FAO TRADE POLICY BRIEFS
on issues related to the WTO negotiations on agriculture

No. 9. A SPECIAL SAFEGUARD MECHANISM for developing countries

SUMMARY

- *The July 2004 WTO Framework Agreement foresees a Special Safeguard Mechanism (SSM), to protect against depressed import prices and import surges for agricultural products, that is available to all developing countries. The SSM would in principle be applicable to all products. However, limits on the number of products for which a country can simultaneously apply additional duty under the SSM could be applied to prevent abuse.*
- *Simplicity and flexibility would be desirable features of the SSM to allow its effective use, while ensuring it is not abused as a permanent protection instrument.*
- *The SSM would benefit from the inclusion of both price and volume triggers. However, if used as a basis for triggers in the SSM, the price and volume formulae in the current agricultural special safeguard (SSG) would need simplification, with removal of the biases against lower-income economies in the current volume SSG.*
- *Agreeing that the SSM would consist of an initial application of a safeguard for up to one year, followed by a maximum of two sequential applications, would provide a link between how often the SSM can be triggered for a product and the length of a depressed price period, which averages about three years for most products. After the SSM has been triggered up to three times for one product, a restriction placed on its further application during an agreed period of time would ensure that it is not used as a more permanent protection measure.*

Negotiation of the Special Safeguard (SSG) during the Uruguay Round (UR) took place amid fears that tariffication could make countries more vulnerable to market instability, depressed import prices, and import surges that might damage agricultural production. In the current Doha Round, countries are negotiating to reduce bound tariff rates further, thus limiting the option that developing countries have to raise applied tariffs to prevent or offset the damage of sudden import increases or world price depressions.

Vulnerability to external commodity shocks particularly concerns developing countries, and a new Special Safeguard Mechanism (SSM) is under negotiation for all developing countries to allay fears of the diminished flexibility implied by a narrower gap between bound and applied tariffs. The challenge is to design an SSM that is simple to use and effective, but not open to abuse. This Policy Brief reviews the key parameters for negotiation and a number of options in the design of an SSM.[1]

The design of the SSM is likely to be based on the existing SSG. This SSG is only available to 22 developing countries, of which only six used it during 1995-2004. These countries triggered 163 SSGs, which is only 1 percent of the cases (tariff lines and years) on which SSGs could have been

[1] Technical arguments supporting the options set out in this brief are more fully explained in the associated FAO Trade Policy Technical Note No. 9. http://www.fao.org/trade/policy_en.asp

applied between 1995 and 2004. Individual country level utilization rates were also small: for example, the Republic of Korea used it for only 7 percent of the eligible cases, Nicaragua 2.4 percent, Costa Rica 1 percent and the Philippines 0.8 percent.

The SSG appears to be neither simple nor flexible enough for effective use, and applying it involves considerable administrative costs. Other reasons for the limited use may be that although import prices fell and/or imports surged, no response was necessary because it was determined that these would not seriously damage the domestic agriculture sector. Also, it may be that the bound tariffs were high enough to allow increases in applied tariffs to offset depressed import prices and surges. Many countries followed this approach, in particular during 1998-2000, when world market prices of several basic foods declined sharply. Other countries have been unable to increase applied tariffs towards bound rates due to loan conditionalities; Ghana is a recent example.

1 Eligibility for an SSM

COUNTRY ELIGIBILITY

The Framework Agreement does not limit the SSM to particular developing countries. The justification for this is due to difficulties in establishing eligibility, whether based on threshold levels of food insecurity or vulnerability, or levels of domestic support and bound tariffs.

PRODUCT ELIGIBILITY

Product eligibility could be determined on the basis of either: (a) multilaterally agreed, development-related criteria, (b) the depth of tariff cuts and/or the level of the bound tariff under a new agreement, (c) self-designation by WTO members with an agreed maximum number of products and/or tariff lines, or (d) access could be given to all tariff lines. There is a strong case for making the SSM accessible to all tariff lines if they meet the requirements to trigger the safeguard, as it is not likely to be feasible to negotiate objective criteria (e.g. food security) to identify products eligible for SSMs, or to agree on a fixed number of SSM products or tariff lines for self-designation. There is also a case to extend the SSM to cover products not produced in the country, but which are close substitutes for products that are domestically produced.

Some countries with a large, diversified agriculture may justify the need for the SSM to apply to many products, including similar or import-competing products not necessarily produced by them. Others with a small, less diverse agriculture may need access to an SSM for far fewer products. Critics of extending SSMs to all tariff lines fear its misuse, triggering many SSMs. However, SSG experience to date indicates that such concerns over extension of an SSM to all products may be unfounded.

2 Triggers

Under the current price-based SSG, the permitted additional duty depends on how much the import price falls below a trigger level. The SSM could be developed to respond to sharp, short-term price depressions but not to longer-term gradual, albeit cumulative, large price declines. The key parameter to ensure this is the reference price for triggering the safeguard. In the SSG of the UR, reference prices were fixed at the average 1986-88 import prices. For many products, current prices bear little relationship to the fixed reference prices of more than 15 years ago, so the method of determining reference prices may need to be revised. The chosen reference price could aim to avoid excessive interference with the world market by being set at low enough levels which, if reached would damage domestic producers. Periodic adjustments to the trigger prices could reflect possible long-term trends in commodity prices and allow a reasonable transmission of world price changes to the domestic market.

The formula for the current price SSG seems unnecessarily complicated. It should be possible to develop a simpler, single formula to replace the current five bands while maintaining the basic principle that the remedy (additional tariff) should depend on the level of price depression.

Under the volume-based SSG, the trigger volume derives from: a) actual imports averaged over the preceding three years; b) the share of imports in domestic consumption over the same period; and c) the absolute volume change in consumption for the latest year with available data. The trigger level is higher, the greater the level of the three-year average imports, the lower the share of imports in domestic consumption, and the faster the growth in domestic consumption. The maximum extra duty may not exceed 30 percent of the ordinary customs duty in effect in the year the SSG is invoked.

The volume-based SSG formula includes other variables in addition to the import volume, namely, consumption changes and the degree of market penetration, that make the formula complex and create biases against certain groups of countries. For example, the SSG formula implicitly rewards "openness" by using a scaling factor,[2] the value of which is smaller, the larger the share of imports in domestic consumption. The rationale for the new SSM, on the other hand, is often based on concerns such as food insecurity where further openness may not be appropriate at certain stages of development. There is a justification for avoiding this bias either by removing the scaling factor in the SSG formula, or changing it so that the SSM formula favours less open and potentially more vulnerable sub-sectors.

Similarly, a positive change in consumption in the preceding years raises the trigger level in the SSG and this lowers the chance of an SSG trigger. Although there is wide variation in agricultural consumption trends across countries, the formula may be biased against lower-income countries since their food consumption trends are typically positive because of population and income growth, whereas food consumption may be flat or even falling in richer countries. A formula meant for lower-income countries should not work to the disadvantage of economies where food consumption is growing. Safeguarding the competing domestic food sub-sector may be important from a food security perspective, irrespective of the positive trend in consumption, in view of the fact that the majority of the poor and hungry depend on agriculture for their livelihood.

Some analysts have argued that volume triggers should not be the basis of a safeguard policy. The reasoning is that that the damage to the domestic sector is not the result of import volumes as such, but in reduced net producer income related to a price decline. Where increases of import volumes do not lead to depressed prices, this hints at the existence of competitive sectors which may not require protection through additional duties.

However, there are concerns not addressed by a price trigger alone. For example, targeted export sales, with or without export subsidies, are often seen as a potential source of volume surges without necessarily depressed import prices. Where there are export subsidies, it is possible that an exporter may target a country or region for strategic trade reasons, incurring some losses from the sales but recouping them from the export subsidy. Such "predatory" trading behaviour can induce volume surges without necessarily depressing prices, and such possibilities support the need for volume triggers.

3 Remedy

In the UR SSG, the remedy is an additional ordinary tariff without provision for quantitative restrictions. In contrast, the general WTO trade remedy measures (anti-dumping, countervailing and emergency safeguards) allow quantitative restrictions. Thus the guidelines in Article 5.1 of the Safeguards Agreement may be relevant for the design of the SSM, including the design of the volume trigger, in case of agreement on use of quantitative restrictions.

The additional duty most appropriate for a particular combination of a country and commodity is likely to vary widely. The issue here is knowing the degree of vulnerability of the commodity or sub-sector. Aside from the special case of the Least-Developed Countries, it is virtually impossible to agree on vulnerability criteria. Analysis of the price depressions of agricultural commodity markets shows that the maximum price declines from trends are typically in the 30-50 percent range, and additional duties under the current rules are typically in the 10-15 percent range, which will generally be inadequate. If members agree that this remedy is inadequate, it is straightforward to modify the parameters in the price SSG formula to raise the level of additional tariff.

There are similar questions about a volume trigger: Is the maximum additional duty of one-third, currently allowed,

[2] The trigger level of imports is the product of the scaling factor and the average level of imports, plus the change in the level of domestic consumption. A detailed explanation of the formula and the value of the scaling factor under different circumstances is provided in FAO Trade Policy Technical Note No. 9.

adequate? It is worth considering whether the volume-related duty should vary with the level of the surge. For example, the remedy level could be progressively raised for three to four bands that characterise the level of the surge. Also it is important to clarify that "duty in effect during the year" should refer to the bound rate. This is particularly significant for developing countries because their applied tariffs are often well below the bound rates. A one-third maximum extra tariff from an applied rate could be very low and inadequate to protect an affected domestic sector from an import surge.

4 Duration of the SSM

The current duration of the SSG, i.e. until the end of the calendar year when the SSG is applied, appears appropriate, but there are other options to consider. For example, there is no reason why the end of the calendar year must be the end of the safeguard period. A particular safeguard could run for six, nine or twelve months from initiation, rather than end abruptly on 31 December irrespective of when it started during the year. Statistical or reporting considerations may be a problem in implementing and monitoring this option.

It is important to maintain the principle that "an SSM for a particular product may remain in place until the problem being addressed is over". For the price-based SSM, such a basis is the cycle of depressed world market prices. During the last few decades the typical length of a price slump for primary commodities was about three years. If the maximum SSM trigger is twelve months, this implies that the SSM for the same product should be triggered at most three times (the initial application and up to two extensions). Following these three years, a further three year period would follow, during which the safeguard cannot be triggered for that product. There is no similar guidance grounded on behaviour of the world agricultural markets for the volume trigger, but the same rule could apply – three triggers in a row, with three subsequent periods when the SSM cannot be used as a basis for applying additional duty on imports of the product.

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