important role as a monitoring device under Option I in checking that support reduction measures notified by participants actually brought about the negotiated annual reduction. In theory, all that would be involved, in the example given in paragraph 2 above, would be to calculate the PSE for Year 2 in constant (base year) prices in order to determine whether, as a result of good luck or good

management, the Year 2 ceiling of 9,000 units had been respected. Where this is not the case, the question would undoubtedly arise whether the overrun is attributable to internal policy-related factors or to exogenous factors over which the participant concerned would have little, if any, influence. The technical difficulty of assessing the relative impact of these different factors would seem to be rather acute. Time lags between the introduction of support reduction measures and their effects on domestic production would constitute another example of the technical limitations of using a static measurement of support in a dynamic context.

7. While these technical or operational drawbacks of the PSE as a monitoring device are not peculiar to Option I they assume greater significance under this Option because commitments would be expressed and monitored in PSE terms. At the same time, it may be noted that the technical difficulties encountered in comparing a recent PSE estimate with the base reference PSE would tend to be more significant than would be the case if the recent PSE estimate were to be calculated using the exchange rate and external reference prices implicit in the base reference PSE. The latter approach would put the focus on policy-induced changes and would, in other words, effectively convert the PSE into an index of domestic policy support.

8. A second category of technical/operational issues relates to the PSE value of particular changes in support arrangements. The technical issues involved are common to most of the options for using the PSE in negotiations. By its nature the PSE is sensitive to, or reflects, changes that reduce the gap between internal and external reference prices and to reductions in budgetary transfers. It does not purport to measure directly other changes which may have minimal effects in PSE terms but which have a positive impact on production and trade, although indirectly and over time such measures may well be reflected in an improvement in world price levels. Supply controls, improvements in access under quotas and other non-tariff border measures are examples. The technical issue is one of disaggregation, the operational issue is one of trade impact. These aspects are dealt with in Spec(87)37 (paragraphs 14, 19 and 20) and a separate secretariat paper is to be circulated on supply control.

Option II: The PSE as a unit of account or yardstick

9. Under this option the PSE would be used to gauge the value of commitments to reduce protection and support pursuant to a prior understanding that would specify the general parameters of the overall reduction to be aimed for. In contrast to Option I what would be bound in the GATT would be specific commitments to reduce protection and support undertaken by participants together with a schedule or plan for the implementation of these reductions within an agreed time-frame. In addition to its use under this Option as a unit of account or yardstick in measuring the relative value of proposed commitments, the PSE could also be used to monitor developments in overall support during the agreed transition period.

10. The technical implications of using the PSE as a yardstick or unit of account would depend in part on the precise role assigned to the base reference PSE and in part on the extent to which the PSE is capable of being used to evaluate specific commitments to reduce protection and support.

11. It is assumed that any political undertaking on the general parameters of a negotiated reduction in agricultural protection and support would presuppose prior or concurrent general understandings on the base reference period, on commodity coverage, on the measures that would be subject to or exempt from reduction, and on the transition period. Thus, for example, the undertaking might be to achieve in subsequent detailed negotiations a "substantial reduction" or "a reduction of not less than x per cent" in agricultural protection and support relative to the levels prevailing in the base reference period, say 1984 to 1986.

12. In this scenario it would seem to be logical, or at least a reasonable operational assumption to make, that specific offers tabled to reduce protection and support would be evaluated by re-calculating the base reference PSE on the basis thereof. This would mean, amongst other things, that the average exchange rates and world reference prices implicit in a multi-year base reference PSE would remain constant and that the principal variables (in respect of which commitments would be negotiated) would be internal prices, explicit and implicit budgetary transfers and border measures. The results of this re-calculation of the base reference PSE would demonstrate whether or not the proposed offers to reduce protection and support would meet the reduction target. The essence of the negotiation would consist in a request/offer procedure to maximize the overall reduction in agricultural protection and support and to optimize, or achieve greater specificity with respect to, commitments on access and export subsidies.

13. From a technical point of view it is apparent that the re-calculation of the base reference PSE to reflect an offer to modify a measure already covered by the base reference PSE would not pose particular problems. Whether the indicated PSE reduction is considered to adequately reflect proposed commitments is another matter. The position could be different, however, where a new policy or measure is introduced in the interval between the base period and the detailed negotiations. This may not be a significant problem since the new measure could simply be treated as replacing the earlier measured policy. What it could suggest, however, is that the subsequent detailed negotiating phase would be facilitated if the detailed negotiations were to take place against the background of an undertaking to freeze support levels or not to introduce new support measures.

14. It may be noted that the PSE yardstick as outlined above would function as an index of policy changes in a manner not greatly dissimilar from that mentioned in paragraphs 5 and 7 under Option I, with one of the essential differences being that the GATT commitments in one case would be on specific policy changes and in the other on the PSE itself.

15. The extent to which a PSE yardstick would be capable of being used to evaluate and compare specific offers to reduce protection and support raises issues similar to those referred to in paragraph 8 above. As already noted one of the main problems is that certain types of commitments, particularly those whose effects are measured jointly via the internal/external price differential technique, would not be reflected automatically in a re-calculated PSE. Recourse to pragmatic or econometric assumptions about the PSE value of such commitments could therefore become necessary, unless it were decided simply to deal with trade commitments on a collateral basis. However, it may be noted that this problem is not limited to trade access issues but also to the measurement of a commitment, for example, to reduce a floor or intervention price. The evaluation of such a commitment in PSE terms would depend on assumptions about future relationships between producer prices and the floor price.

16. The technical aspects of separately evaluating particular concessions in this and other options could well have a tendency to assume an undue importance, since what would be evaluated in both PSE and general trade policy terms would be the acceptability or adequacy of the overall package. What this discussion perhaps illustrates is that if the re-calculated yardstick PSE is to approximate reduced levels of protection and support at the end of a relatively lengthy transition period, the commitments exchanged would, at least for technical PSE-related reasons, need to be spelt out with reasonable precision.

Option III: The PSE as a monitoring device

17. This Option would not appear to call for extensive comment. As a general approximation of levels of protection and support the PSE could also be used to monitor the overall shape and direction of domestic agricultural policies. If the PSE is used to monitor specific commitments and those commitments are negotiated on the basis of the PSE indices referred to under Options I and II, then it is reasonably apparent that the PSE for a subsequent, more remote year would reflect the particular price and other relevant economic conditions prevailing in that year. There would thus be no intrinsic connection between the base reference PSE and the PSE for a subsequent year unless certain parameters remained constant. An approach to this issue under Option I would consist in re-setting the PSE index at regular intervals. In the case of Option II this issue may not arise since the focus of a review would be on the implementation of commitments on specific measures and policies.

Option IV: The PSE as an adjunct to strengthened and more operationally effective GATT rules and disciplines

18. The general objective under this Option would be to give greater precision and authority to the GATT rules and disciplines, particularly under Articles XI and XVI.

19. The essence of an effective reinforcement of the Article XI:2(c) disciplines relating to effective limitation of production and access would be to extend the explicit coverage of the Article to include all non-tariff access restrictions, as well possibly as such high tariffs as discourage

the importation of even minimum quantities, and to spell out in concrete terms the extent of contracting parties' obligations under the minimum access provisions of Article XI:2(c). Under such an approach a general monitoring role could be envisaged for the PSE in the context of the transitional arrangements under which contracting parties would bring their existing measures into line with reinforced disciplines relating to effective control of production and access, but such a role would not be essential in the access context.

20. The existing effect-oriented GATT rules and disciplines on agricultural export subsidies have proved to be far from effective and the scope for improvement within the existing Article XVI:3 "equitable share" framework is rather circumscribed. In any event it is difficult to see what specific role could be played by the PSE in the interpretation and application of these disciplines.

21. On the other hand, the PSE could have a role to play in the context of any new framework of disciplines on the use of agricultural export subsidies based on a "general prohibition subject to exceptions" as developed by the Committee on Trade in Agriculture under the Recommendations adopted by the CONTRACTING PARTIES in November 1984. Thus if direct export subsidies are to be progressively phased out in favour of arrangements under which producers, not government treasuries, meet the effective cost of bridging the gap between internal and external prices, then it would be important to ensure that these producer-financed arrangements do not in practice simply result in the cost of bridging the gap being transferred to consumers. One method of achieving this would be to use a variant of the PSE as a ceiling or "sinking lid" on domestic or non-prohibited subsidies and to make this one of the conditions governing the producer-financed exception to a general prohibition on the use of subsidies on agricultural products.

#### General

22. Finally, the options selected for discussion are not necessarily exhaustive of the range of possibilities for using a PSE-based aggregate measurement of support in the negotiations, nor for that matter are the options selected mutually exclusive. Indeed, as pointed out in Spec(87)37, some of the options may be combined.