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of Support and Related Matters

IMPORT ACCESS AND THE PSE

Background Note Prepared by the Secretariat at the Request
of the Group at its Meeting on 22 April 1988

1. Examination of the Producer Subsidy Equivalent (PSE) and of its possible use in a negotiating context raises two separate but related concerns regarding market access restrictions. The first of these regards whether changes in import access opportunities are equitably measured by the PSE. The second, whether reductions in a country's PSE would per se result in improved import access.

PSE Measurement of Import Restrictions

2. It must be recalled that the PSE was designed to measure income transfers to producers, not trade distortions. Quantitative import restrictions are thus seen as a measure implemented to maintain or increase prices received by farmers by limiting the quantity of external supply available in the market. As indicated in Spec(87)37, policies affecting import access, including tariffs, variable levies, voluntary restraint agreements, quotas and other quantitative restrictions, are among those policies whose effects are measured through the internal/external price differential. For products subject to such policies, the resulting income transfer to producers is calculated as the difference between a supported internal price and a representative world market reference price. The price difference on a per unit basis is multiplied by the amount of domestic production to provide an aggregate measurement of the transfer effects of the policies in question. In the static context for which the PSE was designed, i.e., as a "snapshot" of the levels of support at any one point in time, increased imports would theoretically be expected to reduce the domestic price and thus that component of the PSE reflecting the internal/external price gap.

3. The use of the price differential methodology raises some particular problems which have been previously identified and discussed in the Technical Group, including the selection of an appropriate external reference price for comparison with the internal price and the effects of currency fluctuations on the internal/external price differential. Another difficulty which arises from the use of the price differential methodology is that a number of measures are jointly quantified. These can include not

only import access measures, but also internal stocking arrangements, export assistance programmes, some health and sanitary regulations, and the effects of the operations of marketing boards. The price differential implicitly quantifies the joint effects of the measures and it is not possible to disaggregate the income transfer effects of each individual border measure. Whereas it might be possible to reduce the number of included measures, by estimation of the budgetary outlays for some of the aggregated measures (i.e., export subsidies, storage arrangements) and adjustment of the price differential to exclude these and tariffs, complete disaggregation is not usually possible.

4. Thus although tariffs can be easily identified, the effects of non-tariff import restrictions are not specifically measured by the PSE but implicitly included in the price differential measurement. Voluntary restraint agreements and other such market sharing arrangements may be reflected in the PSE if their effect is to increase the internal/external price differential. However, if their existence leads to higher import prices for the importing country because of the "quotas rents" generated, they may effectively escape measurement by the PSE. The same difficulty arises with respect to minimum import prices.

5. In addition to the benefits arising from quota rents, the OECD has also identified as a difficulty the effects of import quotas imposed on only a particular category of a non-homogenous product. In this situation the quota's effect is considered to be a partial increase in the domestic price of all the commodity in question, as the substitution effects would be limited in the case of non-homogenous commodities. Furthermore, account must be taken of the joint effects of quotas and other measures, as in some cases the quotas are not the binding constraint on imports and should thus not be included in the PSE calculation.

6. The measurement difficulties are more serious if the PSE is used in a dynamic context and one wishes to predict in advance the effects on the PSE of changes in import access. As noted in the discussion document submitted by the European Communities (NG5/W/45), the price elasticities of supply and demand would be required to predict price, production and consumption changes expected from increased imports. Such elasticity estimates, when available and not too disputed, vary from country to country. In this regard, the EC offers two suggestions:

"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."

Effects of PSE Reductions on Import Access

7. The second issue which arises is how to assure that a reduction in a country's aggregate PSE results in an improvement, or at least not in a worsening, of import access to that country. It is indeed possible for a country to reduce its PSE - for example, through reduction in internal prices, research support, domestic production levels, or devaluation of its currency - while maintaining or increasing quotas and other barriers to imports. If negotiated commitments are on the PSE level itself, with parties free to select which policies they adjust, this problem could be quite serious, indeed. On the other hand, if commitments are made regarding policies, it would seem logical that fulfilment of the negotiated commitment would be judged primarily on the basis of whether quotas or tariffs were eliminated, for example, regardless of whether the consequences of such action were fully reflected in the PSE.

8. The concept of a "hierarchy" of policies, with emphasis and first action to be taken on those policies considered as most trade distorting, would also resolve some of this concern. Import restrictions are by definition trade distorting and thus might logically be included among those measures subject to priority action. Again, examination of changes in the PSE alone might not be sufficient and other factors might also need to be reviewed to determine compliance with the liberalization commitment.

9. The use of the Trade Distortion Equivalent (TDE) as opposed to the PSE could be expected to focus more closely on import restrictions and would go some way in addressing the noted concerns. The effects of import access restrictions are quantified in the TDE on the basis of the same price differential methodology as for the PSE and are thus subject to the same difficulties identified above. However, by encompassing only those policies considered to be trade-distorting, including quantitative import restrictions, the TDE estimate should be smaller than the PSE, and more sensitive to changes in any of its components. Thus a change in the internal/external price differential resulting from improved market access would have a greater effect on the TDE than on the PSE. TDE commitments made on the above basis of a "hierarchy" of policies could go even further towards assuring improvements in import access.

10. It does not appear that the existing PSE methodology could be feasibly modified to address these concerns regarding import access. In this light, one alternative is to undertake traditional negotiations on quota levels, administration, etc. A more comprehensive and transparent approach would be the negotiation and enforcement of new rules on access. If agreement were reached to phase-out all import quotas, most of which are contrary to the existing GATT rules and whose effects are difficult to measure, the PSE could be used to estimate total protection to a product, which could subsequently be provided through an ad valorem tariff. A number of suggestions for possible modifications relating to Article XI and import access in general were discussed in the Committee on Trade in Agriculture and are set out in AG/W/9/Rev.3 at Annexes A-I through A-VI.