MULTILATERAL TRADE

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Group of Negotiations on Goods (GATT) Negotiating Group on Agriculture

THE EC APPROACH ON AGGREGATE MEASUREMENT OF SUPPORT

1. At the meeting of the Trade Negotlations Committee in April 1989, it was agreed that the long-term objective of the agricultural negotlations is to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets. This goal will be realized through negotlations on specific policies and measures, through the negotlations on commitments on an aggregate measurement of support, the terms of which will be negotlated, or through a combination of these approaches.

The participants were invited to advance detailed proposals for the achievement of the long-term objective, including the terms and use of an aggregate measurement of support.

The purpose of this document is to give further impetus to the discussions on the terms and use of an aggregate measurement of support, both in relation to domestic support and protection.

2. In its proposal for multilateral trade negotiations on agriculture (MTN.GNG/WG5/W/20) the European Community stated that in order to enable GATT undertakings on support to become operational, agreement will be needed on how to measure the various forms of aid to agriculture by contracting partles. The measurement devised by the OECD, the producer subsidy equivalent (PSE), could be taken as a basis for a unit of measurement, provided it was suitably adjusted for use as a negotiating instrument. The adjustments would involve essentially (a) taking account only of measures with a significant incidence on trade, (b) including a method of quantifying production restraints, and (c) considering how to accommodate problems related to world price and currency fluctuations.

The European Community has also submitted a document outlining the technical aspects of a concerted reduction of support with a view to establishing a sound basis for long-term actions in this area (MTN.GNG/NG5/W/82). In this paper the Community envisaged that each contracting party in addition to binding the support levels by reference to an aggregate measure of support also should identify the national policy instruments they intend to adjust in order to comply with the obligations undertaken. It was also suggested that bindings of support levels should remain unchanged during a period to be determined e.g. 5 years.

3. The discussions which have taken place so far show how difficult it is to encompass support and to ensure equivalency of commitments by negotiating on spacific policies and measures. One has to deal with different and very sophisticated support systems which use a panoply of instruments. Further, if there is a commitment on one instrument, governments will inevitably be tempted to shift to other instruments not covered by commitments.

The Community considers it therefore imperative to develop an AMS-method which can be used as a negotiating instrument. This method should be used in the main agricultural sectors, others where support systems are less elaborate may be treated differently.

The SMU device proposed by the EC seems to be the most appropriate and the weaknesses and insufficiencies of the device referred to by other countries should be addressed in order to find appropriate solutions.

4. The fixed external reference price applied in SMU calculations eliminates the impact of, in particular, currency fluctuations during the pariod for which the same external price is applicable. It is therefore possible for a party to enter into commitments knowing precisely to what it is committing itself.

Since the purpose of a measurement should be to capture elements which would influence the farmer's decision to produce, any commitment should include a reference to unit SMU, expressed in the currency of the contracting party concerned. The unit SMU alone would, however, not capture the effect of variations of production levels in a country. In order to moderate the incentives to increase the total production any commitments should therefore also include a reference to total SMU.

The measurement would be made on a product by product basis.

- 5. The PSE estimates established by OECD divide the policy measures captured into the following groups:
 - market price support
 - direct payments
 - reduction of input costs
 - general services
 - sub-national and
 - other(1)

For the purpose of devising a negotiating instrument, it might be sufficient at this stage to limit the policy coverage of the SMU system to policies having the most significant impact on the farmer's decision to produce. These policies are especially those included under "Market price support" and "Direct payments" and represent the largest amount of support granted in agriculture. Other supports, in particular reduction of input costs, may also include measures which have a significant impact on the farmer's decision to produce and having a significant impact on trade. The final decision on policies to be captured by the SMU system, in particular concerning national and sub-national support, has therefore to be taken when the discussions of other issues in the negotiations have led to a conclusion.

⁽¹⁾ Shown in the MTN.GNG/NG5/TG/PSE series.

The section "Direct payments", also captures, however, diversion and disaster payments. Disaster payments do not influence the farmer's decision to produce when correctly applied. it would therefore be appropriate to exclude such payments from the SMU calculations. Diversion payments, which exclusively represent a direct and immediate compensation for the reduction of production factors, should as suggested by the European Community (doc. MTN.GNG/WG5/W/62) also be excluded from SMU calculations.

Annex I shows how SMUs are derived from the PSE data in accordance with the guidelines outlined.

It should be recalled that the European Community in doc. MTN.GNG/W5/W/82 has suggested that support measures which were not captured by the aggregate measurement, should be subject to monitoring.

6. The Trade Negotiations Committee agreed at its April meeting that credit will be given for measures implemented since the Punta del Este declaration which contribute positively to the reform programme. It would therefore be logical to establish SMUs from that year onwards. That year should therefore also be included when determining the fixed external reference price.

Taking into consideration previous discussions on this issue, the European Community suggests the fixed external reference price be calculated as the average of external prices for the years 1984, 1985 and 1986.

After the first period of bindings the level of the fixed external reference price may be reconsidered if movements of world market prices so justify.

- 7. Supply control measures have received special attention during previous discussions. The quantitative effects of such measures are caught by the total SMU but in an insufficient manner becaue it overstates an increase of prices without giving allowance for the effect of the production control. It is possible to find methods to that end e.g. by calculating shadow prices and production levels. If such a method is considered too complicated, it could be decided to grant credit by a specific amount for the period of binding before commitments were undertaken.
- 8. Some parties have expressed doubts as to the functioning of the SMU device in cases where domestic prices are following those of the world market. Higher world market prices could lead to increased SMUs although such increases were due to factors other than domestic policies.

This situation is not a real problem in circumstances in which the measurement is only used to cover "Market price support" and "Direct payments". The market price support gap would by nature disappear in such a case and the party concerned could discontinue any direct payments. The result would be that the party did not grant any SMU support and the domestic prices could hence follow the world market prices.

> The practical result for the farmers would be that their prices could correspond to world market prices as soon as the the fixed external reference price increased by the maximum SMU were lower than the world market prices.

9. The SMU device has been criticized because of shortcomings as regards border measures. While the SMU cannot automatically be transposed into an import charge or an export subsidy, this does not exclude that unit SMUs are used as a core element when dealing with such measures.

The unit SMU may, in addition to expressing a support level, indicate the gap between an internal and external price level. That amount could therefore also be used as an element when measuring import protection and export subsidy when allowance is made for, in particular, world market price fluctuations.

10. It has been suggested that since SMUs are established ex post a weakness exists with regard to adjustments or amendments of policy measures.

This should not be a major problem because the principal domestic decision which will influcence the level of unit SMUs concerns the domestic prices. When determining domestic prices, the decision-taking authorities will be able to judge rather easily the consequences as regards changes of the SMU level and the other policy instruments to be applied will to a great extent be those which are described in Annex II. In addition, a monitoring procedure as outlined by the European Community in doc. MTN.GNG/TG5/W/45 would provide for the possibility of keeping track of events.

- 11. In Annex II, the European Community has calculated the SMUs for wheat for a number of countries. The data used are those applied by OECD but only the following policy measures are taken into consideration:
 - market price support
 - direct payments.

However, disaster payments and payments which exclusively represent a direct and immediate compensation for the reduction of the use of production factors have been excluded from "direct payments".

Finally, Annex II gives a short description of the main policy measures applied in the country concerned.

ANNEX I

Examples showing calculations of support in the EC and USA measured by SMUs

- 1. The raw data used in the examples are those established by OECD. These data may differ slightly from those shown in doc. MTN/GNG/NG 5/TG/PSE/ EEC/1 and USA/1 because OECD has prepared a revised version.
- 2. The average of the external prices applied in 1984, 1985 and 1986 is used as fixed external reference.

For the EC the external reference prices during those years were as follows / 1984 : 175,1 ECU/t, 1985 : 119,8 ECU/t and 1986 : 75,4 ECU/t.

In the USA the external reference price is equal to the internal producer price, reduced by the amount resulting from EEP. Since the EEP did not operate in 1984 the internal producer price has been used as external reference price for that year. The external reference prices are hence as follows : 1984 : 124,0 \pm , 1985 : 110,1 \pm , 1986 : 80,6 \pm .

Examples

Year 1986	EEC 12		USA	
Producer price	182,0	ECU/t	88,0	\$/t
Direct payments	-0,5	ECU/t	70,4	\$/t
Gross amount	181,5	ECU/t	158,4	\$/t
External reference price	123,4	ECU/t	105,0	\$/t
Unit SMU	58,1	ECU/t	53,4	\$/t
	17 31 81 (R 22			
Production Mio t	64,8		56,8	
Total SMU	(64,8 .	58,1)	(56,8 .	53,4)
	3.764,9		3.033,1	
	MIO Ecu		MIO \$	

ANNEX 11

1. EEC(*)

a) Trends in PSE

Year	Total PSE BIII ECU	Index	Unit PSE ECU/t	Index	External reference price ECU/t	Index
1984 1985 1986 1987 1988	1,5 4,1 7,5 7,6 4,2	- 100 101,1 55,4	22,0 68,9 116,3 118,3 61,1	18,9 59,3 100 101,7 52,6	175,1 119,8 75,4 66,6 122,1	232,2 158,9 100 88,3 161,9

b) Trends in SMU

Year	Total SMU BIII ECU	Index	Unit SMU ECU/t	Index	External reference price ECU/t
1984 1985 1986 1987 1988	4,4 3,3 3,8 3,3 3,3 3,3	- 100 87 89	62,6 54,6 58,1 50,7 49,0	108 94 100 87 84	123,4 123,4 123,4 123,4 123,4 123,4

c) Production volume and adjusted producer prices

Year	Production mio t	Index	Adjusted producer prices ECU/t	Index
1984 1985 1986 1987 1988	70,2 60,1 64,8 64,4 68,3	- 100 99,4 105,4	185,8 177,8 181,6 174,1 172,4	102,3 97,9 100 95,9 94,9

Notes: Index: 1986 = 100 Adjusted producer prices include payments under section "Direct payments" in doc MTN.GNG/NGS/TG/PSE/EEC1. (For the EC this means that co-responsibility levies are deducted).

(*) (The years 1984 and 1985 cover EEC 10; the subsequent years cover EEC 12)

Policy measures

The intervention price (expressed in ECU) was reduced in 1985/86 and again in 1986/87 for feed wheat, but has remained unchanged during the following years. Other decisions affecting the internal prices have, however, been adopted. In particular, the introduction of co-responsibility levies has instigated price fails. Also the fact that the buying-in price of cereals is no longer the intervention price but only a specific percentage thereof, has led to price decreases. Finally, the intervention system has been alleviated, in particular as regards the period when intervention is open and as regards the market conditions triggering off the intervention.

The SMUs also take into consideration the guarantee threshold for cereals of 160 Mio tonnes (all cereals combined) introduced in 1988 as well as the effect in production levels resulting from the recently introduced set aside and extensification programmes.

2. USA

a) Trends in PSE

Year	Total PSE BIII \$	Index	Unit PSE \$/t	Index	External reference price \$/t	Index
1984	3,5	62,2	49,4	50,0	124,0	153,8
1985	4,0	70,9	60,4	61,0	110,1	136,6
1986	5,6	100	98,9	100	80,6	100
1987	5,4	96,2	94,3	95,4	70,9	88,0
1988	3,1	55,7	63,5	64,2	122,6	152,1

b) Trends in SMU

Year	Total SMU BIII \$	Index	Unit SMU \$/t	Index	External reference price \$/t
1984	2,6	86	37,0	69	105,0
1985	2,4	79	36,3	68	105,0
1986	3,0	100	53,5	100	105,0
1987	2,5	83	43,8	82	105,0
1988	2,6	96	53,1	99	105,0

c) Production volume and adjusted producer prices

Year	Production mio t	Index	Adjusted producer prices \$/t	Index
1984	70,7	124,5	142,2	89,8
1985	66,0	116,2	141,5	89,3
1986	56,8	100	158.4	100
1987	57,3	100,9	149,2	94,2
1988	49,3	86,8	158,0	100

Notes: Index: 1986 = 100

Adjusted producer prices include payments under section "Direct payments" in doc. MTN.GNG/NGS/TG/PSE/USA1, except for diversion payments and disaster payments.

Policy measures

The target price has remained unchanged from 1984 to 1987. However, measures related to the target price system has led to the result that not all farmers have obtained the target price for their products even though the number of farmers benefitting from the scheme have steadily increased.

In order to participate in the target price program, the farmers had in 1984 and 1985 to set aside 20 % of their wheat area without compensation (acreage reduction program) and a minimum of 10 % and a maximum of 30 % as paid land diversion. In 1986 the respective figures were 22.5 % and a minimum of 2.5 % and a maximum of 12.5 %. In 1987 and 1988 the non-paid set aside was increased to 27.5 % and the paid set aside was no longer a condition for participation in the target price program and was not applied during those two years.

3. <u>Canaca</u>

a) Trands in PSE

Year	Total PSE BIII CAN\$/t	Index	Unit PSE CAN\$/t	Index	External reference price CAN\$/t	Index
1984	1,2	46,2	57,4	68,4	151,8	179,2
1985	1,7	63,8	69,1	82,4	116,5	137,5
1986	2,6	100	83,9	100	84,7	100
1987	2,2	83,2	84,4	100,6	88,9	105,0
1988	1,6	60,8	103,2	123,0	137,0	161,8

b) Trends in SMU

Year	Total SMU BIII CAN\$/t	Index	Unit SMU CAN\$/t	Index	External reference price CAN\$/t
1984	1,6	126	73,2	187	117,7
1985	1,3	107	54,0	138	117,7
1986	1,2	100	39,2	100	117,7
1987	1.2	94	44,8	114	117,7
1988	1,1	91	72,2	184	117,7

c) Production volume and adjusted producer prices

Year	Production mlo t	Index	Adjusted producer prices CAN \$ /t	Index
1984	21,2	67,6	190,5	121,8
1985	24,3	77,4	171,2	109,5
1986	31,4	100	156,4	100
1987	26,0	82,7	162,5	103,9
1988	15,5	49,4	189,9	121,4

Notes: Index: 1986 - 100

Adjusted producer prices include payments under the section "Direct Payments" in doc. MTN.GNG/NG5/TG/PSE/CAN/1, except for disaster payments.

Policy measures

The Canadian Wheat Board is operating a delivery quota system. The openess of the quota varies from season to season. The transport subsidy (crow rate) has increased during the period under consideration. This is due to the fact that both the unit amount of subsidy and the production have increased. The domestic minimum price for bread wheat was higher than the export price in 1985 and 1986 and triggered off a compensatory payment from the government (two price wheat).

The Western Grains Stabilisations Act (WGSA) essentially guarantees the net cash flow at a level not below the previous five-year average. Since the world market prices have fallen considerably during the period examined, the support under this act has more than doubled from 1984 to 1986. In addition to this system, in 1987 Canada introduced the Special Grains Programs (SCGP) in order to cushion farmers from the effects of falling world prices by offsetting income losses. In 1986/1987 the payment under this program was more or less at the same level as payments under WGSA. The SCGP program will not apply in 1988 because of higher world prices and the two price wheat system is being phased out for the 1988/1989 crop year, with one year income compensation for producers. The remaining support programs are thus the crow rate and the WGSA.

The total SMU for subsequent years is thus influenced by decisions as regards the delivery quota, the crow rate and the WGSA payments.

4. Japan

Total PSE BIII YEN	index	Unlî PSE 1000 YEN/t	Index	External reference price 1000 YEN/t	Index
46,6	80,8	197,9	95,6	41,3	187,7
70,7	94,1	195,3	94,4	36,6	166,4
81,3	100	207,0	100	22,0	100
69,9	93,7	196,7	95,0	21,3	96,8
80,4	99,5	176,7	85,4	26,5	120,5
	Total PSE BIII YEN 46,6 70,7 81,3 69,9 80,4	Total index PSE BIII YEN 46,6 80,8 70,7 94,1 81,3 100 69,9 93,7 80,4 99,5	Total index Unit PSE PSE PSE BIII 1000 YEN/t 46,6 80,8 197,9 70,7 94,1 195,3 81,3 100 207,0 69,9 93,7 196,7 80,4 99,5 176,7	Total index Unit Index PSE PSE PSE 1000 YEN YEN/t YEN/t 1000 46,6 80,8 197,9 95,6 70,7 94,1 195,3 94,4 81,3 100 207,0 100 69,9 93,7 196,7 95,0 80,4 99,5 176,7 85,4	Total index Unit Index External PSE PSE 1000 reference price Bili 1000 YEN/t 1000 YEN/t 1000 YEN/t 46,6 80,8 197,9 95,6 41,3 70,7 94,1 195,3 94,4 36,6 81,3 100 207,0 100 22,0 69,9 93,7 196,7 95,0 21,3 80,4 99,5 176,7 85,4 26,5

a) Trends in PSE

b) Trends in SMU

Year	Total SMU BIII YEN	Index	Unit SMU 1000 YEN/t	Index	External reference price 1000 YEN/t
1984	106,2	78,8	151,7	101,3	33,3
1985	136,5	101,2	151,7	101,3	33,3
1986	134,8	100.	149,7	100	33,3
1987	126,6	93,9	140,7	94,0	33,3
1988	132,7	98,4	132,7	88,6	33,3

c) Production volume and adjusted producer prices

Year	Production mic t	Index	Adjusted producer prices 1000 YEN/t	Index
1984	0,7	84,6	185	101,0
1985	0,9	99,8	185	101,0
1986	0,9	100	183	100
1987	0,9	98,6	174	95,1
1988	1,0	116,6	166	90,7

Notes: Index: 1986 = 100

Adjusted producer prices are equal to the producer prices in Japan because no Direct payments" are granted (Japan grants diversion payment but they are excluded from the SMU calculations).

Policy measures

Domestic prices for wheat are set by the government. The prices show a decrease during the period considered.

In addition, Japan applies a set aside program for which the costs are fairly stable. To reduce total SMU level Japan would therefore have to reduce the domestic prices and/or extend the set aside program.