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PREFACE

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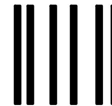

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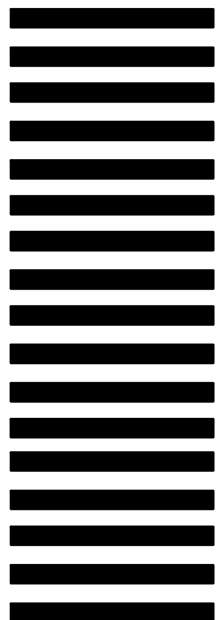

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U.S. Tobacco Quota Buyout: Issues and Analysis

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Plummeting domestic and international demand for U.S. leaf tobacco has led to a sharp reduction in U.S. production and farm receipts, resulting in an "unprecedented crisis" on the U.S. tobacco farming sector.[1] Since 1997, U.S. tobacco output has fallen by one-half, from 1.7 billion pounds to 844 million pounds in 2003,[2] whereas the value of production has declined from $3 billion to $1.6 billion over that period.[3] A variety of factors have led to the decline, including strong competition from low-cost international tobacco suppliers, a steady fall in domestic cigarette consumption, and technological advancements in cigarette manufacturing that use less and lower-priced tobacco per cigarette. The Federal tobacco price support program, which restricts U.S. output and prices from adjusting to current world market conditions has been a major contributing factor to the declining price competitiveness of U.S. tobacco. This article provides brief overviews of the U.S. tobacco industry and the Federal tobacco program, examines market factors that have made the Federal tobacco program unsustainable, and presents quantitative insights from partial equilibrium modeling. The analysis indicates that the elimination of the tobacco program likely would increase U.S. production and exports of U.S. leaf tobacco.

Author's note: On October 22, 2004, President Bush signed into law, HR 4520, The American Jobs Creation Act, that included a buyout of the Federal tobacco program. Under this law (PL 108357), the Federal tobacco quota and price support program will be terminated after the 2004 marketing year. Owners of tobacco marketing quota and farmers will be provided with buyout and transition payments estimated at $10 billion and funded by assessments on the tobacco products industry.

The Federal tobacco program was established to maintain high and stable prices for tobacco farmers by restricting output through a system of marketing (production) quotas to correspond with anticipated demand. Under this supply management system, production is set annually through quotas that specify the number of pounds of tobacco that can be produced by a tobacco farm.[4] In return for limiting production, farmers were provided support prices. Marketing quotas were allocated to farms in 1938 based on historical production levels. The right to produce and market tobacco conferred economic value to the quotas which, under certain rules, can be leased or rented. Today, over one-half of these quotas are held by nonproducing absentee owners.

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* The views expressed in this article are those of the author. They are not the views of the U.S. International Trade Commission (USITC) or of any individual Commissioner. The author is an international trade analyst in the Agriculture and Forest Products Division, Office of Industries.

Active tobacco farmers who do not own quotas or wish to plant and sell more tobacco than their marketing quotas allow, must rent or lease additional quotas. Currently, quota lease expenses account for as much as one-third of the price of tobacco, a significant cost to U.S. tobacco farmers. The rising cost of production for active farmers has been exacerbated in recent years as rental or lease costs have increased dramatically in response to falling demand. Moreover, while the number of U.S. tobacco farmers has contracted substantially since the price support program was established, the program encourages a large number of less-efficient farmers to continue producing.

The Federal tobacco program functioned as intended as long as U.S. tobacco could command premium prices based on superior quality; however, as low-cost foreign suppliers, particularly Brazil, improved the quality of their output, relatively high-priced U.S. tobacco steadily lost market share in the United States and in key export markets. The sharp decline in production since the mid 1990s brought the supply management system to the breaking point. A Presidential Commission established in 2000 to examine issues facing the U.S. tobacco-growing sector concluded that the U.S. tobacco program is no longer capable of providing sufficient income for the number of farmers and nonproductive quota owners who participate in the system.[5] The President's Commission recommended a buyout of the price support program coupled with U.S. Food and Drug Administration (FDA) regulation of tobacco products. The proposal–embraced by both tobacco farmers, whose income has dwindled in recent years, and absentee owners, who foresee their quota assets potentially becoming worthless if the program collapses–would eliminate the Federal tobacco program by compensating quota holders for the value of their marketing rights, and paying tobacco farmers to either transition out of tobacco farming or make substantial new investments to participate in a more competitive free-market environment.[6]

More than 90 percent of U.S. tobacco production consists of the flue-cured and burley tobacco varieties that combined with imported Oriental tobacco[7] are the basic tobacco ingredients of the *American blend* cigarette.[8] Flue-cured leaves are cured[9] by supplemental heat in enclosed barns.[10] In contrast to flue-cured tobacco, where only the leaves are cured, the entire burley stalk is hung in open-air barns for curing.[11] U.S. flue-cured and burley tobaccos have been regarded among the highest quality "flavor"[12] tobacco produced worldwide. Among the world's flue-cured producers, only the United States, Brazil, and Zimbabwe are significant producers and exporters of high-quality flavor tobacco. In recent years, the quality gap has narrowed markedly between U.S. flue-cured and its competitors' leaf. U.S. burley tobacco, however, is still regarded as the highest quality type produced worldwide, but other world suppliers are likewise improving their leaf quality.[13]

The U.S. Tobacco Price Support Program

Since the Great Depression, flue-cured and burley tobaccos have been produced under the supply management system of the Federal tobacco program administered by the Farm Service Agency (FSA) of the U.S. Department of Agriculture (USDA).[14] Under this program (box 1), subject to grower (quota holder) referendum every 3 years,[15] output is restricted in order to maintain market prices[16] above support level prices. The FSA sets the total quantity of flue-cured and burley tobaccos that can be produced and sold in each marketing year, to correspond with anticipated domestic and international demand. The annual supply (National marketing quotas) for each tobacco type is based on a formula of domestic cigarette manufacturers purchasing intentions, the preceding 3-year average of exports, and a reserve stock adjustment. The National quotas are then subdivided among quota holders apportioning the number of pounds/acreage corresponding to the quantity of flue-cured and burley tobaccos that can be sold during the annual marketing season.[17]

Box 1
Basic features of the U.S. Federal tobacco program

Background
- Established in 1938 to maintain high and stable prices for tobacco farmers.
- Program must be approved by referendum every 3 years.

Supply Management
- Farmers limit the amount of tobacco they will produce and market in return for price support.
- Production is restricted through marketing quotas (rights to produce and sell), which are allocated to each farm.
- The national marketing quota is set by the U.S. Department of Agriculture's (USDA), Farm Service Agency, and is based on cigarette manufacturers purchasing intentions, a 3-year weighted average of exports, and a stock adjustment factor.
- Transfer of quota is restricted: the flue-cured quota can only be sold or leased through the farm on which the quota is assigned.
- The burley quota may be sold or leased to other growers within the same county. Since 1991, growers in Tennessee have been allowed to transfer quota across county lines.

Price Support
- Minimum support prices are applied to USDA graded tobacco based on type and quality.[1]
- Tobacco that is not purchased at the support price may be delivered to grower cooperatives in return for nonrecourse commodity loans.
- Nonrecourse loans are provided by the USDA, Commodity Credit Corporation which contracts with the cooperatives to administer the price stabilization programs. Cooperatives process, store, and market all tobacco under loan.
- The program operates on the basis of no-net-cost to the Government.[2] Assessments are charged to buyers and sellers for all tobacco marketed in the United States including imported tobacco.
- Fees cover the costs of processing and storage of the tobacco and any shortfalls when the cooperative sells the tobacco it has stored under loan.

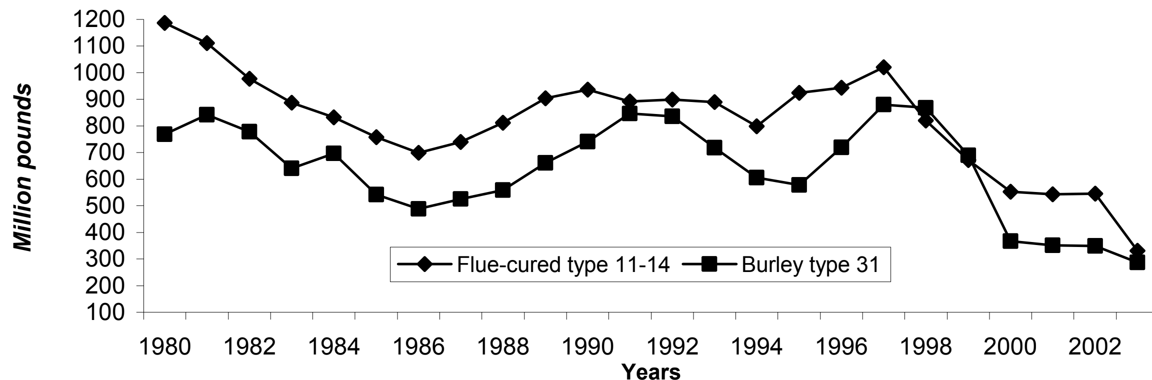
[1] Quality is determined by stalk position, color, aroma, consistency, and other factors.
[2] Some administrative costs of the program are included in the USDA budget.

Sources: U.S. Department of Agriculture, Farm Services Agency, Fact Sheets Burley Tobacco, *2002 Support Program and Related Information*, Mar. 2003; U.S. Department of Agriculture, Farm Services Agency, Fact Sheets Flue-cured Tobacco, *2002 Support Program and Related Information*, Mar. 2003.

When the Federal tobacco program was initiated in 1938, only active farmers held marketing quotas. Today, more than 60 years later, a substantial portion of marketing quotas are held by nonproducers, such as retired farmers, farm widows, nonfarming heirs of quota owners, and purchasers of land with assigned quota. In 2002, the U.S. national flue-cured quota comprised 36,850 individual flue-cured quotas, with owners estimated to number between 25,000 to 30,000.[18] Of these quota holders, only between one-third and one-half reportedly are estimated to be active farmers.[19] Similarly for burley leaf, which is planted on much smaller parcels, there were 224,308 quotas held by an estimated 170,000 quota holders in 2002. Active burley farmers are estimated to possess only between 45 to 50 percent of the total burley quota.[20]

The erosion of demand for U.S. flue-cured and burley tobaccos has had a dramatic effect on the National flue-cured and burley marketing quotas. Since 1997, the effective quota[21] for flue-cured tobacco fell by 46 percent, and the effective quota for burley tobacco dropped by over 60 percent (figure 1). Tobacco farmers needing to maintain incomes and cover substantial fixed-cost investments, including new equipment required by cigarette manufacturers,[22] have been compelled to acquire additional quotas to compensate for the falling levels that each quota allows them to produce and market. This cost-squeeze

Figure 1
Flue-cured and burley tobacco: National marketing quotas, 1980-2003[1]



[1]Effective quota, includes basic quota plus carryover.

Source: Compiled from official statistics of the U.S. Department of Ariculture, (USDA) Farm Service Agency, Tobacco and Peanuts Division; and USDA, Economic Research Service, *Tobacco Situation and Outlook* , Dec. 2003

has resulted in farmers bidding up the price of quotas to historic highs, and according to most industry observers, unsustainable levels.

Surveys of cooperative extension agents conducted by tobacco extension economists indicate that burley and flue-cured quota lease rates have increased sharply in response to the dramatic declines in the National marketing quotas.[23] In Tennessee, burley quota lease rates surged between 5- and 10-fold from an average rate between $0.05 and $0.10 per pound during most of the 1980s to over $0.50 per pound after 1999.[24] In Kentucky, average burley quota lease rates were reported to average an estimated $0.65 in 2002, more than doubling from the previous decade.[25] Although quota lease rates for flue-cured tobacco are less transparent than burley rates (because flue-cured quotas, unlike burley quotas, cannot be transferred from one farm to another), survey results suggest that lease rates also have escalated dramatically.[26]

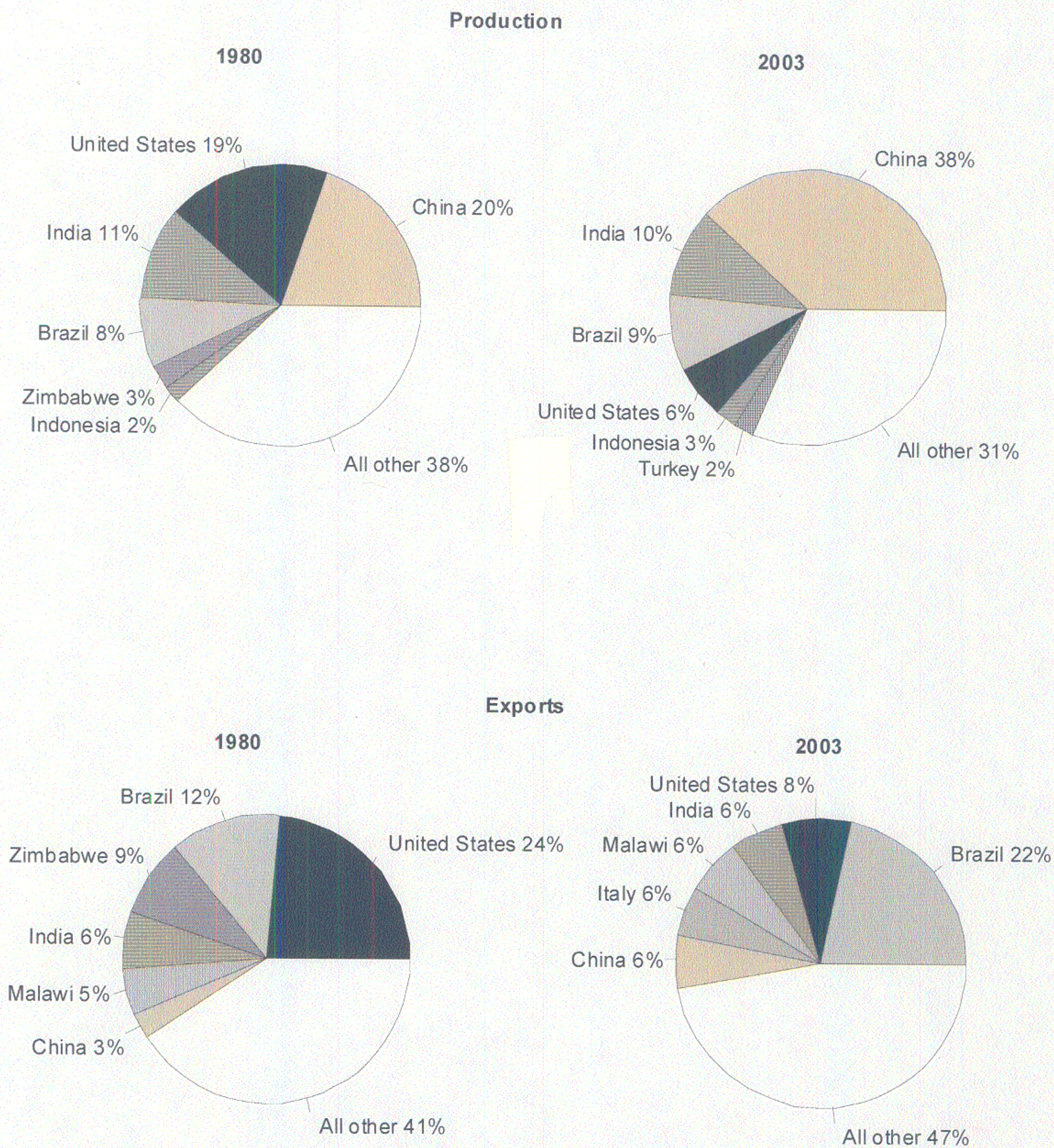
Another factor contributing to the substantial rise in marketing quota lease rates has been supplemental payments provided to U.S. tobacco farmers under a Master Settlement Agreement (MSA) between the tobacco products industry and state governments.[27] Under the MSA (phase II payments), U.S. farmers and absentee quota holders have received $5 billion.[28] In addition, market loss and disaster relief funds provided to farmers have totaled $1 billion since 1998.[29] Without this supplemental income, many growers and economists question the industry's ability to sustain such high lease rates. Moreover, according to a North Carolina State University (NCSU) economist, quota lease and rental prices have also risen on expectations that buyout payments and other farm payments related to the MSA may be linked to output.[30]

U.S. Tobacco Demand Factors

Trade and Competition

The deteriorating position of the U.S. tobacco growing industry relative to the rest of the world is illustrated by figure 2. In 1980, U.S. leaf represented nearly 1 in every 5 pounds of tobacco harvested globally; by 2003, the U.S. share accounted for just 6 percent of global output. Likewise, the United

Figure 2
Unmanufactured tobacco: Shares of world production and exports for selected countries, 1980 and 2003



Source: U.S. Department of Agriculture (USDA), Foreign Agriculture Service (FAS), Tobacco: World Markets and Trade, Table 1, FT-06-04, June 2004; and USDA, FAS, facsimile sent to USITC staff, recieved May 8, 2003.

States was once the worlds' dominant tobacco exporter, supplying one-quarter of world exports in 1980, but its share declined to 8 percent in 2003. During 1999-2003, U.S. exports of flue-cured and burly tobacco have trended downwards (table 1). U.S. flue-cured exports to Japan, one of the largest U.S. markets for flue- cured leaf, fell by more than one-half during the period as Japanese manufacturers began to import tobacco from lower-cost alternative suppliers. U.S. burley exports declined by more than 11 percent during 1999-2003, with exports to European Union markets falling by over one-third. Not only did U.S. tobacco lose market share abroad, but demand in the domestic market also contracted as U.S. cigarette manufacturers increasingly switched to lower-priced imported tobacco. U.S. tobacco imports more than doubled during the early 1990s, before moderating by the end of the period.

Table 1
U.S. exports: Flue-cured and burley tobacco to selected markets, 1999-2003[1]

Market	1999	2000	2001	2002	2003	Percent change 1999-2003
	metric tons					
Flue cured tobacco:						
European Union	36,745	39,893	47,078	31,758	40,474	10
Japan	16,914	18,916	16,028	12,650	8,139	-52
Other	22,723	26,978	24,613	27,016	20,383	-10
Total	76,382	85,787	87,719	71,424	68,996	-10
Burley tobacco:						
European Union	30,915	17,288	25,226	21,535	19,355	-37
Japan	5,773	6,267	4,948	5,571	5,912	2
Other	8,482	11,948	11,057	11,950	14,833	75
Total	45,170	35,503	41,231	39,056	40,100	-11

[1] Schedule B subheadings: flue-cured stemmed and stripped, 2401.20.80.10; and burley stemmed and stripped 2401.20.80.20.

Source: Compiled from official statistics of the U.S. Department of Commerce.

Strong competition from other world tobacco suppliers has been a significant reason for the decline in U.S. tobacco exports. U.S. leaf, once the world's preeminent flavor tobacco, no longer has the market power to command high price premiums relative to other suppliers. Flavor and semiflavor tobacco-producing countries such as Brazil, Zimbabwe, Malawi and Argentina have narrowed the quality gap and are producing good-quality tobacco at much lower prices (table 2). Grower prices in Brazil and other countries may be understated as farmers reportedly receive support on inputs such as fertilizer and seeds;[31] however, even accounting for any such distortion in prices, U.S. leaf is still significantly more costly than tobacco from other world suppliers.

Table 2
Flue-cured and burley grower prices: Selected world producers, 2001- 2003

Country	Flue-cured			Burley		
	2001	2002	2003[1]	2001	2002	2003[1]
	Dollar/kilogram (*farm weight*)					
United States	4.07	4.11	4.03	4.35	4.36	4.32
Brazil	1.16	1.18	1.19	1.04	1.12	1.01
Zimbabwe	2.59	2.12	2.15	([1])	([1])	([1])
Malawi	1.87	1.86	1.60	1.10	1.14	1.13
Argentina	1.18	0.83	1.16	1.09	0.66	1.12

[1] Not available.

Source: Universal Leaf Tobacco Co., *Supply & Demand*, Sept. 2002 and Aug. 2003.

Among international tobacco suppliers, Brazil has supplanted the United States as the world's leading tobacco producer and exporter of flavor and semi-flavor tobacco.[32] From 1990 to 2003, Brazil's flue-cured production, its largest tobacco crop, more than doubled.[33] As exports of U.S. leaf declined steadily over the last 2 decades to just over 400 million pounds in 2003, shipments from Brazil rose by 150 percent to over 1 billion pounds (figure 3). Although Brazilian exports trended slightly downwards in 2003, expanded planting and increased yields are expected to increase Brazilian tobacco output substantially (by 40 percent) in 2004 with exports forecast to reach over 1.6 billion pounds.[34] The development of Brazil's tobacco industry and certain other tobacco exporting countries has been facilitated by a handful of international tobacco dealers, many based in the United States, that have sought to diversify their sources of supply in order to provide the international tobacco industry with a wide variety of tobacco qualities at various prices.

In addition to strong competition from low-cost international suppliers, an important factor limiting U.S. tobacco exports is their concentration in just a few high-income markets, particularly Japan and the EU. In 2003, nearly two-thirds of U.S. flue-cured and 70 percent of U.S. burley exports were shipped to these high-income mature markets, which also are experiencing declining rates of cigarette consumption similar to the United States. In addition to requiring less tobacco as consumption falls, cigarette manufacturers in these markets are increasingly turning to lower-cost international tobacco suppliers. For example, the quantity of U.S. flue-cured tobacco exported to Japan declined by 75 percent over the last decade,[35] and in 2002, Japan reportedly imported tobacco from Brazil for the first time.[36] In most other nontraditional tobacco markets, importers are very price sensitive, and tend not purchase relatively expensive U.S. leaf. Consequently, the growth potential for U.S. tobacco exports to new markets where smoking rates are not declining is limited.

Cigarette Consumption and Manufacturing Trends

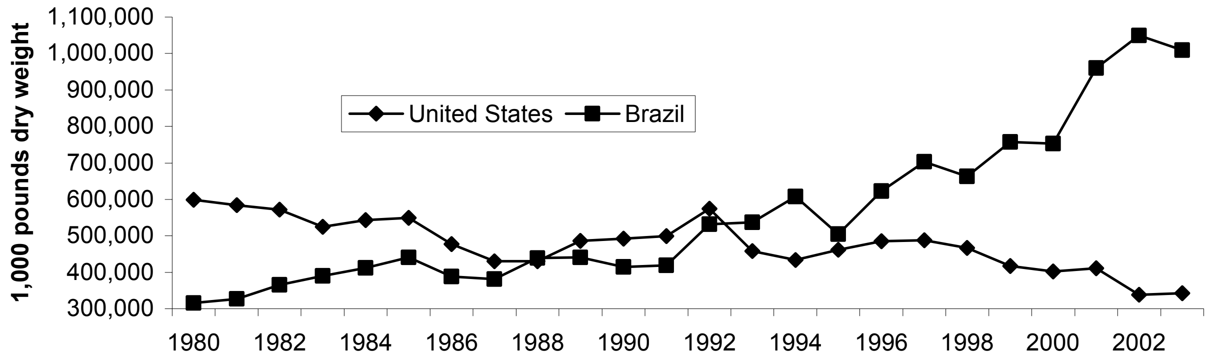
The decline in U.S. cigarette exports also has negatively affected demand for U.S.-produced tobacco. Although the United States still remains the world's leading exporter of cigarettes, U.S. exports have steadily declined since reaching their peak at over 200 billion units in 1996 (figure 4). U.S. exports have decreased to just over 100 billion units in 2003 and manufacturers are increasingly using higher proportions of more economical imported leaf combined with domestic tobacco, thus, further limiting demand for U.S. leaf tobacco.

In addition, declining U.S. cigarette consumption has been an important factor affecting the U.S. tobacco growing industry. By most measures, U.S. cigarette consumption has declined significantly during the last 2 decades. Since 1980, total domestic consumption of cigarettes fell by 200 billion units, a drop of one-third during 1980-2003. Per capita cigarette consumption similarly declined, falling from just under 4,000 cigarettes per adult in 1980, to roughly 1,900 in 2003.[37] Further, the percentage of the U.S. population that smokes has also decreased, from well over one-third of the population in 1980 to about 23 percent in 2001.[38]

Declining rates of U.S. cigarette consumption can be attributed to a variety of factors such as overwhelming scientific evidence that smoking causes disease,[39] increasing restrictions on cigarette marketing, prohibitions on smoking in public places, and a steep increase in cigarette prices. Rising cigarette prices are viewed by both the cigarette industry and antismoking advocates as having a critical dampening effect on smoking rates. During the last 2 decades, the average U.S. price for a pack of cigarettes increased 5-fold, rising from $0.60 in 1980 to $3.65 in 2002.[40] Increased state and Federal excise taxes, and manufacturer price increases, have contributed to the escalation of cigarette prices.[41]

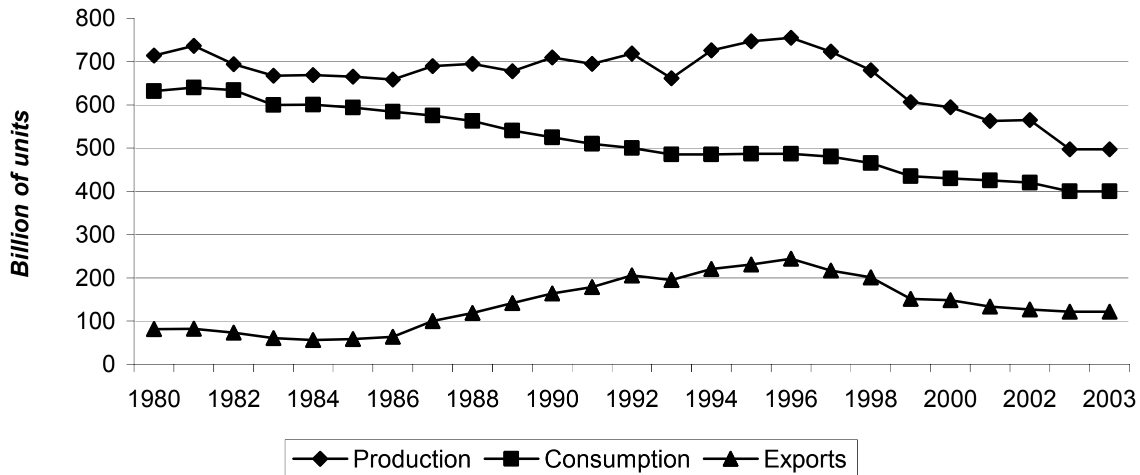
Cigarettes are one of the most highly taxed consumer products in the United States. During the last decade alone, Federal taxes increased by 62 percent to $0.39 per pack, generating revenues over $6 billion.[42] State

Figure 3
Unmanufactured tobacco: U.S. and Brazilian exports, 1980-2003



Source: U.S. Department of Agriculture (USDA), Economic Research Service (ERS), U.S.Tobacco Statistics, table 165: World tobacco leaf exports, selected countries, d-95, found at http://www.ers.usda.gov/data/sdp/view.asp?f=specialty/94012/, retrieved June 8, 2004; USDA, ERS, Tobacco Situation and Outlook, table 31: U.S. and world production and exports of flue-cured, burley, and all unmanufactured tobacco, 1955-99, TBS-248, Dec. 2000, pp. 43-44; USDA, ERS, Tobacco Situation and Outlook, table 9: U.S. exports of unmanufactured tobacco by types and to principal importing countries, TBS-2003, Dec. 2003, p. 25; USDA, Foreign Agriculture Service (FAS), Tobacco: World Markets and Trade, table 1: World's Leading Unmanufactured Tobacco Producing, Trading and Consuming Countries, FT-06-04, June 2004; and USDA, FAS, Tobacco: World Market and Trade Archives, table A: World Leaf Exports by Exporting Country, FT-12-00, Dec. 2000, found at http://www.fas.usda.gov/tobacco_arc.html, retrieved June 8, 2004.

Figure 4
Cigarettes: U.S. production, consumption, and exports, 1980-2003



Source: U.S. Department of Agriculture (USDA), Economic Research Service (ERS), *Tobacco Situation and Outlook* , table 1: Cigarettes: U.S. output, removals, and consumption, TBS-2003, Dec. 2003, p. 18.

excise taxes have also risen markedly, more than doubling in the last 10 years to an average of $0.71 per pack in 2003.[43] During 2002 and 2003, 26 states raised cigarette excise taxes,[44] which ranged from a low of $0.03 in tobacco-producing Kentucky to a high of $2.05 in New Jersey.[45] Sixteen states impose taxes of $1.00 per pack or more. Local jurisdictions, including cities and counties also levy cigarette excise taxes. New York City, for example, boosted its cigarette tax from $0.08 per pack in 2002 to $1.50, making the average retail pack of cigarettes cost $7.00. The twin goals of raising much needed revenues, while discouraging cigarette consumption, have made raising cigarette taxes an attractive policy instrument for state governments and local jurisdictions.

Cigarette manufacturers have also contributed to the rising price of cigarettes, particularly after 1998, due in part to fund the multibillion dollar MSA with state governments.[46] Between, June 1990 and April 2002 (latest available), manufacturers increased wholesale cigarette prices approximately 30 times,[47] with the price rising from $1.02 in 1990 to $2.76 in 2002 per 20 cigarettes.[48] The combination of rising excise taxes and manufacturer wholesale price increases has led to a near doubling of the Consumer Price Index for cigarettes during the last 5 years.[49]

Recent technological advancements in tobacco leaf processing and cigarette manufacturing have also made lower-cost imported tobacco more competitive with higher-cost and relatively higher-quality U.S. tobacco. Technological advancements include innovative tobacco flavoring and blending techniques, and the use of highly sophisticated filler products called “blend enhancers.”[50] Lower-cost imported tobacco is often used in these new blends and to produce these filler products, and “is considered an integral part of any quality and cost-effective American Blended cigarette.”[51] Consequently, the content of imported leaf in U.S. cigarettes has increased steadily, from 10 percent in 1960 to nearly one-half today. Moreover, whereas the classic American blended cigarette was composed of 80 percent flue-cured and burley tobaccos, cigarettes made with current manufacturing technology use as little as 53 percent of the leaf combined. Advances in cigarette manufacturing technology have not only affected the demand for U.S. leaf by domestic cigarette manufacturers, but have also contributed to declining U.S. tobacco exports as foreign manufacturers are using the same cost-saving manufacturing technologies.

Tobacco Program Elimination Model Simulation[52]

Eliminating the Federal tobacco program likely would lower the price of U.S. tobacco, making it more competitive in the United States and world markets. Quantitative insights from economic modeling suggest how U.S. output and trade likely would be affected if the program were eliminated.

A partial equilibrium model was used to examine the effect on U.S. flue-cured and burley production and trade from eliminating the U.S. Federal tobacco program, which is simulated by removing quota license fees from the costs of tobacco production. The removal of the licence fee is modeled as the removal of a production tax equivalent to the price gap (price wedge) generated by the licence fee, estimated to be 32 percent for flue-cured and 26 percent for burley.[53] As in Brown, Snell, and Tiller,[54] the sensitivity in demand to price changes (price elasticity of demand) for U.S.-produced flue-cured tobacco is assumed to be -0.9 for the domestic market and -3.0 for the export market. For U.S. burley tobacco, the price elasticities are assumed to be lower at -0.1 and -1.5 for domestic and export demand, respectively.[55] Price elasticities of demand are measures of price sensitivity, i.e. the percent change in quantity demanded when price changes by 1 percent. These demand elasticities were used along with the value of market shares in the base year of 2002 to derive the substitution and aggregate demand elasticities for flue-cured and burley tobacco. The modeling simulations also assume that the supply of flue-cured and burley tobacco in the long term is highly responsive to price changes (highly elastic), which is consistent with most industries, including the tobacco-growing sector.[56]

The modeling simulation results suggest that elimination of the quota rental fees (e.g. eliminating the Federal tobacco program) would lead to a significant fall in the market price of U.S. flue-cured tobacco, and to a lesser extent, burley tobacco. The price of flue-cured would be anticipated to drop by 24 percent, while the price of burley would be anticipated to decline by 20 percent (table 3). Prices paid to growers (producer prices), however, would remain relatively unchanged according to the modeling simulations, owing to the assumption that tobacco producers are highly responsive to changes in price.

Table 3
U.S. flue-cured and burley tobacco: Anticipated economic results based on modeling simulations of quota license fee elimination from the 2002 baseline

Item	Flue-cured	Burley
	Percent change	
Market price	-24.0	-20.5
Producer price	0.3	0.1
Production	25.9	11.2
Domestic shipments	21.6	2.0
Exports	71.9	30.7
Imports	-52.7	-36.0

The modeling results suggest that for flue-cured tobacco, the quantity produced would increase by 26 percent from the 2002 baseline level. Domestic shipments would rise by 22 percent in quantity to meet higher demand from U.S. cigarette manufacturers because of the lower relative cost of U.S. flue-cured tobacco compared to imported leaf. The model results indicate that imports of flue-cured would fall by one-half as domestic cigarette manufacturers would replace some imports with more competitively priced domestically produced flue-cured. The drop in the market price of U.S. flue-cured would also make U.S. tobacco more competitive in price-sensitive world markets, such that the quantity of flue-cured exports would expand by an estimated 72 percent from the baseline 2002 level.

Demand for burley tobacco is less responsive to price changes compared with flue-cured tobacco because it maintains a higher quality premium in the United States and world markets. Therefore, the changes from the baseline case are less dramatic. The model simulation suggests that the quantity of U.S. burley production would increase by 11 percent. However, because domestic demand for burley tobacco is less sensitive to changes in price (e.g. price inelastic), U.S. shipments to domestic cigarette manufacturers would increase by only 2 percent, resulting in an anticipated decline in imported burley of about 36 percent. Export markets for burley are also less price sensitive than flue-cured because of the quality premium. Consequently, although the quantity of U.S. exports of burley would rise by nearly one-third, the magnitude in export growth likely would be less than one-half the anticipated export growth for flue-cured tobacco.

The model examines U.S. tobacco production and trade as a whole and does not specifically examine the variable cost structures of individual growers. It therefore does not provide implications on the number or size of tobacco farms that would remain by terminating the Federal tobacco program. However, assuming the price of U.S. tobacco approaches the marginal cost of production, many of the less-efficient farmers would be expected to exit the industry. Under a free market scenario, tobacco growing would likely shift away from high-cost production regions to lower-cost areas. Tobacco farm sizes would increase to take advantage of economies of scale, suggesting that consolidation would occur.[57] In addition, the modeling simulation only considers relative price changes and market shares. Other relevant factors are difficult to assess in this quantitative analysis, for example, in export markets such as Japan, which have begun to import tobacco from Brazil, cigarette manufacturers may continue to import lower-cost leaf from alternative suppliers, even with U.S. tobacco becoming more price competitive under a free-market scenario.■

ENDNOTES

1. President's Commission on Improving Economic Opportunity in Communities Dependent on Tobacco Production while Protecting Public Health, *Tobacco at a Crossroad, A Call for Action*, Final Report, May 14, 2001.
2. Thomas Capehart, U.S. Department of Agriculture (USDA), Economic Research Service (ERS), *Tobacco Situation and Outlook Yearbook*, Dec. 2003, table 29, p. 42.
3. USDA, National Agricultural Statistics Service (NASS) *Agricultural Statistics,* 1998 and 2003.
4. Marketing quotas are tied to the land. For more information, see the U.S. Tobacco Price Support Program section.
5. President's Commission on Improving Economic Opportunity in Communities Dependent on Tobacco Production while Protecting Public Health, *Tobacco at a Crossroad, A Call for Action*, Final Report, May 14, 2001.
6. Tobacco quota buyout legislation passed both the House of Representatives and Senate in the Summer of 2004. The buyout legislation, attached to a major tax restructuring bill, "The American Jobs Creation Act of 2004," HR 4520, passed out of conference committee and was signed by the President on October 22, 2004 and became Public Law 108357. Under the law, termination of the Federal quota and price support system will be accompanied by buyout payments to quota owners and transition payments to tobacco farmers over a 10-year period. Owners of quota will be compensated $7 per pound based on the 2002 marketing quota year. Tobacco farmers will also be compensated at a variable rate of between $3 and $1 per pound of quota during 2002-2004. The final buyout legislation did not include FDA regulation of the tobacco products industry. See Jasper Womach, summary of "Fair and Equitable Tobacco Reform Act of 2004" found at *http://www.house.gov/agriculture/info/fsc%20eti%tobacco%20Summary.pdf*, retrieved Nov. 11, 2004; and A. Blake Brown, "Summary of Tobacco Buyout in HR 4520," Oct. 11, 2004, found at *http://www.ces.ncsu.edu/depts/agecon/tobacco_econom/Buyout.html*, retrieved Nov. 4, 2004. For full text of HR 4520, Title VI "Fair and Equitable Tobacco Reform" see *http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=108_cong_bills&docid=f:h4520enr.txt.pdf*, retrieved Nov. 9, 2004.
7. Most Oriental tobacco used in American blend cigarettes originates from Turkey and to a lesser extent, the European Union (primarily Greece).
8. Includes the world's leading brand, Marlboro. Flue-cured tobacco is grown primarily in the sandy soils of the coastal and Piedmont areas of North Carolina and Virginia. Production of burley tobacco is centered in the limestone-rich soils of Kentucky and Tennessee.
9. Curing is the process which removes moisture from the tobacco plant.
10. Flue-cured tobacco derives its name from the traditional method of curing that relies on flues to circulate heat and remove smoke from the curing barn. U.S.-produced flue-cured is now cured with heat exchange technology to minimize the effects of carcinogenic tobacco-specific nitrosamines that were caused by the direct heat-source curing method. The addition of retrofitting barns with this expensive technology has added to the fiscal exposure of tobacco farmers in recent years.
11. Flue-cured is also produced in South Carolina, Georgia, and Florida. Burley tobacco is also grown in North Carolina, Virginia, Ohio, Indiana, West Virginia, and Missouri.
12. Flavor tobacco imparts taste and aroma characteristics to cigarettes and is contrasted with lower quality, filler-type tobacco.
13. Primary competitors are Brazil and Argentina, which produce flavor and semi-flavor quality burley tobacco.
14. This program is based on the first commodity support legislation enacted by Congress, the Agricultural Adjustment Act of 1933. The marketing quota and price support legislation was included in the Agricultural Adjustment Act of 1938 (P.L. 75-430). Jasper Womach, *Tobacco Price Support: An Overview of the Program*, Congressional Research Service (CRS) Report to Congress, updated June 10, 2004.
15. Over 90 percent of growers (quota holders) regularly vote in favor of restricting output in exchange for price support. Will Snell, U.S. Tobacco Grower Issues, presentation to the USDA, Agricultural Outlook Forum 2003, Washington, DC, Feb. 2003. As the quota production rights represent economic rents, owners of quota have a vested interest in voting for continuation of the program. A. Blake Brown, William M. Snell, and Kelly Tiller, *The Changing Political Environment For Tobacco - Implications for Southern Tobacco Farmers, Rural Economies, Taxpayers and Consumers*, presented at the Southern Agricultural Economics Association annual meeting, Memphis, TN, Feb. 2, 1999.

16. The traditional auction system has largely been replaced by direct contract production. Tobacco farmers are directly contracted by cigarette manufacturers and international leaf dealers. For both tobacco varieties, over 80 percent of production in 2003 was direct contracted.
17. Flue-cured tobacco marketing quotas are based on acreage-poundage quotas; burley tobacco marketing quotas are based solely on poundage quotas.
18. USDA, FSA staff, telephone interview by USITC staff, June 16, 2003.
19. Ibid.; and Linda F. Foreman, "Tobacco Farmers' Ownership and Rental of Tobacco Quota," special article, *Tobacco Situation and Outlook*, Sept. 2001, pp. 43-51.
20. USDA, FSA staff, telephone interview by USITC staff, June 16, 2003.
21. The effective marketing quota is the amount that producers can sell during the marketing year. It is the basic quota adjusted for over or under marketings during previous marketing seasons.
22. Tobacco farmers were required to invest in expensive new processing technology. Particularly for flue-cured tobacco, farmers were required to retro-fit curing barns with new heat-exchange technology as requested by cigarette manufacturers to reduce carcinogenic compounds created during the curing process.
23. The U.S. Government does not collect data on tobacco quota lease rates.
24. Kelly H. Tiller and Jennifer Brown, *Proposed Tobacco Quota Buyout Legislation: Effects on Tennessee Tobacco Farms*, presented at the Southern Agricultural Economics Association, annual meeting, Mobile, AL, Feb. 2-5, 2003.
25. Will Snell, "Average Kentucky Burley Quota Lease Prices," found at *http://www.uky.edu/Agriculture/TobaccoEcon/ slideshows/aug02ts0/aug02tso.ppt*, retrieved June 18, 2003.
26. A. Blake Brown, North Carolina State University (NCSU), e-mail message sent to USITC staff, July 29, 2003.
27. The 1998 MSA between the tobacco products industry and state governments was a multibillion dollar settlement of a lawsuit brought about by 46 state attorneys general to compensate each participating state for health care costs incurred from disease caused by tobacco products.
28. Phase II payments are funds paid by cigarette manufacturers and other tobacco products companies to tobacco producing states. These funds have been provided to active growers and quota holders as part of the MSA.
29. Jasper Womach, *Tobacco Quota Buyout Proposals in the 108th Congress*, CRS, Aug. 4, 2003.
30. A. Blake Brown, NCSU, interview by USITC staff, Washington, DC, July 1, 2003.
31. USITC staff telephone conversation with industry representative, Mar. 12, 2004.
32. China and India produce more tobacco, but most of this production is low-quality output for domestic consumption.
33. Universal Leaf Tobacco Corp., "Supply and Demand," Aug. 2002, found at *http://www.universalcorp.com/Reports/SelectReport.asp?ID=725&Menu=Tob*, retrieved July 16, 2003.
34. USDA, Foreign Agriculture Service (FAS), *Brazil Tobacco Products Annual 2004*, GAIN Report No. BR4010, July 2, 2004.
35. Compiled from official statistics of the U.S. Department of Commerce.
36. Thomas Capehart, USDA, ERS, "U.S. Tobacco Industry Responding to New Competitors, New Challenges," *Amber Waves*, Sept. 2003, p. 15.
37. For the population 18-years-and-older, USDA, ERS, Table 2, "U.S. cigarette consumption per capita by persons 18 years and older and pounds of tobacco used in cigarettes (including overseas forces), 1935-94," found at *http://www.ers.usda.gov/data/sdp/view.asp?f=specialty/94012/*, retrieved Sept. 17, 2004; and USDA, ERS, *Tobacco Situation and Outlook*, table 2, Apr. 23, 2003.
38. Latest available data. Median smoking prevalence for states and the District of Columbia. Smoking prevalence by state ranged from 13.3 percent to 30.9 percent. Compiled from official statistics of the U.S. Centers for Disease Control, found at *http://www.cdc.gov/tobacco/adultprv.htm*, retrieved July 10, 2003.
39. Cigarette manufacturers now acknowledge that cigarette consumption causes disease. Philip Morris, the largest U.S. and world cigarette manufacturer states that there is "overwhelming medical and scientific consensus that cigarette smoking causes lung cancer, heart disease, emphysema and other serious diseases in smokers. Smokers are far more likely to develop serious diseases, like lung cancer, than non-smokers. There is no "safe" cigarette." Philip Morris, found at *http://www.philipmorrisusa.com/-health,* retrieved June 10, 2003.
40. Inclusive of state tax but not local and sales taxes. 1980 data from "U.S. Historical Data, the Tax Burden on Tobacco, 1955-1997," found at *http://www.drugs.indiana.edu/drug_stats/cigtax_burden.html*,

retrieved July 10, 2003. Data on 2003 price per pack found at
http://tobaccofreekids.org/research/factsheets/pdf/0097.pdf, retrieved July 10, 2003.
41. Although the price of tobacco rose over the same period, tobacco's share of the final cost of cigarettes is estimated to be only about 2 percent. Tommy J. Payne, R.J. Reynolds Tobacco Holdings, Inc., testimony before the House Committee on Agriculture, July 24, 2003.
42. Tax Policy Center data found at
http://www.taxpolicycenter.org/taxfacts/excise/excise_type.cfm#Page2, retrieved July 15, 2003.
43. Thomas Capehart, USDA, ERS, *Tobacco Situation and Outlook*, Apr. 23, 2003.
44. National Association of State Legislatures, data from the National Association of Convenience Stores, found at *http://www.nacsonline.com/NACS/News/Daily_News_Archives/July2003/nd0703031.htm*, retrieved Aug. 12, 2003.
45. Federation of Tax Administrators, *State Excise Tax Rates On Cigarettes*, July 2003.
46. For a summary and full text of the agreement see CRS, Report for Congress,
http://www.ncseonline.org/NLE/CRSreports/Agriculture/ag-55.cfm, retrieved May 12, 2004.
47. USDA, ERS, *Tobacco Situation and Outlook*, table 4, Apr. 23, 2003.
48. Calculated with data from Thomas Capehart, USDA, ERS, *Tobacco Situation and Outlook*, table 4, Apr. 23, 2003.
49. The Producer Price Index rose over 70 percent during the same period. U.S. Bureau of Labor Statistics, CPI series Id: CUUR0000SEGA0, PPI Series Id: WPS1521.
50. These filler products include reconstituted tobacco, expanded tobacco, and cut-rolled expanded stems. "This trend in blending has allowed for optimum use of a wider range of leaf types and grades as well as maximum utilization of by-products-mixed stems, fines, scraps, slivers, reclaim shorts, and dust." Fawky Abdullah, "Know-How Transfer," *Tobacco Reporter*, Mar. 2003, pp. 60-65.
51. Fawky Abdullah, "Recon's New Role," *Tobacco Reporter*, May 2003.
52. Based on modeling simulations conducted by George Serletis (Office of Industries, 202-205-3315) and James Fetzer (Office of Economics, 202-708-5403) unpublished USITC working paper.
53. Calculated with data from Linda F. Forman, *Production Costs and Returns for Tobacco in 2002*, USDA, ERS, June 2004.
54. Brown, Snell, and Tiller, *The Changing Political Environment for Tobacco.*
55. These elasticities were also assumed for foreign-produced tobacco in the U.S. and foreign markets.
56. Long-run high elasticity of supply means that in the long-run, the factors of production, including capital and labor are highly mobile across economic sectors and will move in or out of industries in response to price changes.
57. A. Blake Brown, *Farm Level Effects an Increase in Federal Cigarette Taxes under Two Scenarios: Keep vs. Eliminate the Tobacco Program*, p. 3, Mar. 9, 1998, found at
http://www.ces.ncsu.edu/depts/agecon/tobacco_econ/-policy/Settlemen(3).pdf, retrieved June 10, 2004.

WTO Agricultural Trade Negotiations: A Fourth Update[1]

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After 4 years of setbacks and intense negotiation beyond final implementation of the Uruguay Round Agreement on Agriculture (URAA), a framework for further trade liberalization of world agriculture among World Trade Organization (WTO) members has been developed. The specific details on how quickly and to what extent reforms will be undertaken are yet to be negotiated however, and a long period of discussion and debate is anticipated before a final new WTO Agreement on Agriculture is reached. This article, another in a series tracing the developments in the agricultural negotiations, covers the period from the Doha Ministerial in November 2001 up to agreement in July 2004 on a framework for opening markets to foreign competition, and reducing export subsidies and trade-distorting domestic supports.

Recapping the Doha Ministerial

At the Fourth World Trade Organization (WTO) Ministerial[2] in Doha, Qatar, on November 9-14, 2001, WTO members unanimously adopted a Ministerial declaration (the Doha Development Agenda, or DDA) which launched a new comprehensive round of trade negotiations. Specifically, the DDA for agriculture (box 1) included comprehensive negotiations aimed at "substantial improvements in market access; reduction of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support."[3] The members also agreed that special and differential (S&D) treatment for developing countries should be part of all elements of the negotiations, and that nontrade concerns expressed in the negotiating proposals be taken into account in the negotiations.[4] The final Ministerial declaration from Doha established an ambitious timetable for completing the agricultural negotiations. It was agreed that modalities (trade rules)[5] for further commitments should be setup no later than March 31, 2003, with the final negotiations to be completed by January 1, 2005.

The Run-Up to Cancun

Even though the discussions missed the March 31, 2003,[6] deadline, discussions continued at a technical level, aimed at ironing out differences. Technical discussions were held during April 2003-June 2003 on most key areas, including domestic support categories, tariffs, tariff-rate quotas (TRQs), export credits, food aid, and S&D treatment for developing countries. In the July 2003 report of the Trade Negotiations Committee (TNC), Chairman Stuart Harbinson noted that 11 technical consultations had taken place and that progress had been made on several issues concerning rules and a framework for future

* The views expressed in this article are those of the authors. They are not the views of the USITC as whole or of any individual Commissioner. The authors are international trade analysts in the Agriculture and Forest Products Division, Office of Industries.

Box 1:
Final Declaration from Doha Ministerial Conference, November 9-14, 2001.

Agriculture

13. We recognize the work already undertaken in the negotiations initiated in early 2000 under article 20 of the Agreement on Agriculture, including the large number of negotiating proposals submitted on behalf of a total of 121 Members. We recall the long-term objective referred to in the Agreement to establish a fair and market-oriented trading system through a program of fundamental reform encompassing strengthened rules and specific commitments on support and protection in order to correct and prevent restrictions and distortions in world agricultural markets. We reconfirm our commitment to this program. Building on the work carried out to date and without prejudging the outcome of the negotiations we commit ourselves to comprehensive negotiations aimed at: substantial improvements in market access; reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support. We agree that special and differential treatment for developing countries shall be an integral part of all elements of the negotiations and shall be embodied in the Schedules of concessions and commitments and as appropriate in the rules and disciplines to be negotiated, so as to be operationally effective and to enable developing countries to effectively take account of their development needs, including food security and rural development. We take note of the nontrade concerns reflected in the negotiating proposals submitted by Members and confirm that nontrade concerns will be taken into account in the negotiations as provided for in the Agreement on Agriculture.

14. Modalities for the further commitments, including provisions for special and differential treatment, shall be established no later than 31 March 2003. Participants shall submit their comprehensive draft Schedules based on these modalities no later than the date of the Fifth Session of the Ministerial Conference. The negotiations, including with respect to rules and disciplines and related legal texts, shall be concluded as part and at the date of conclusion of the negotiating agenda as a whole.

Source: World Trade Organization, *Final Declaration from Doha Ministerial Conference*, Nov. 9-14, found at *http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm#agriculture*.

modalities. Progress had also been made at several "mini-Ministerials," that brought together trade negotiators from key countries to discuss proposals and policy differences.[7] However, no consensus was reached on specific targets for trade reform. Several observers indicated that this was a period when there was a lack of political direction as to how far and how fast governments would be willing to go.[8] Progress also was slow as a result of the delayed announcement by the European Union (EU) of Common Agricultural Policy (CAP) reform (box 2), which would greatly affect the EU negotiating position in the WTO agricultural negotiations.[9]

With no agreement on the Harbinson modalities document, the Chairman of the WTO General Council, Carlos Pérez de Castillo, released on July 18, 2003 an initial draft of the Cancun Ministerial declaration.[10] The draft covered all areas in the Doha declaration, but contained no modalities or schedule for trade reforms, and it was agreed that a modalities framework be attached to the draft Cancun Ministerial text once agreement on these points had been reached.

Reaching agreement on such a modalities framework proved elusive. The Cancun Ministerial concluded with both developing and developed countries reportedly unwilling to move from their positions (see "The Cancun Ministerial" summarized later), and agreement on a framework for establishing modalities could be reached only at the end of the WTO General Council Meeting and adopted on August 1, 2004 (see later section describing the framework).

Box 2:
Reform of the European Union's Common Agricultural Policy

On June 23, 2003, major reforms of the Common Agricultural Policy (CAP) were announced that would significantly alter how farmers are supported in the European Union (EU). The main thrust of the reforms involve decoupling the majority of farm payments from production, thereby providing farmers flexibility to produce for the market rather than in response to government programs. Under this reform, a new single farm payment (SFP) scheme will be introduced, where payments are linked to farm practices, such as maintaining environmental, food safety, and animal welfare standards. In addition, reforms in the CAP with respect to certain commodities were also introduced. The legal texts were formally adopted at the Agriculture Council of September 2003, and most of the new programs will be introduced during 2004 and 2005, with some countries being allowed flexibility to complete implementation by 2007.

The reforms were made in order to control production and the budgetary cost of the CAP and to strengthen the EU's negotiating position within the agricultural negotiations. In particular, most of the SFP would be considered a "green-box" (non-trade-distorting) payment under WTO rules. Thus the trade-distorting domestic supports by the EU will be significantly curtailed, allowing EU negotiators more flexibility to gain concessions in other areas.

Specific elements of the CAP reform include:

(i) SFP for EU farmers, mostly decoupled from production;
(ii) Part of the SFP may be linked to production, provided farmers comply with environmental, food safety, animal and plant health, and animal welfare standards, and that they keep farm land in good condition;
(iii) Widening of rural development schemes to assist farmers in meeting environment, quality, and animal welfare production standards by 2005;
(iv) Expanded rural development programs to be financed by reductions in direct payments ("modulation") received by larger farms;
(v) A mechanism to control farm spending in order to meet EU agricultural budget targets (farm budget is fixed until 2013); and
(vi) Revisions to the market policy of the CAP:
  (a) intervention prices for butter and skim milk powder cut by 25 and 15 percent, respectively, over 4 years;
  (b) A 50-percent reduction of the monthly increments in the cereals sector, while maintaining current intervention prices; and
  (c) Rice, durum wheat, nuts, starch potatoes, and dried fodder sectors also subject to reform.

Source: European Commission, "CAP Reform—a Long-Term Perspective for Sustainable Agriculture," found at *http://europa.eu.int/comm/agriculture/capreform/index_en.htm*.

Comparison of Proposals in the Three Major Pillars

The EU-U.S. Joint Paper[11]

A breakthrough in negotiations came on August 13, 2003, when the EU and United States released a joint proposal was released. This paper covered approaches to trade reform that would fulfil the DDA mandate for "substantial improvements in market access; reductions, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support." The paper also provided a negotiating framework for these three major pillars (market access, export competition, and domestic support), but it did not include specific numbers or deadlines. It also identified "issues of interest but not agreed," including the peace clause, nontrade concerns, implementation period, sectoral initiatives, continuation clause, and geographical indications.[12, 13]

Specific details of the EU-U.S. joint paper are outlined below, and a comparison of its treatment of key issues with other specific proposals in each of the three major pillars is summarized in tables A1-A3 in the Annex at the end of this article.

Market Access

Tariff reduction formula

- A combination (or blend) of methods for increasing market access that would apply to both developed and developing countries. Specifically:
  - (i) [ ][14] percent of tariff lines to face a [ ]-percent average tariff cut and a minimum of [ ] percent, with the most import-sensitive products (i.e., those facing the minimum tariff cut) market access to increase through both tariff cuts and TRQ quantity increases;[15]
  - (ii) [ ] percent of tariff lines to face cuts determined by a Swiss formula with a coefficient of [ ];[16] and
  - (iii) [ ] percent of tariff lines to become duty-free.

Other tariff issues

- To address tariff peaks,[17] tariffs exceeding a maximum of [ ] percent to be either lowered to that maximum, or countries to provide increased market access through a request/offer approach that might include TRQs.
- Tariff escalation not mentioned.
- Special agricultural safeguards (SSGs)[18] to remain open for discussion.

S&D treatment for developing countries

- Special agricultural safeguard mechanism (SSM) to be created for import-sensitive products of developing countries.
- Developed countries to provide duty-free access for at least [ ] percent of imports from developing countries.
- Developing countries to be subject to lower tariff-reduction commitments and longer periods to implementing reforms (as in the URAA).

Export Competition

Export subsidies

- Export subsidies to be eliminated over a [ ]-year period for those products of particular interest to developing countries.
- For other products, subsidy quantities and budgetary outlays to be reduced (although not eliminated).[19]

Export credits

- Subsidy component of export credits to be phased out (by requiring repayment terms to conform with commercial practice) for those same products of particular interest to developing countries and over the same implementation period as export subsidies.
- For other products, export credit subsidies to be subject to trade rules in a manner consistent with reductions in export subsidies.

State trading enterprises

- Controls to be placed on the practices of export-oriented state trading enterprises (STEs) (such as ending financing and single-desk export privileges, and monopoly pricing) that might result in providing subsidies to exports.

Food aid

- Provisions to be introduced that would prevent food aid shipments from displacing commercial sales.

S&D treatment for developing countries
- S&D treatment with respect to export subsidies to be recognized, however, some net food-exporting countries to be required to face less comprehensive S&D treatment.

Domestic Support

The EU-U.S. joint paper called for developed countries to reduced their levels of domestic support for their farmers significantly below the levels under the URAA, and that countries that provide greater support be required to make greater commitments to cut such supports.

Amber box
- Amber box (trade-distorting) domestic support to be reduced within a range of [ ] to [ ] percent.

Blue box
- Blue-box programs (referred to in the EU/U.S. paper as less trade-distorting domestic support) to be redefined to include:
  (i) payments based on fixed areas and yields,
  (ii) Payments made on 85 percent or less of the base level of production, and
  (iii) Livestock payments made on a fixed number of head.[20]
- Less trade-distorting domestic support expenditures to be reduced to no more than 5 percent of the value of agricultural production by the end of the implementation period.

De minimis[21]
- *De minimis* support to be reduced by [ ] percent.

Combined support
- The sum of trade-distorting domestic support, less trade-distorting domestic support, and *de minimis* to be reduced significantly below the 2004 level of support under the existing amber box, blue box, and *de minimis*.

Green box[22]
- Green-box (non-trade-distorting) support not mentioned.

S&D treatment for developing countries
- S&D treatment for domestic support not specified.

The G-20 Framework Proposal[23]

On August 20, 2003, a group of 20 developing countries released a counter proposal to the EU-U.S. paper. Like the EU-U.S. proposal, the G-20 framework covered the three pillars, but also included more specific detail on S&D treatment for developing countries. Specific details of the G-20 framework proposal are outlined below, and a comparison of its treatment of key issues with other specific proposals in each of the three major pillars is summarized in tables A1-A3 in the annex at the end of this article.

Market Access

The G-20 framework captured several aspects of the EU-U.S. text for market access modalities, except that it made strong distinctions between developed and developing country commitments.

Tariff reduction formula
- For developed countries, tariff reduction to be based on a blend approach, including:
  - (i) [ ] percent of tariff lines to be subject to a [ ]-percent tariff cut,[24]
  - (ii) [ ] percent of tariff lines to be reduced through a Swiss formula with a coefficient of [ ], and
  - (iii) [ ] percent of tariffs to be made duty-free.

Other tariff issues
- To address tariff escalation, a factor of [ ] to be applied to the tariff-rate cut of any processed product, if the tariff on the processed products is higher than the tariff of the product in its unprocessed form.
- Tariffs exceeding a maximum of [ ] percent to be lowered to that maximum.
- TRQ quantities to be increased to [ ] percent of domestic consumption.
- In-quota tariffs to be eliminated.
- Rules governing TRQ administration to be introduced.
- SSGs for developed countries to be eliminated.

S&D treatment for developing countries
- Developing countries to face lower tariff reductions and longer implementation periods.
- Special products (SPs) to be designated that would receive exemption or relief from the reforms. The formula applicable for tariff reductions to be as follows:
  - (i) all tariffs would face a [ ]-percent cut on average, with a minimum of [ ] percent; and
  - (ii) developing countries not required to increase TRQ quantities or eliminate in-quota tariffs.
- For developing countries, SSM to be established.
- For developed countries, duty-free access to be provided to agricultural products that account for no less than [ ] percent of their imports from developing countries.
- For developed countries, tariffs to be removed on all tropical product imports (and others mentioned in the Preamble of the URAA).

Export Competition

Export subsidies
- Export subsidies on products of particular interest to developing countries to be phased out over [ ] years.
- Export subsidies on other products to be phased out over [ ] years.

Export credits
- Export credits, guarantees, and insurance programs to be subject to a rules-based approach that would include identification and elimination of the subsidy component of these programs.

State trading enterprises
- STEs to be subject to disciplines.

Food aid (same as EU-U.S. joint paper)
- Provisions to be introduced that would prevent food aid shipments from displacing commercial sales.

S&D treatment for developing countries
- Continuation of the URAA provisions (paragraph 9.4) that developing countries be exempt from commitments on export subsidies that:
  - (i) Reduce the costs of marketing exports of agricultural products (other than widely available export promotion and advisory services), including handling, upgrading and other processing and international transport and freight, and
  - (ii) Reduce the internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favorable than for domestic shipments.

Domestic Support

Amber box
- All forms of trade-distorting domestic support to be reduced on a product-by-product basis by between [ ] and [ ] percent, with the range of no more than [ ] percentage points.
- Products subject to above-average domestic supports to face the upper levels of reduction requirements.
- Exported products receiving domestic support and accounting for more than a specified share of world exports, to face domestic support reductions at the upper levels of the reduction range, and such support to be phased out over time.
- In the first year of implementation, trade-distorting domestic-support reductions would be at least [ ] percent, regardless of the product category.

Blue box
- Blue box to be eliminated.

De minimis (same as EU-U.S. joint paper)
- Developed countries to reduce their *de minimis* support by [ ] percent.

Combined support
- The sum of amber box and *de minimis* support to be cut at least [ ] percent.

Green box
- Green-box payments by developed countries to be capped and/or cut.

S&D treatment for developing countries
- The scope of Article 6.2 of the URAA[25] to be widened to include focused and targeted programs.
- Developing countries exempt from *de minimis* reduction requirements.

The Pérez del Castillo Text[26]

On August 24, 2003, Chairman Carlos Pérez del Castillo and WTO Director-General Supachai Panitchpakdi submitted their draft Cancun Ministerial Declaration to ministers, that included a framework for establishing modalities in agriculture. This text was based largely on the EU-U.S. paper and the G-20 proposal, as well as other proposals from WTO members.[27] Specific details of the Castillo text are outlined below, and a comparison of its treatment of key issues with other specific proposals in each of the three major pillars is summarized in tables A1-A3 in the annex at the end of this article.

Market Access

The Castillo text used many of the market access provisions included in the EU-U.S. paper, while incorporating the strong distinction between developed and developing countries from the G-20 framework.

Tariff reduction formula (same as EU-U.S. joint paper)
- For developed countries, tariffs to be reduced based on a blended-formula approach, including:
  (i) [ ] percent of tariff lines to be lowered by an average of [ ] percent, with a minimum cut for each tariff line of [ ] percent, and for these most import-sensitive items, market access increases to be a result of both tariff cuts and TRQ increases;
  (ii) [ ] percent of tariffs to be cut based on a Swiss formula with a coefficient of [ ]; and
  (iii) A certain percent of tariff lines to be made duty-free.

Other tariff issues

- For developed countries, tariffs above a maximum of [ ] percent to be lowered to that maximum or additional market access to be provided through an expansion of TRQ quantities.
- Tariff escalation to be addressed (no specific modalities mentioned).
- SSGs use and duration to be negotiated (no specific modalities mentioned).

S&D treatment for developing countries

- For developing countries, tariff reduction to be based on a three-tiered approach involving:
  - (i) [ ] percent of tariffs to face a [ ]-percent average cut and [ ]-percent minimum cut; and for the import-sensitive products subject to the minimum cuts, growth in market access to result from both tariff cuts and TRQ increases. In this tier, developing countries to be allowed to designate SPs on which tariffs would not have to be lowered beyond a minimum of [ ] percent, and for which commitments on additional TRQs quantities would not be required;
  - (ii) [ ] percent of tariffs to face a [ ]-percent average cut and [ ]-percent minimum cut; and
  - (iii) [ ] percent of tariffs to face a [ ]-percent average cut and [ ]-percent minimum cut.[28]

As an alternative to (ii) and (iii) above, [ ] percent of tariff lines to be subject to a Swiss formula with a coefficient of [ ].

- SSM to be established for use by developing countries for specified products, under unspecified conditions.
- For developed countries, tariffs to be removed from at least [ ] percent of imports from developing countries.

Export Competition

Export subsidies (same as EU-U.S. joint paper)

- Export subsidies to be eliminated over a [ ]-year period on products that are of special interest to developing countries.
- For other products, export subsidy reduction, with a view to phasing out[29] budgetary and quantity subsidy allowances.

Export credits

- Subsidy component of export credits to be phased out (by requiring repayment terms to conform with commercial practice) for those same products of particular interest to developing countries and over the same implementation period as export subsidies.
- For other products, export credit to be disciplined in order to reduce, with a view to phasing out, the subsidy element of export credit programs.

State trading enterprises

- Disciplines on export subsidies and credits would also apply when such measures are provided either directly or indirectly through STEs.

Food aid (same as EU-U.S. joint paper)

- Provisions to be introduced that would prevent food aid shipments from displacing commercial sales.

Other provisions

- Measures covering export restrictions and prohibitions (Article 12 of the URAA) to be introduced.

S&D treatment for developing countries

- The S&D component for export competition to include a longer implementation period for reducing and phasing out of export subsidies by developing countries.
- Continuation of the URAA provisions that developing countries be exempt from commitments on export subsidies that:
  (i) Reduce the costs of marketing exports of agricultural products (other than widely available export promotion and advisory services), including handling, upgrading and other processing, and international transport and freight; and
  (ii) Reduce the internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favorable than for domestic shipments.
- Export credit disciplines to be established that provide for differential treatment in favor of least-developed and net food-importing developing countries.

Domestic Support

For domestic support, the Castillo text followed the EU-U.S. paper rather closely with a few exceptions. Castillo proposed that all developed countries should reduce amber box support by significantly more than during the Uruguay Round.

Amber box

- Under the proposal, the bound total Aggregate Measure of Support (AMS) would be lowered by a range between [ ] and [ ] percent.

Blue box

- Blue-box programs to be redefined to include:
  (i) Payments based on fixed areas and yields,
  (ii) Payments made on 85 percent or less of the base level of production, and
  (iii) Livestock payments made on a fixed number of head.
- Blue box-type support would be lowered in two steps. First it would be reduced to 5 percent of the 2000-02 average value of agricultural production by the year [ ], and then, second, it would be reduced by [ ] percent annually for a further period of [ ] years.[30]

De minimis (same as EU-U.S. joint paper)

- *De minimis* to be lowered by [ ] percent.

Combined support

- Total AMS support, blue box, and *de minimis* support to be lowered in an initial period to a level substantially lower than the sum of these three from their 2000 levels (compared with 2004 levels in the EU-U.S. paper).

Green box

- Green-box payments to remain under negotiation.

S&D treatment for developing countries

- Allowance for lower amber-box reductions and longer implementation periods.
- Special treatment to be provided as in Article 6.2 of the URAA[31] and with respect to the green box.
- Exemption from lowering the *de minimis* level of support.

Other Provisions

Among other provisions, the Castillo text proposed that least-developed countries should be exempt from reduction commitments, and that the goal of duty-free and quota-free market access for products originating from least-developed countries should be expedited. The Castillo text also identified several issues of interest by not agreed upon, such as product-specific AMS commitments, mechanisms for increasing TRQ quantities, in-quota tariff rates, single-desk export privileges, export taxes, nontrade concerns, implementation period, sectoral initiatives, peace clause, and geographical indications.

The Cancun Ministerial

Proceedings

The Cancun Ministerial, the fifth official Ministerial-level conference to be held since the WTO was created in 1995, took place in Cancun, Mexico, during September 10-14, 2003. The mandate for this meeting, established at Doha, was to assess the progress to date in the DDA negotiations, provide political guidance, and make decisions as necessary to move forward. The structure of the 5-day Ministerial provided for working groups covering the following areas: agriculture; nonagricultural market access; development; Singapore issues (i.e., trade facilitation, investment, competition, and transparency in government procurement); and miscellaneous issues.[32] Each working group was led by a facilitator who met daily with Heads of Delegations to provide substantive reports on progress. While all working groups met simultaneously, events leading up to the Ministerial made it clear that the pace of the overall negotiations would be set by the progress made in the agriculture working group.[33] For example, on the eve of the meeting, a group of 21 developing countries (G-21)[34] declared that success in Cancun would depend on the progress made according to their specified goals for agriculture,[35] and as the Ministerial got underway, several Members indicated that their offers in other areas of the negotiations were contingent on progress in the agricultural talks.

The Castillo text developed prior to the Ministerial outlined the decisions that needed to be made in all areas of the negotiations and served as the basis for the talks. Recall that the portion of that draft dealing with agriculture, drawn largely from the August 2003 EU-U.S. joint paper, instructed the agriculture working group to reach agreement on the parameters for negotiating new formulas for cutting tariffs and subsidies for agriculture products. Additional agriculture issues, such as the extension of the peace clause and provisions for geographical indications, were also identified for possible discussion.[36]

The day before the Ministerial officially began, the G-21 formally requested that the G-20 proposal[37] be circulated as a formal document to the Ministerial. As mentioned above, this proposal called for more restrictions on trade-distorting subsidies for developed countries and less significant market access concessions for developing countries. The G-21 submission was the only formal counterproposal to the Castillo text, and thus the significant differences between the two documents served as a starting point for negotiations on agriculture. As the Ministerial got underway, G-21 representatives met with their U.S. and EU counterparts separately to provide them with a better understanding of their position. Subsequently, the United States raise the concern that whereas the G-21 countries had articulated many demands, they had not indicated where they were willing to move on their own positions.[38] For its part, the EU rejected the G-21 proposal as imbalanced and indicated that strong developing-country agricultural exporters (such as Brazil) benefit too much from the proposal.[39]

Another key development at the start of the Ministerial was the "cotton initiative" proposed by four West and Central African (WCA) countries of Benin, Mali, Chad, and Burkino Faso.[40] Prior to the start of

the Ministerial, these countries had proposed that the WTO address the rapid elimination of cotton subsidies that distort prices and negatively affect the livelihoods of millions of poor African farmers who depend on the commodity for export.[41] As a result, a sectoral initiative on cotton became a formal item on the Ministerial Agenda by being included in the draft Ministerial declaration.[42] During Cancun, the initiative was successfully linked to the overall agricultural discussions when Director-General Supachai led discussion of the topic in the Ministerial's opening plenary session. In the following days, he served as facilitator for negotiations on the topic between WCA countries and other key players, namely the United States and the EU.[43]

In its discussions with WCA countries, the United States refused to focus on cotton subsidies directly but instead suggested that the solution lay in addressing distortions in the cotton/man-made fibers/textiles/clothing sector as a whole.[44] The U.S. position was that by making efforts to diversify their economies into textiles, WCA countries could benefit from preferential access to the U.S. market under the African Growth and Opportunity Act (AGOA).[45] The EU, on the other hand, showed some early support for the WCA cotton initiative by stating its willingness to consider the elimination of trade-distorting domestic support and export subsidies for cotton and offering duty-free and quota-free market access for all cotton products from developing countries. This EU position reflected its existing leverage in this area owing to its lack of export subsidies for cotton and the recent CAP reforms that shift cotton subsidies to the green box. In addition, the EU already provides quota-free and duty-free access to most developing-country exports.[46]

In the various agriculture working group sessions, members generally restated their positions with respect to market access, export assistance, and domestic support.[47] The United States indicated its willingness to adjust domestic support in return for increased market access to the EU, Japan, and other developed countries. The EU also reiterated its position on increased protections for geographic-specific product names (geographical indications), and the recognition that direct payments for upholding environmental production standards be considered non-trade-distorting. Other Members, such as Canada, expressed some sympathy for the G-21 position that developing countries should not have to further open their markets. Canada also stressed the elimination of export subsidies by an agreed upon date, the reduction of trade-distorting domestic support, and improved market access. However, Canada indicated that it was not interested in providing for special status for products with geographical indications.[48] After 2 days of talks, Members had shown little movement from their originally stated positions in agriculture and consensus in any area remained elusive.[49] This early lack of progress in agriculture, combined with the WCA country demands on cotton and G-21 insistence on S&D treatment, began to affect other areas of the negotiations, where Members held back concessions pending movement in the agriculture talks.

Marked divisions between the United States and the EU continued on the third day of the 5-day ministerial.[50] In an effort to move negotiations forward, the United States agreed to the EU position on extending the peace clause, although significant divisions remained in other areas. For instance, the EU called on the United States to agree to domestic support reductions from the 2002 Farm Bill that would match those of the CAP reform, and to put disciplines on export credit programs comparable to EU reductions on export subsidies. Conversely, the United States called for worldwide domestic support to be harmonized which would require the EU to make steeper cuts because the EU subsidy ceiling is higher than that of the United States as a result of the URAA.

Bolstered by the success of the G-21 and the WCA in gaining sympathy for their negotiating positions, two other alliances emerged on the fourth day of the Ministerial. First, a group of 33 developing countries (including the Dominican Republic, Honduras, Kenya, Nicaragua, Panama, and Sri Lanka) formed around an initiative to include a list of protected and self-designated SPs and a SSM for developing countries.[51] Second, countries belonging to the African Union (AU), the African, Caribbean, and Pacific (ACP) countries (former EU colonies enjoying preferences in the EU market), and other least-developed countries joined a proposal for the introduction of self-designated SPs, a SSM, the preservation of existing

preferential access schemes, as well as a market access formula to target high tariffs, tariff peaks, and tariff escalation.[52]

The Derbez Text[53]

On the penultimate day of the Ministerial, Conference Chairman, Mexican Foreign Minister Luís Ernesto Derbez issued a new draft declaration that contained a revised annex outlining a framework for establishing modalities in agriculture.[54] This text was based on the Castillo text, although it also contained revisions that reflected discussions at Cancun, as well as new papers covering specific aspects of the Castillo draft.[55] However, it contained no numerical targets or timeframes.

Changes to the text reflected an approach to provide something for everyone. For instance, in response to key demands of the G-21, it was proposed that domestic support be capped on a product-specific basis and measures for S&D treatment of certain SPs given to developing countries. On domestic support, the new text favored the EU by retaining the concept of the blue box, while favoring large agricultural exporters (such as Brazil and the Cairns Group countries) by calling for green-box criteria to be reviewed and disciplined. Flexibility would be given to developed countries with respect to products designated on the basis of non-trade concerns, a position of the G-10 countries.[56] The Derbez text proposed extending the peace clause in the short term, which had been advocated by the EU and recently agreed to by the United States. Specific details of the Derbez text are outlined below, and a comparison of its treatment of key issues with other specific proposals in each of the three major pillars is summarized in tables A1-A3 in the Annex at the end of this article.

Market Access

Tariff reduction formula

- For developed countries, tariff reduction to be based on a three-tiered approach:
  (i) [ ] percent of tariff lines to be reduced an average of [ ] percent and a minimum of [ ] percent (market access expansion for such import-sensitive tariff lines to be from both tariff cuts and TRQ volume increases),
  (ii) [ ] percent of tariff lines to be lowered according to a Swiss formula with a coefficient [ ], and
  (iii) [ ] percent of tariff lines would to become duty-free.
- For developed countries, tariff cuts to result in a simple average tariff reduction for all agricultural products of not less than [ ] percent.[57]

Other tariff issues

- A maximum tariff of [ ] percent to be imposed on developed countries, who must either lower tariffs to the maximum, or ensure additional market access in these or other areas through a request/offer process that could include TRQs.
- Members to be allowed to designate a very limited number of products on the basis of nontrade concerns that would only be exempt from the maximum tariff commitment.
- To address tariff escalation, a factor of [ ] to be applied to the tariff reduction required for a processed product in situations where the tariff on the processed products is higher than the product in its unprocessed form.
- In-quota tariffs to be reduced by [ ] percent.
- SSGs use and duration to be negotiated (no specific modalities mentioned).

S&D treatment for developing countries
For developing countries, tariff reduction to be based on a three-tiered approach involving:

(i) [ ] percent of tariffs to face a [ ]-percent average cut and [ ]-percent minimum cut; and for the import-sensitive products subject to the minimum cuts, growth in market access to result from both tariff cuts and TRQ increases. In this tier, developing countries would be allowed to designate SPs on which tariffs would not have to be lower beyond a minimum of [ ] percent, and for which commitments on additional TRQs quantities would be not required; where tariffs are very low (less than [ ] percent) no tariff reductions would be required;
(ii) [ ] percent of tariff lines to be reduced according to a Swiss formula with a coefficient of [ ]; and
(iii) [ ] percent of tariff lines to be bound between 0 and 5 percent, taking into account the importance of tariffs as a source of revenue for developing countries.

- For developing countries, additional time period of [ ] years to be allowed for implementing tariff cuts in (ii) and (iii) above.
- SSM to be established for use by developing countries for specified products.
- All developed countries to provide duty-free access for no less than [ ] percent of imports from developing countries (in particular tropical products).
- Members required to consider the importance of preferential access arrangements for developing countries.

Export Competition

Export subsidies
- Export subsidies to be eliminated over a [ ]-year period for those products of particular interest to developing countries. A list of these products to be established that would be part of the a country's comprehensive draft of commitment schedules. Export subsidy elimination of these specific products would take place over [ ] years.
- For other products, export subsidy reduction, with a view to phasing out[58] budgetary and quantity subsidy allowances.

Export credits (same as Castillo text)
- Subsidy component of export credits to be phased out (by requiring repayment terms to conform with commercial practice) for those same products of particular interest to developing countries and over the same implementation period as export subsidies.
- For other products, export credit to be disciplined in order to reduce, with a view to phasing out, the subsidy element of export credit programs.

State trading enterprises (same as Castillo text)
- Disciplines on export subsidies and credits to be applied when such measures are provided either directly or indirectly through STEs.

Food aid (same as EU-U.S. joint paper)
- Provisions to be introduced that would prevent food aid shipments from displacing commercial sales.

Other provisions
- Measures covering export restrictions and prohibitions (Article 12 of the URAA) to be introduced.

S&D treatment for developing countries (same as Castillo text)
- The S&D component for export competition to include a longer implementation period for reducing and phasing out export subsidies by developing countries.

- Continuation of the URAA provisions that developing countries be exempt from commitments on export subsidies that:
  (i) reduce the costs of marketing exports of agricultural products (other than widely available export promotion and advisory services), including handling, upgrading and other processing, and international transport and freight; and
  (ii) reduce the internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favorable than for domestic shipments.
- Export credit disciplines to be established that provide for differential treatment in favor of least-developed and net food-importing developing countries.

Domestic Support

The Derbez text called for developed countries to reduce their domestic support significantly more than in the Uruguay Round, and that Members with the higher trade-distorting subsidies make greater cuts.

Amber box
- For developed countries, amber-box expenditures to be reduced to a range of [ ] to [ ] percent.
- Amber box support for individual products to be capped at their levels during the period of [ ] years.

Blue box (same as Castillo text)
- Blue-box payments[59] to be lowered to 5 percent or less than the total value of agriculture production in the 2000-2002 period by the year [ ], and thereafter blue-box support to face linear annual reductions of [ ] percent for [ ] years.

De minimis (same as EU/U.S. joint paper)
- *De minimis* to be reduced by [ ] percent.

Combined support
- The sum amber-box, blue-box, and *de minimis* support in 2000 to be reduced no less than [ ] percent, including a reduction of [ ] percent during the first implementation year.

Green box
- Green-box criteria to be revised in order to ensure that the trade-distorting impact on production of such measures is minimal.

S&D treatment for developing countries (same as Castillo text)
- Allowance for lower amber-box reductions and longer implementation periods.
- Special treatment to be provided as in Article 6.2 of the URAA[60] and with respect to the green box.
- Exemption from lowering the *de minimis* level of support.

Other Provisions

The Derbez text would allow least-developed countries to be exempt from reduction commitments, and would require developed countries to afford duty-free and quota-free market access to products exported from least-developed countries. The text provided for continuation of the peace clause for [ ] months. Several issues which countries continue to have substantial disagreement were identified in the Derbez text. They include single-desk export privileges, export taxes, proposals for flexibility for certain groupings, certain non-trade concerns, implementation period, sectoral initiatives, inter-pillar linkages, continuation clause, geographical indications, and other detailed rules.

The Cotton Initiative

All Members disagreed strongly with at least some aspects of the agriculture draft, especially WCA countries concerned that the draft adopted the U.S. position regarding the sector initiative on cotton.[61] The text called on developing-country cotton producers to address the market distortions in the cotton/synthetic fibers/textiles/clothing sector as a whole, and for compensation in the form of resources from relevant international organizations to encourage economic diversification. The section contained nonbinding language urging cotton-subsidizing countries not to use the discretion provided for on domestic subsidy allocation to avoid reducing supports for cotton. Strong dissent expressed by WCA countries and their supporters lead to overnight negotiations resulting in a complete redraft of the cotton text, which required Members, within 3 months, to take measures to eliminate export subsidies for cotton in 3 years and production subsidies for cotton in 4 years starting in 2005. It also provided for the creation of a transitional fund for cotton-producing and -exporting least-developed countries with a working group to explore methods of financing.[62]

Outcome

On the last day, sessions were scheduled to discuss whether and how to address the Singapore issues to be followed by a session on agriculture. Chairman Derbez reportedly determined that more of a consensus existed on agriculture and therefore decided to address Singapore issues first.[63] However, this approach did not anticipate the resolve of certain countries to proceed with all four Singapore issues as a package and of certain other Members (particularly developing countries) to exclude one or more of the four issues from the talks altogether. After different developing countries expressed unwillingness to move from their positions, Chairman Derbez formally closed the Ministerial with no agreement on Singapore issue text and no further discussions on agriculture.[64]

After Cancun

After the breakdown of the talks in Cancun, the momentum of the negotiations appeared all but lost according to many observers.[65] The EU made public statements that it would enter an "internal period of reflection" regarding its trade policy, whereas the United States publicly stated that it would focus on its own regional and bilateral agreements with countries that were willing to constructively negotiate.[66] Without the momentum of the two largest trading blocks, the WTO process appeared to be at a standstill. Throughout November and December, the EU and United States made public statements calling on other WTO members (particularly major agriculture-exporting, developing countries) to make concessions.[67] However, there was little movement on country positions throughout the rest of the year. In fact, a November 2003 proposal by the G-22 (formerly the G-21) included the concept of a "free-round" for developing countries in which their borders would be closed to agricultural imports while having considerably more latitude than developed countries to subsidize their farmers.[68] Developed countries indicated that there was little incentive for them to reduce domestic subsidies for agriculture if developing countries were not willing to increase market access. In addition, during this time period, Governments of the United States, EU, Japan, and Canada were focused on other issues, such as the conflict in Iraq and domestic macroeconomic policies.

Relaunch of Negotiations, January-July 2004

During the December 15 meeting of the WTO General Council, Chairman Castillo proposed that negotiations should begin in all negotiating areas (including agriculture) in early 2004, following appointment of the new Chairs to each of the negotiating committees. In February 2004, Ambassador Tim Groser of New Zealand was selected to chair the WTO Committee on Agriculture (CoA). Agricultural negotiations resumed in a series of six special negotiating sessions of the CoA in Geneva during March-July, 2004.[69] The Derbez text formed the starting point for these discussions.[70] However, given the divergence of views, it also became

clear at the March session that an immediate goal for the negotiations was to reach agreement on a negotiating framework by the end of July, with agreement on modalities left for negotiation during 2005.[71] Meaningful negotiations would be put on hold after July until early 2005, because of the U.S. Presidential election and new EU Commission taking office, in early November 2004.

The ***March and April negotiating sessions*** of the CoA were dominated by two pillars—export competition and market access. In the area of export competition, the United States, the Cairns Group, and G-22 held firm to the position that a certain date be set to end traditional export subsidies.[72] The EU was alone in its opposition to this point as it only wanted to agree to eliminate them on products of interest to developing countries. The EU position also included the concept of "parallelism"—that any reduction or elimination by the EU of traditional export subsidies must be matched by the United States on all government-funded export credit programs and food aid, and matched by other WTO members on disciplining exporting STEs.[73]

The major stumbling block during these sessions was in the area of market access, and specifically on reaching a consensus on the methodology for reducing tariffs.[74] The "blended approach," advocated by the United States and the EU, was strongly criticized by the G-10 and G-22 and many developing countries.[75] Under the blend approach, tariffs are lowered using a combination of Uruguay Round linear cuts with minimum reduction per tariff line, the Swiss formula (cutting higher tariffs more with a maximum ceiling), and zero duties. Some members, such as the Cairns Group, questioned whether this approach would really improve market access, whereas others, such as the G-10, were concerned that the approach would not provide sufficient flexibility to shield certain sensitive products from tariff cuts.[76] Exacerbating the divisions was the statement by U.S. negotiators that only 2-3 percent of tariff lines ought to be cut using the Uruguay Round approach, with up to 10 percent for developing countries. Most other countries wanted a much larger portion (as high as 25 percent) of tariffs to face linear cuts.[77] The United States stated its firmness on this point owing to the fact that domestic political support on reduction of domestic support would be heavily dependent on getting much improved market access from other countries in return.[78] At this time, two significant developments outside the special CoA negotiating sessions took place (box 3).

The ***third special negotiating session of the CoA, during June 2-4***, continued to focus on the issues of market access and export competition. On market access, developing countries submitted a proposal that outlined the essential elements that an acceptable formula must have: progressivity (higher tariff cuts more than lower ones), flexibility (to take SP into account), neutrality (formula should not be biased against the tariff structures of certain Members), and proportionality (less than full reciprocity between developed and developing countries as in the URAA). Although the proposal was criticized by some for lack of detail, other Members considered it as a constructive piece that could move the negotiations forward.[79] Differences remained among members on how to deal with SPs (i.e., those with increasing market access would present political problems for governments, such as sugar and dairy in the United States, and rice in Japan). In the area of export competition, the United States and EU continued to demonstrate divergent positions. According to the EU view of parallelism, the elimination of export subsidies by the EU should be countered by the elimination of export credits by the United States. The U.S. view was that parallelism should be between export subsidies and the export subsidy component of export credits. On domestic support, there appeared to be considerable consensus on substantial reduction of amber-box support and a cap on blue-box support, although differences emerged from discussions over whether U.S. counter-cyclical payments under the Farm Bill should be treated as blue box,[80] as the U.S. contended, or as amber box.[81] Despite the differences, in particular over market access, Chairman Groser described the session as generally positive, and there was a sense of renewed political momentum to make progress on tough issues.[82]

Box 3:
Significant Developments Outside the Special Committee on Agriculture Negotiating Sessions

In late April 2004, a WTO dispute settlement panel handed down its interim decision on whether the U.S. cotton program violates its obligations under the WTO Agreement on Agriculture, the Agreement on Subsidies and Countervailing Measures, and the General Agreement on Tariffs and Trade of 1994. Brazil (along with third-parties Argentina, Australia, Benin, Canada, Chad, China, the EU, India, New Zealand, Pakistan, Paraguay, Taiwan, and Venezuela) had challenged that the support provided to U.S. agribusiness during 1999-2000 to purchase American cotton and those authorized to farmers in the 2002 Farm Bill, encouraged over-production. The United States had argued that its program did not encourage over-production because they were provided independent of the yield of farmers. Based on the interim report and the report detailing the final decision (which was issued to Brazilian and U.S. officials on June 18, but not made public), Brazil claimed victory on this point and the United States conceded that the subsidies were found to be in violation of international trade obligations. It is the view of the United States that its commodity programs are fully consistent with its WTO commitments and it has committed to appeal the decision, a process that would take up to a year or more. The United States has stated that distortion in world cotton markets should be addressed through the WTO agriculture negotiations. U.S. Government officials and lawmakers defended U.S. practices and criticized Brazil's tactic to single out U.S. cotton support when many other countries maintain allegedly unfair trading practices which should all be dealt with as part of WTO negotiations, not through litigation. U.S. officials stated that they had no intention of unilaterally cutting the payments to cotton farmers. Observers have stated that the decision could pressure the United States and other countries with major domestic support programs (such as the EU) to be more flexible in the Doha Round of negotiations.

The second development occurred in early May 2004 when a letter sent from the EU Commissioners of Agriculture and Trade, Franz Fischler and Pascal Lamy, to all WTO members offered to eliminate all EU export subsidies for all agricultural products in return for a balanced deal on market access, domestic support, non-trade concerns, and strict parallelism on export competition. Despite protests from France, the EU Commissioners signaled that they were willing to negotiate on this point. While this was encouraging for the future of the talks, some observers viewed that the conditions placed on the offer somewhat mitigated its impact.

Source: "WTO Interim Report on U.S. Cotton Case: Brazil Claims Victory," *Bridges Weekly Trade News Digest*, Apr. 28, 2004; "WTO Cotton Case Goes Against U.S.," *Feedstuffs*, May 3, 2004; "WTO Rules Against US Cotton Subsidies," *New York Times*, June 19, 2004; "Cotton Ruling Could Affect Farm Subsidies," *Financial Times*, Apr. 28, 2004; "EU Offers to Abolish Export Subsidies," *agranet.com*, May 13, 2004; and, "EU Proposes Eliminating Subsidies," *Wall Street Journal*, May 11, 2004.

A ***fourth special negotiating session of the CoA, June 23-25,*** again focused on the issues of export competition, domestic support, and market access. On export competition, there was a convergence of the view on the need to end export subsidies and to discipline other export support, however a potential deal breaker continued to be the EU's demand that if the EU eliminates export subsidies, then the United States must end its government support of export credit programs. The United States continued to argue that only the subsidies element of export credit programs ought to be disciplined (such as by shortening the period of credit repayment).[83] By the end of the session, no agreement had been reached on this issue. On domestic support, disagreement remained over amendments in the definition of the blue box. The United States proposed changes that would allow direct payments that do not limit production but meet other blue-box criteria. This change would qualify U.S. counter-cyclical payments as blue box and thus exempt from limitations. Meanwhile, developing countries called for an overall cap to blue box, as well as product-specific caps in the blue box.[84] The market access debate centered on how to structure tariff reductions that provide greater access, while at the same time allow members to protect sensitive products. A U.S. proposal involved a band approach, in which the higher the band, the deeper the required tariff cuts. Within each band the U.S. proposed a Swiss formula approach. However this idea was rejected by India. China suggested that in each band, a blend approach be adopted in which products would be subject to either a straight-line tariff reduction or Swiss formula.[85] At the end of the session, the assessment of Chairman Groser was that considerable progress had been made at the political level, but at a technical level more work was needed before specific language on a modalities framework could be drafted.

The July 2004 Framework for Establishing Modalities in Agriculture

The July 2004 Framework

After an intense period of negotiations among WTO members in Geneva during the July negotiating session, a "Framework for Establishing Modalities in Agriculture"[86] (July 2004 framework) was finally agreed upon at the end of the WTO General Council meeting, July 27-30. The framework was adopted by the WTO General Council on August 1, 2004. Specific details of the framework are outlined below, and a comparison of its treatment of key issues with other specific proposals in each of the three major pillars is summarized in tables A1-A3 in the annex at the end of this article.

Market Access

The framework calls for substantial overall tariff reductions as a final result from negotiations.

Tariff reduction formula

- Tariff reduction for most products to be based on a tiered formula approach, in which different tariffs bands are created with separate tariff reduction formulas established for each band. No specific modalities were identified. For example, not specified were the number of bands, the thresholds for defining the bands, the type of tariff reduction in each band, and the role of a tariff cap in a tiered formula.
- Tariff reductions to be based on bound rates.
- In-quota tariff rates to be reduced or eliminated.

Other tariff issues

- SPs to be designate by members and which would not be subject to the tiered approach. For SPs, the framework calls for substantial improvement in market access via a combination of TRQ increases and tariff reductions applying to each product, based on an agreed-upon formula with some TRQ expansion required for all such products.
- TRQ administration to be improved.
- Tariff simplification to be addressed.
- Tariff escalation to be addressed.
- SSGs to be addressed.

S&D treatment for developing countries

- S&D provisions to cover tariff reduction formulas, the number and treatment of SPs, expansion of TRQs, and implementation period.
- Developing countries to face lesser tariff reduction commitments and TRQ expansion commitments.
- Developing countries to designate SPs (based on criteria of food security, livelihood security and rural development needs) that would face more flexible treatment.
- SSM to be established.
- Long-standing trade preference arrangements for developing countries to be recognized.

Export Competition

The framework calls for the establishment of modalities on export competition that encompass parallelism, such that all forms of export assistance that result in subsidized exports would be eliminated by "a credible end date."

Export subsidies
- All export subsidies to be eliminated.

Export credits
- Export credits, export credit guarantees, or insurance programs with repayment periods of more than 180 days to be eliminated.
- Export credit guarantees and insurance programs with less than 180 days repayment to be subject to disciplines covering such elements as payment of interest, minimum interest rates, minimum premium requirements, and other elements which can constitute subsidies or distort trade.

State trading enterprises
- Trade-distorting practices of STEs, such as government subsidies, financing, and the underwriting of losses, to be subject to disciplines.

Food aid (same as EU-U.S. joint paper)
- Measures to be put in place to prevent the displacement of commercial sales of agricultural products by food aid.

S&D treatment for developing countries
- Developing countries to receive S&D treatment in terms of longer implementation periods for the phasing out of all forms of export subsidies.
- Continuation of the URAA provisions that developing countries be exempt from commitments on export subsidies that:
  (i) Reduce the costs of marketing exports of agricultural products (other than widely available export promotion and advisory services), including handling, upgrading and other processing, and international transport and freight; and
  (ii) Reduce the internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favorable than for domestic shipments.
- Disciplines on export credits, export credit guarantees, or insurance programs to also include differential treatment favoring least-developed and net food-importing developing countries.
- STEs with monopoly status in developing countries that facilitate domestic consumer-price stability and to ensure food security to benefit from special concessions.
- In special cases where food aid, commercial export credits, or preferential international financing facilities are inadequate, concessions to be made for *ad hoc* temporary financing arrangements relating to exports to developing countries.

Domestic Support

Domestic support provisions were based on the DDA call for "substantial reductions in trade-distorting domestic support," taking into account S&D treatment for developing countries, harmonizing reductions made by developed countries from bound AMS level so that countries with high support levels must make deeper cuts.

Amber box
- To ensure that support is cut for all products, product-specific, amber-box payments to be capped at to be agreed-upon average levels.

Blue box
- Blue-box definition to be revised to include direct payments under production limiting programs[87] or direct payments that do not require production.[88]
- Blue-box payments not to exceed 5 percent of a Member's average total value of agricultural production during a to be negotiated historical period.

De minimis (same as EU-U.S. joint paper)
- *De minimis* support to be lowered.

Combined support
- The overall base level of all trade-distorting domestic support (including the sum of total amber-box, permitted *de minimis* level, and blue-box payments) to be lowered based on a tiered formula. In the first year and throughout the implementation period, countries to cut support by at least 20 percent.
- Support to be cut progressively over the implementation period in a manner that ensures countries with high support levels be required to make deeper cuts.

Green box (same as Derbez text)
- Green-box criteria to be revised in order to ensure that the trade-distorting impact on production of such measures is minimal.

S&D treatment for developing countries (same as Castillo text)
- Allowance for lower amber-box reductions and longer implementation periods.
- Special treatment to be provided as in Article 6.2 of the URAA[89] and with respect to the green box.
- Exemption from lowering the *de minimis* level of support.

Looking Ahead

The August 1 agreement on the framework was considered by all sides to be an important achievement, especially after the failure to reach an accord 10 months earlier in Cancun. U.S. Trade Representative Robert Zoellick stated that "today's decision is a crucial step for global trade... after the detour in Cancun we have put these WTO negotiations back on track," while EU Trade Commissioner, Pascal Lamy noted that "I said in Cancun that the WTO was in intensive care. Today I can say that it is not only out of intensive care but well and running." Leaders from developing countries hailed the agreement as a success. Argentina's chief trade negotiator, Martin Redrado, said that "there's been tremendous advance (that) assures substantial reform in world agricultural trade," and India's Minister of Commerce and Industry claimed that "the developed nations have comprehended more the concerns of the developing countries."

Negotiators only have developed a framework for further negotiations. Nothing has been agreed regarding how far and how fast trade liberalization should take place. Much of the text is deliberately vague, especially the text covering market access provisions. Thus, when negotiations start up in early 2005, most observers anticipate very slow progress in reaching consensus among 147 WTO Members. Similarly, some officials foresee that a final agreement may take several years to complete, perhaps extending as late as 2007 or 2008.■

Annex A
Summary of Proposals: Market Access, Export Competition, and Domestic Support

Table A1:
Summary of proposals: Market access

Issue	EU/U.S. joint paper (08/13/2003)	G-20 framework (08/20/2003)	Castillo text (08/24/2003)	Derbez text (09/13/2003)	July 2004 framework (07/27-30/2004)
Tariff reduction formula	Blend approach applicable to both developed and developing countries. Specifically: (i) [ ]-percent of tariffs to face a [ ] percent average tariff cut and a minimum of [ ] percent; for most import-sensitive products market access to grow through both tariff cuts and tariff-rate quota (TRQ) quantity increases; (ii) [ ] percent of tariffs to face Swiss formula with a coefficient [ ]; and, (iii) [ ] percent of tariffs to be duty-free.	Blend approach applicable to developed countries only. Specifically: (i) [ ] percent of tariffs to be subject to a [ ]-percent tariff cut; (ii) [ ] percent of tariffs to face Swiss formula with a coefficient of [ ]; and, (iii) [ ] percent of tariffs to become duty-free.	Same as EU/U.S. joint paper.	Same as EU/U.S. joint paper. For developed countries, tariff cuts to result in a simple average tariff reduction for all agricultural products of no less than [ ] percent.	Tariff reduction for most products to be based on a tiered formula approach, in which different tariffs bands are created with separate tariff reduction formulas established for each band. No specific modalities identified. Tariff reductions to be based on bound rates. In-quota tariff rates to be reduced or eliminated.
Other tariff issues	Tariffs exceeding a maximum of [ ] percent to be either lowered to that maximum, or countries to provide increased market access through a request/offer approach that might include TRQs. Special agricultural safeguards (SSGs) open for discussion.	Tariffs exceeding a maximum of [ ] percent to be lowered to that maximum. Factor of [ ] to be applied to the tariff cut of any processed product, if the tariff on the processed products is higher than the tariff of the product in its unprocessed form. TRQ quantities to be increased to [ ] percent of domestic consumption. In-quota tariffs to be eliminated. Introduce rules for TRQ administration. SSGs for developed countries to be eliminated.	For developed countries, Tariffs exceeding a maximum of [ ] percent to be lowered to that maximum, or additional market access to be provided through an expansion of TRQ quantities. Tariff escalation to be addressed. SSGs use and duration to be negotiated.	For developed countries, tariffs exceeding a maximum of [ ] percent to be lowered to that maximum, or additional market access to be provided through an expansion of TRQ quantities. Very limited number of products on the basis of nontrade concerns to be exempt from the maximum tariff commitment. Factor of [ ] to be applied to the tariff cut of any processed product, if the tariff on the processed products is higher than the tariff of the product in its unprocessed form. In-quota tariffs to be reduced by [ ] percent. SSGs use and duration to be negotiated.	Special products to be designated that would not be subject to the tiered approach, with improvement in market access via a combination of TRQ increases and tariff cuts applying to each product, based on an agreed-upon formula with some TRQ expansion required for all such products. TRQ administration to be improved. Tariff simplification to be addressed. Tariff escalation to be addressed. SSGs to be addressed.

Table A1– (*continued*)
Summary of proposals: Market access

Issue	EU/U.S. joint paper (08/13/2003)	G-20 framework (08/20/2003)	Castillo text (08/24/2003)	Derbez text (09/13/2003)	July 2004 framework (07/27-30/2004)
Special and differential (S&D) treatment for developing countries	Special agricultural safeguard mechanism (SSM) to be created for import-sensitive products of developing countries. Developed countries to provide duty-free access for at least [ ] percent of imports from developing countries. Developing countries to be subject to lower tariff-reduction commitments and longer periods for to implementing reforms.	The formula applicable for tariff reductions to be as follows: (i) all tariffs would face a [ ]-percent cut on average, with a minimum of [ ] percent; and (ii)developing countries not required to increase TRQ quantities or eliminate in-quota tariffs. For developing countries, SSM to be established. For developed countries, duty-free access to be provided to agricultural products that account for no less than [ ] percent of their imports from developing countries. For developed countries, tariffs to be removed on all tropical product imports. Developing countries to face lower tariff reductions and longer implementation periods. Special products (SPs) to receive exemption or relief from the reforms.	For developing countries, tariff cuts to be based on a three-tiered approach involving: (i) [ ] percent of tariffs to face a [ ]-percent average cut and [ ] percent minimum cut; and for the import-sensitive products subject to the minimum cuts, growth in market access to result from both tariff cuts and TRQ increases. In this tier, developing countries to be allowed to exemption designated SPs. (ii) [ ] percent of tariffs to face a [ ]-percent average cut and [ ]- percent minimum cut; and (iii) [ ] percent of tariffs to face a [ ]- percent average cut and [ ] percent minimum cut. As an alternative to (ii) and (iii) above, [ ] percent of tariff lines to be subject to a Swiss formula with a coefficient of [ ]. SSM to be established for use by developing countries for specified products, under unspecified conditions. For developed countries, tariffs to be removed from at least [ ] percent of imports from developing countries.	For developing countries, tariff cuts to be based on a three-tiered approach involving: (i) [ ] percent of tariffs to face a [ ]-percent average cut and [ ]-percent minimum cut; import-sensitive product market access growth to result from both tariff cuts and TRQ increases. In this tier, developing countries allowed to designate SPs on which tariffs would not have to be lower beyond a minimum of [ ] percent, and for which commitments on additional TRQs quantities would be not required; where tariffs are very low (less than [ ] percent) no tariff reductions would be required. (ii) [ ] percent of tariff lines to be cut using a Swiss formula with a coefficient of [ ]; and, (iii) [ ] percent of tariff lines to be bound between 0 and 5 percent, taking into account the importance of tariffs as a source of revenue for developing countries. For developing countries, time period of [ ] years to be allowed for implementing tariff cuts in (ii) and (iii) above. SSM to be established for use by developing countries for specified products. All developed countries to provide duty-free access for no less than [ ] percent of imports from developing countries (in particular tropical products). Members to consider the importance of preferential access arrangements for developing countries.	S&D provisions to cover tariff reduction formulas, the number and treatment of SPs, expansion of TRQs, and implementation period. Developing country to face lesser tariff-reduction commitments and TRQ expansion commitments. Developing countries to designate SPs that would face more flexible treatment. SSM to be established. Long-standing trade preference arrangements for developing countries to be recognized.

Table A2:
Summary of proposals: Export competition

Issue	EU/U.S. joint paper (08/13/2003)	G-20 framework (08/20/2003)	Castillo text (08/24/2003)	Derbez text (09/13/2003)	July 2004 framework (07/27-30/2004)
Export subsidies	Export subsidies to be eliminated over a [ ]-year period for those products of particular interest to developing countries. For other products, subsidy quantities and budgetary outlays to be reduced (although not eliminated).	Export subsidies on products of particular interest to developing countries to be phased out over [ ] years. Export subsidies on other products to be phased out of [ ] years.	Same as EU/U.S. joint paper	Export subsidies to be eliminated over a [ ]-year period for those products of particular interest to developing countries. A list of these products to be established that would be part of the a country's comprehensive draft of commitment schedules. Export subsidy elimination of these specific products would take place over [ ] years. For other products, export subsidy reduction, with a view to phasing out, budgetary and quantity subsidy allowances.	All export subsidies to be eliminated.
Export credits	Subsidy component of export credits to be phased out (by requiring repayment terms to conform with commercial practice) for those same products of particular interest to developing countries and over the same implementation period as export subsidies. For other products, export credit subsidies to be disciplined in a manner consistent with reductions in export subsidies.	Export credits, guarantees and insurance programs to be subject to a rules-based approach that would include identification and elimination of the subsidy component of these programs.	Subsidy component of export credits to be phased out (by requiring repayment terms to conform with commercial practice) for those same products of particular interest to developing countries and over the same implementation period as export subsidies. For other products, export credit to be disciplined in order to reduce, with a view to phasing out, the subsidy element of export credit programs.	Same as Castillo text.	Export credits, export credit guarantees or insurance programs with repayment periods of more than 180 days to be eliminated. Export credit guarantees and insurance programs with less than 180 days repayment to be subject to disciplines covering such elements as payment of interest, minimum interest rates, minimum premium requirements, and other elements which can constitute subsidies or distort trade.
State-trading enterprises (STEs)	Controls to be put on the practices of export-oriented STEs (such as ending financing and single-desk export privileges, and monopoly pricing) that might result in providing subsidies to exports.	STEs to be subject to disciplines.	Disciplines on export subsidies and credits would also apply when such measures are provided either directly or indirectly through STEs	Same as Castillo text.	Trade-distorting practices of STEs, such as government subsidies, financing, and the underwriting of losses, to be subject to disciplines.

Table A2– (*continued*)
Summary of proposals: Export competition

Issue	EU/U.S. joint paper (08/13/2003)	G-20 framework (08/20/2003)	Castillo text (08/24/2003)	Derbez text (09/13/2003)	July 2004 framework (07/27-30/2004)
Food aid	Provisions to be introduced to prevent food aid shipments from displacing commercial sales.	Same as EU/U.S. joint paper.	Same as EU/U.S. joint paper.	Same as EU/U.S. joint paper.	Same as EU/U.S. joint paper.
Special and differential (S&D) treatment for developing countries	S&D treatment with respect to export subsidies to be recognized, however, some net food-exporting countries to be required to face less comprehensive S&D treatment.	Continuation of the Uruguay Round Agreement on Agriculture (URAA) provisions (paragraph 9.4) that developing countries be exempt from commitments on export subsidies that: (i) reduce the costs of marketing exports of agricultural products (other than widely available export promotion and advisory services), including handling, upgrading and other processing, and international transport and freight; and (ii) reduce the internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favorable than for domestic shipments.	The S&D component for export competition to include a longer implementation period for reducing and phasing out of export subsidies by developing countries. Continuation of the URAA provisions that developing countries be exempt from commitments on export subsidies that: (i) reduce the costs of marketing exports of agricultural products (other than widely available export promotion and advisory services), including handling, upgrading and other processing costs, and the costs of international transport and freight; and (ii) reduce the internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favorable than for domestic shipments. Export credit disciplines to be established that provide for differential treatment in favor of least-developed and net food-importing developing countries.	Same as Castillo text.	Developing countries to receive S&D treatment in terms of longer implementation periods for the phasing out of all forms of export subsidies. Continuation of the URAA provisions that developing countries be exempt from certain commitments on export subsidies. Disciplines on export credits, export credit guarantees, or insurance programs to also include differential treatment favoring least-developed and net food-importing developing countries. STEs with monopoly status in developing countries that facilitate domestic consumer-price stability and to ensure food security to benefit from special concessions. In special cases where food aid, commercial export credits, or preferential international financing facilities are inadequate, concessions to be made for *ad hoc* temporary financing arrangements relating to exports to developing countries.

Table A3:
Summary of proposals: Domestic support

Issue	EU/U.S. joint paper (08/13/2003)	G-20 framework (08/20/2003)	Castillo text (08/24/2003)	Derbez text (09/13/2003)	July 2004 framework (07/27-30/2004)
Amber box (trade distorting)	Trade-distorting domestic support to be reduced within a range of [ ] to [ ] percent.	All forms of trade-distorting domestic support to be reduced on a product-by-product basis by between [ ] and [ ] percent, with a range of no more than [ ] percent. Exported products receiving domestic support and account for more than a specified share of world exports, to face domestic support reductions at the upper levels of the reduction range. In year 1, trade-distorting domestic support reductions to be at least [ ] percent, regardless of the product category.	Under the proposal, the bound total Aggregate Measure of Support (AMS) would be lowered by a range between [ ] and [ ] percent.	For developed countries, amber- box expenditures to be reduced to a range of [ ] to [ ] percent. Amber-box support for individual products to be capped at their levels during the period [ ].	To ensure that support is cut for all products, product-specific amber-box payments to be capped at to be agreed-upon average levels.
Blue box (less trade-distorting)	Less trade-distorting domestic support) to be redefined to include: (i) payments based on fixed areas and yields; (ii) payments made on 85 percent or less of the base level of production; and (iii) livestock payments made on a fixed number of head. Less trade-distorting domestic support expenditures to be reduced to no more than 5 percent of the value of agricultural production by the end of the implementation period.	Blue box to be eliminated.	Blue-box programs to be redefined to include: (i) payments based on fixed areas and yields; (ii) payments made on 85 percent or less of the base level of production; and (iii) livestock payments made on a fixed number of head. Blue box-type support to be lowered in two steps. First it would be reduced to 5 percent of the 2000-02 average value of agricultural production by the year [ ], and then, reduced by [ ] percent annually for a further period of [ ] years.	Same as Castillo text.	Blue-box definition to be revised to include direct payments under production limiting programs or direct payments that do not require production. Blue-box payments not to exceed 5 percent of a Member's average total value of agricultural production during a to be negotiated historical period.
De minimis	*De minimis* support to be reduced by [ ] percent.	Same as EU/U.S. joint paper.	Same as EU/U.S. joint paper.	Same as EU/U.S. joint paper.	Same as EU/U.S. joint paper.

Table A3– (*continued*)
Summary of proposals: Domestic support

Issue	EU/U.S. joint paper (08/13/2003)	G-20 framework (08/20/2003)	Castillo text (08/24/2003)	Derbez text (09/13/2003)	July 2004 framework (07/27-30/2004)
Combined support	The sum of trade-distorting domestic support, less trade-distorting domestic support, and *de minimis* to be reduced significantly below the 2004 level of support under the existing amber box, blue box, and *de minimis*.	The sum of amber box and *de minimis* support to be cut at least [ ] percent.	Total AMS support, blue box, and *de minimis* support to be lowered in an initial period to a level substantially lower than the sum of these three from their 2000 levels.	The sum amber box, blue box, and *de minimis* support in 2000 to be reduced no less than [ ] percent, including a reduction of [ ] percent during the first implementation year.	Base level of all trade-distorting domestic support to be lowered based on a tiered formula. In the first year and throughout the implementation period, countries to cut support by at least 20 percent. Support to be cut progressively over the implementation period in a manner that ensures countries with high support levels be required to make deeper cuts.
Green box (non-trade-distorting)	Not mentioned.	Green-box payments by developed countries to be capped and/or cut.	Green-box payments to remain under negotiation.	Green-box criteria revised to ensure minimal impact of programs on production.	Same as Derbez text.
Special and differential (S&D) treatment for developing countries	S&D treatment for domestic support not specified.	The scope of Article 6.2 of the Uruguay Round Agreement on Agriculture (URAA) to be widened to include focused and targeted programs. Developing countries exempt from *de minimis* reduction requirements	Allowance for lower amber-box reductions and longer implementation periods. Special treatment to be provided as in Article 6.2 of the URAA and with respect to the green box. Exemption from lowering the *de minimis* level of support.	Same as Castillo text.	Same as Castillo text.

ENDNOTES

1. Four earlier *Industry Trade and Technology Review* articles about multilateral trade negotiations for agriculture, are Jonathan R. Coleman, "Agriculture in the WTO: The Seattle Ministerial and Beyond," *Industry Trade and Technology Review,* USITC publication 3293, Mar. 2000, pp. 21-45; Jonathan R. Coleman, "WTO Agricultural Negotiations: An Update," *Industry Trade and Technology Review*, USITC publication 3363, Oct. 2000, pp. 1-6; Joanna Bonarriva and Jonathan R. Coleman, "WTO Agricultural Negotiations: A Second Update," *Industry Trade and Technology Review*, USITC publication 3501, Mar. 2002, pp. 7-36; and Jonathan R. Coleman and Joanna Bonarriva, "WTO Agricultural Negotiations: A Third Update," *Industry Trade and Technology Review*, USITC publication 3602, Apr. 2003, pp. 1-24. All articles are posted on the USITC Internet site at *www.usitc.gov/webpubs.htm*.
2. Ministerial conferences are the WTO's highest level decision-making body.
3. WTO, Final Declaration from Doha Ministerial Conference, *http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm#agriculture*.
4. U.S. Department of Agriculture (USDA), Foreign Agricultural Service (FAS), "Doha Ministerial Provides New Impetus for Multilateral Negotiations on Agriculture," *AgExporter*, Feb. 2003, pp. 4-6.
5. The term "modalities" refers to trade rules governing how far and how fast countries reduce export subsidies and trade-distorting domestic supports, and open markets to foreign competition.
6. A discussion of developments in the WTO agricultural negotiations during November 2001-March 2003 is provided in Coleman and Bonarriva, "WTO Agricultural Negotiations: A Third Update."
7. Mini-Ministerials took place in Sharm El-Shek, Egypt; Montreal; Sydney; and Tokyo.
8. "WTO Negotiators Wait for Political Direction," *Feedstuffs*, May 26, 2003; and "WTO Members Fail to Make Progress at Mini-Ministerial," *Bridges Weekly Trade News Digest*, June 25, 2003.
9. "Meetings Abound Ahead of Key Trade Negotiations," *Feedstuffs*, July 28, 2003.
10. This draft declaration can be found at, *http://www.ictsd.org/ministerial/cancun/docs/draft_cancun_minist_text.pdf*.
11. Joint EC.U.S. Paper, Job(03) 157, Aug. 13, 2003, found at, *http://usinfo.state.gov/topical/econ/wto/ag030813.htm*.
12. For details of these issues, see Coleman and Bonarriva, "WTO Agricultural Negotiations: A Third Update."
13. Although agreement on a framework between the EU and United States was lauded as a necessary step in the process, criticism of the plan was voiced from several sides. The Cairns Group (18 medium-sized agricultural exporting countries with the shared goal of liberalizing global commodity markets. Members include Australia, Argentina, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Fiji, Guatemala, Indonesia, Malaysia, New Zealand, Paraguay, the Philippines, South Africa, Thailand, and Uruguay) indicated disappointment that the plan did not call for the elimination of all export subsidies, and that the proposals on market access were vague. Concerns were also expressed about the proposed changes of blue-box payments and the lack of changes to the green box, that, according the Cairns Group countries, would allow the EU and United States to continue to maintain high levels of domestic support. Developing countries were critical of the plan because it failed to mention special products, and had not included provisions for least-developed countries. There was also concern that significant net food-exporting developing countries would face less stringent S&D treatment compared with net-importing developing countries, and that developing countries should not be subject to differentiation. Japan reacted to the paper with caution, noting concern over the market-access provisions, especially the proposal to place a ceiling on tariff levels. "Agricultural Negotiations at the WTO, Post-Cancun Outlook Report," International Center for Trade and Sustainable Development, Geneva, Switzerland, Nov. 2003, found at *http://www.agtradepolicy.org/output/resource/agriculturenegotiations9.pdf*; and Josling, Tim, and Dale Hathaway, "This Far and No Farther? Nudging Agricultural Reform Forward," Institute for International Economics, International Economics Policy Brief, No. PB04-1, Mar. 2004, found at *http://www.iie.com/publications/pb/pb04-1.pdf*. For description of domestic support boxes under the URAA, see Coleman, "Agriculture in the WTO: The Seattle Ministerial and Beyond."
14. The [ ] denotes an unspecified amount, to be determined in the negotiations.
15. This method was applied under the URAA and advocated by the EU.
16. The Swiss formula for industrial tariff reduction in the Tokyo Round reduced higher tariffs proportionally more than lower tariffs. Under the formula, the final tariff = (base tariff * coefficient) / (base tariff + coefficient). Assuming a coefficient (which is also the tariff ceiling) of 15, a base tariff of 10 percent would be reduced to

6 percent, whereas a base tariff of 60 percent would be reduced to 12 percent. The Swiss formula approach was advocated by the United States.
17. Tariffs that are substantially higher than average tariffs for other products.
18. Introduced in the Uruguay Round, SSGs enable countries to temporarily apply extra duties for products specified in their schedules of concessions if import prices should fall below a certain level or if the quantity of imports rises too quickly in relation to an average over the previous 3 years.
19. This method was applied under the URAA.
20. This definition differs from the blue box under the URAA in that it does not require production limitations, such as set asides, or other supply management. The definition would allow U.S. countercyclical payments, as under the 2002 Farm Bill, to qualify as less trade-distorting domestic support. "Agriculture: Real Negotiations Start as EC, U.S. Table Joint Modalities," *Bridges Weekly Trade News Digest*, Aug. 21, 2003.
21. *De minimis* is currently 5 percent for developed countries and 10 percent for developing countries.
22. Green box policies are those domestic support policies considered not to be trade distorting and not subject to limitations (e.g., conservation programs, research and extension, marketing and promotion programs, inspection and grading policies, domestic food aid, disaster relief, revenue insurance programs, and direct payments not linked to production).
23. WTO, "Agriculture - Framework Proposals," joint proposal by Argentina, Bolivia, Brazil, Chile, China, Colombia, Costa Rica, Cuba, Ecuador, El Salvador, Guatemala, India, Mexico, Pakistan, Paraguay, Peru, the Philippines, South Africa, Thailand, and Venezuela, Job (03)/162, Aug. 20, 2003, found at *http://www.wto.org/english/tratop_e/agric_e/negs_bkgrnd21_props3_e.htm*.
24. Note, that under the EU-U.S. proposal, tariffs in this first category are cut by both an average and minimum amount, as in the URAA.
25. Under Article 6.2 of the URAA, certain types of domestic support by developing countries are not countered toward the Aggregate Measure of Support (AMS). Exempt from the AMS are programs such as government support to promote agricultural and rural development that are part of development programs, investment subsidies which are generally available to agriculture, agricultural input subsidies generally available to low-income or resource-poor producers, and domestic support to producers to encourage diversification away from growing illicit narcotic crops.
26. For text see, *http://www.wto.org/english/thewto_e/minist_e/min03_e/draft_decl_annex_e.htm*.
27. For example, proposals were also received from the African Union (AU); African, Caribbean and Pacific (ACP) countries, and least-developed countries (Aug. 24, 2003); Joint text from the Dominican Republic, Honduras, Kenya, Nicaragua, Panama, and Sri Lanka (See "Agricultural Negotiations at the WTO, Post-Cancun Outlook Report," International Center for Trade and Sustainable Development).
28. The three-tiered approach based on the URAA average and minimum tariff cuts requirement was first proposed for all countries in the Harbinson text.
29. Note, the Castillo text included the phrase "with a view to phasing out." This was not part of the EU-U.S text.
30. Note in the EU-U.S. paper, support would be lowered to 5 percent of the value of agricultural production by the end of the implementation period.
31. Under Article 6.2 of the URAA, certain types of domestic support by developing countries are not counted toward the AMS. Exempt from the AMS are programs such as government support to promote agricultural and rural development that are part of development programs, investment subsidies which are generally available to agriculture, agricultural input subsidies generally available to low-income or resource-poor producers, and domestic support to producers to encourage diversification away from growing illicit narcotic crops.
32. WTO, "Summary of 10 September 2003. Day 1: Conference Kicks Off with 'Facilitators' Named and Cotton Debated," press release, Sept. 10, 2003, found at *http://www.wto.org/english/thewto_e/minist_e/min03_e/min03_10sept_e.htm*.
33. "Cotton - the 'Trips and Health' of Cancun?" *Bridges Daily Update*, Sept. 11, 2003.
34. Argentina, Bolivia, Brazil, Chile, China, Colombia, Costa Rica, Cuba, Ecuador, Egypt, El Salvador, Guatemala, India, Mexico, Pakistan, Paraguay, Peru, the Philippines, South Africa, Thailand, and Venezuela.
35. "Cancun Ministerial: Setting the Stage."
36. These issues were identified in the draft as "of interest but not agreed" by the membership for discussion in Cancun.
37. Egypt joined the G-20.
38. "New Ministerial Text to be Issued Today," *Bridges Daily Update,* Sept. 13, 2003.
39. "Cotton - the 'Trips and Health' of Cancun?" *Bridges Daily Update.*
40. WTO, "Summary of 10 September 2003."

41. "Poverty Reduction: Sectoral Initiative in Favor of Cotton," joint proposal by Benin, Burkina Faso, Chad, and Mali, WTO document WT/MIN(03)/W/2*, Aug. 15, 2003.
42. WTO, "Agricultural Backgrounder: Cotton Initiative," found at *http://www.wto.org/english/tratop_e/agric_e/negs_bkgrnd20_cotton_e.htm*.
43. "Will Chair's Ag. Text Warm Up Frozen Talks? *Bridges Daily Update*, Sept. 12, 2003.
44. "Cotton - the 'Trips and Health' of Cancun?" *Bridges Daily Update.*
45. AGOA was signed into law in 2000, and designates 34 sub-Saharan African countries as eligible for duty-free access to the U.S. market through the General System of Preferences program. For more background information on AGOA, see *http://www.ustr.gov/regions/africa/factsheet.pdf*, retrieved July 14, 2003.
46. "New Ministerial Text to be Issued Today" *Bridges Daily Update*, Sept. 13, 2003.
47. "Cancun Ministerial: Setting the Stage," *Bridges Daily Update*, Sept. 10, 2003.
48. "Cotton - the 'Trips and Health' of Cancun?" *Bridges Daily Update.*
49. WTO, "Summary of 12 September 2003. Day 3: Facilitators Start Work on New Draft Declaration," press release, Sept. 12, 2003, found at *http://www.wto.org/english/thewto_e/minist_e/min03_e/min03_12sept_e.htm*.
50. WTO, "Summary of 13 September 2003. Day 4: As Ministers Comment on New Draft, Chairman Warns of Dangers of Failure," press release, Sept. 13, 2003, found at *http://www.wto.org/english/thewto_e/minist_e/min03_e/min03_13sept_e.htm*.
51. "New Ministerial Text to be Issued Today."
52. Ibid.
53. For text see, *http://www.wto.org/english/thewto_e/minist_e/min03_e/draft_decl_annex_rev2_e.htm*.
54. "At the Eleventh Hour, Divergence All Over Again," *Bridges Daily Update*, Sept. 14, 2003.
55. "Agricultural Negotiations at the WTO, Post-Cancun Outlook Report," International Center for Trade and Sustainable Development.
56. The G-10 are Bulgaria, Taiwan, Iceland, Israel, Japan, Korea, Lichtenstien, Mauritius, Norway, and Switzerland.
57. This proposal was included in "Consolidated African Union/ACP/LDC Position on Agriculture," WT/MIN(03)/W/17, Sept. 12, 2003, found at *http://docsonline.wto.org/DDFDocuments/t/WT/MIN03/W17.doc*.
58. Note, the Castillo text included the phrase "with a view to phasing out." This was not part of the EU-U.S joint paper.
59. Payments based on fixed areas and yields; payments made on 85 percent or less of the base level of production; or livestock payments made on a fixed number of head.
60. Under Article 6.2 of the URAA, certain types of domestic support by developing countries are not countered toward the AMS. Exempt from the AMS are programs such as government support to promote agricultural and rural development that are part of development programs, investment subsidies which are generally available to agriculture, agricultural input subsidies generally available to low-income or resource-poor producers, and domestic support to producers to encourage diversification away from growing illicit narcotic crops.
61. "At the Eleventh Hour, Divergence All Over Again, *Bridges Daily Update*, Sept. 14, 2003.
62. Ibid.
63. "Cancun Collapse: Where There's No Will There's No Way," *Bridges Daily Update,* Sept. 16, 2003.
64. WTO, "Summary of 14 September 2003. Day 5: Conference Ends Without Consensus," press release, Sept. 14, 2003, found at *http://www.wto.org/english/thewto_e/minist_e/min03_e/min03_14sept_e.htm*.
65. For instance, an October 6 negotiating session, planned prior to the Cancun Ministerial, was postponed in the wake of the failed talks.
66. EC, "European Commission Proposes to Put Doha Round of Trade Talks Back on Track," press release, Nov. 26, 2003, found at *http://europa.eu.int/comm/trade/issues/newround/pr261103_en.htm*.
67. Ibid.
68. "Doha Round Agriculture Talks Show No Sign of Breakthrough," *Feedstuffs*, Dec. 8, 2003.
69. WTO, "Agriculture Negotiations: Backgrounder, the Issues, and Where We Are Now," Apr., 2004, found at *http://www.wto.org/english/tratop_e/agric_e/negs_bkgrnd00_contents_e.htm*.
70. "Key WTO Talks to Open March 22," *Feedstuffs*, Mar. 22, 2004.
71. "WTO Agriculture Week: No Negotiating Breakthrough Expected," *Bridges Weekly Trade News Digest*, Mar. 31, 2004.
72. "Agricultural Negotiations at the WTO. Framework Phase Update Report," International Center for Trade and Sustainable Development, Geneva, Switzerland, June 2004, found at *http://www.agtradepolicy.org/output/resource/agriculturenegotiations11.pdf*.
73. "Key WTO Talks to Open March 22," *Feedstuffs*.

74. "Negotiators Reach Consensus to Aim for Framework Accord in WTO Talks," *Feedstuffs*, Apr. 12, 2004.
75. "WTO Agriculture Week: No Negotiating Breakthrough Expected," *Bridges Weekly Trade News Digest*.
76. "Negotiators Reach Consensus to Aim for Framework Accord in WTO Talks," *Feedstuffs*, Apr. 12, 2004.
77. "WTO Agriculture Week: No Negotiating Breakthrough Expected."
78. "US Negotiator 'Encouraged' by Last Week's WTO Talks," *Feedstuffs*, Mar. 29, 2004.
79. "Agriculture Negotiations: Members Still Divided Over Market Access," *Bridges Weekly Trade News Digest*, June 9, 2004.
80. Payments—compensation for farmers for the difference between market prices and target prices determined by the government—are proposed to be put in the blue box when they had been in the amber box.
81. "Negotiators Upbeat After WTO Talks," *Feedstuffs*, June 14, 2004.
82. "Trade Groups' Pledge Over Farm Talks Rules," *Financial Times*, June 15, 2004.
83. "WTO Ag Chair Sees Shift on Market Access, But U.S., EU Still Split on Export Competition," *International Trade Daily*, June, 25, 2004.
84. "Latest WTO Ag Talks Off to Rocky Start; Chairman 'Nowhere Near Ready' with Draft," *International Trade Daily*, June, 24, 2004.
85. Ibid.
86. WTO, "Framework for Establishing Modalities in Agriculture," found at *http://www.wto.org/english/tratop_e/dda_e/draft_text_gc_dg_31july04_e.htm*.
87. The URAA blue-box criteria would still apply, i.e., payments based on fixed and unchanging bases and yields; or livestock payments made on a fixed and unchanging number of head; and such payments are made on 85 percent or less of a fixed and unchanging base level of production.
88. So long as payments are based on fixed and unchanging bases and yields; or livestock payments made on a fixed and unchanging number of head; and such payments are made on 85 percent or less of a fixed and unchanging base level of production.
89. Under Article 6.2 of the URAA, certain types of domestic support by developing countries are not countered toward the AMS. Exempt from the AMS are programs such as government support to promote agricultural and rural development that are part of development programs, investment subsidies which are generally available to agriculture, agricultural input subsidies generally available to low-income or resource-poor producers, and domestic support to producers to encourage diversification away from growing illicit narcotic crops.

APPENDIX A
Key Performance Indicators of Selected Industries and Regions[1]

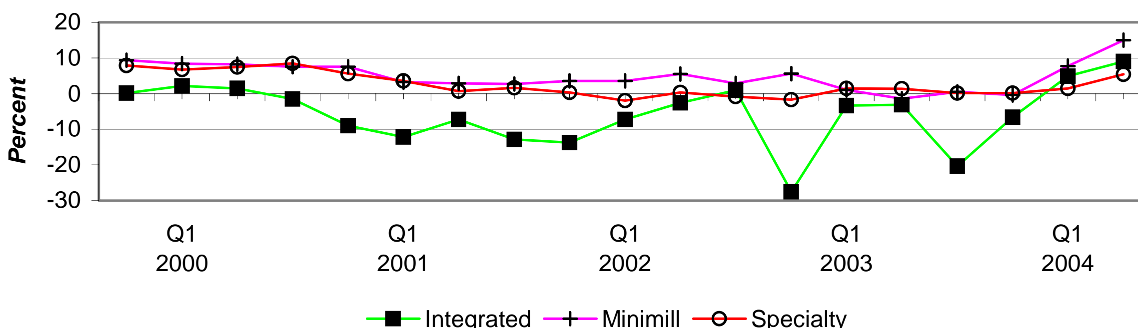
Title	Author[1]	Page
Steel	Harry Lenchitz (202) 205-2737 *harry.lenchitz@usitc.gov*	A-2 A-3
Automobiles	Laura A. Polly (202) 205-3408 *laura.polly@usitc.gov*	A-4
Unwrought Aluminum	Karl Tsuji Judith-Anne Webster (202) 205-3489 *judith-anne.webster@usitc.gov*	A-5
Flat Glass	Vincent DeSapio (202) 205-3435 *vincent.desapio@usitc.gov*	A-6
Services	Cynthia Payne (202) 205-3410 *cynthia.payne@usitc.gov*	A-7
North American Trade	Audry Tafoya Ralph Watkins (202) 205-3492 *ralph.watkins@usitc.gov*	A-8 A-9

[1] The data and views presented for the following indicators are compiled from the industry sources noted and are those of the authors. They are not the views of the United States International Trade Commission as a whole or of any individual Commissioner. Nothing contained in this information based on published sources should be construed to indicate how the Commission would find in an investigation conducted under any statutory authority.

STEEL

Figure A-1

Operating income[1] for all sectors continues positive trend during second quarter 2004



[1] Operating income (loss) as a percent of sales. Integrated group comprises 4 firms. Minimill group comprises 7 firms. Specialty group comprises 4 firms.
Note.--Beginning in first quarter 2004 integrated group includes l previously untracked firm, and no longer includes l previously tracked firm, reflecting ownership changes in the industry.

Source: Individual company financial statements.

- Wheeling-Pittsburgh Corp. closed its public offering of 3,650,000 shares of common stock on September 21, 2004, netting approximately $100 million. Proceeds repaid outstanding debt and funded capital projects. A new ladle metallurgy furnace went operational in October 2004, 14 months after project start. Wheeling-Pitt emerged from Chapter 11 bankruptcy in August 2003. See *http://www.wpsc.com*

- Trade sources report that senior Commerce and USTR officials met with their counterparts in Russia and Ukraine on September 23-24, 2004 to press for the elimination of export taxes and other barriers restricting scrap exports from those countries. Ukraine imposes a 30 euro-per-ton tax on ferrous scrap exports while Russia has a 15-percent ferrous scrap export tax. See *http://www.insidetrade.com*

- The American Iron and Steel Institute, along with five other steel trade associations and the United Steel Workers of America, submitted a joint response to Commerce on September 24, 2004 strongly supporting continuation of the Steel Import Monitoring and Analysis (SIMA) system. The domestic industry called for indefinite extension and enhancement of the SIMA. See *http://www.steel.org*

- Ispat International N.V. announced on October 25, 2004 that it had agreed to acquire LNM Holdings N.V. On the same day, Ispat International and International Steel Group Inc. announced a definitive agreement to merge. The combined firm, Mittal Steel N.V., would be the world's largest steel producer. See *http://www.ispat.com* and *http://www.intlsteel.com*

- Gerdau Ameristeel US Inc. acquired the fixed assets and working capital of North Star Steel from Cargill Inc. on November 1, 2004, including four long-product minimills and three wire-rod processing facilities. See *http://www.gerdauameristeel.com*

Table A–1
Producers' shipments increase, but imports increase more, during second quarter 2004 compared to second quarter 2003 and first quarter 2004

Item	Q1 2004	Percentage change, Q2 2004 from Q1 2004	Q2 2004[1]	Percentage change, Q2 2004 from Q2 2003
Producers' shipments *(1,000 short tons)*........................	28,265	3.7	29,308	13.2
Finished imports *(1,000 short tons)*...............................	5,197	34.2	6,974	58.8
Semifinished imports *(1,000 short tons)*.........................	1,559	18.2	1,843	77.4
Exports *(1,000 short tons)*...	2,105	-7.7	1,942	-27.3
Apparent supply, finished *(1,000 short tons)*..................	31,357	9.5	34,340	24.4
Ratio of finished imports to apparent supply *(percent)*...	16.6	[2]3.7	20.3	[2]4.4

[1] Preliminary.
[2] Percentage-point change.
Note.–Because of rounding, figures may not add to the totals shown.

Source: American Iron and Steel Institute.

STEEL

Table A–2
Steel service centers: Second quarter 2004 shipments increase by more than 10 percent compared with second quarter 2003, but decline by 15 percent from the record level of first quarter 2004

Item	Mar. 2004	June 2004	Percentage change, June 2004 from Mar. 2003	Q2 2003	Q2 2004	Percentage change, Q2 2004 from Q2 2003
Shipments *(1,000 short tons)*	5,441	4,605	-15.4	12,641	13,957	10.4
Ending inventories *(1,000 short tons)*......	12,890	13,809	7.1	12,836	13,809	7.6
Inventories on hand *(months)*.................	2.4	3.0	([1])	3.2	3.0	([1])

[1] Not applicable.

Source: Metals Service Center Institute.

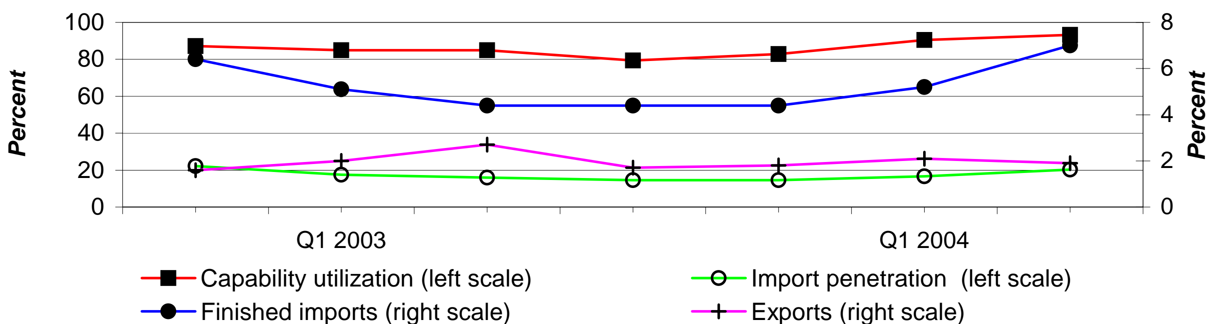
- U.S. steel service centers rebuilt their inventories during second quarter 2004, following record-setting shipments in March (table A-2). Second quarter 2004 steel shipments exceeded year-earlier shipments during each month of the quarter according to the Metals Service Center Institute. See *http://www.msci.org*

- The American Institute for International Steel import market survey (June 2004) predicts increased imports of cut-to-length plate and merchant bar during the next 3 to 5 months. The survey predicts no significant changes in imports of semifinished, hot- or cold-rolled sheet, corrosion resistant, wire rod, structural, pipe and tube, and stainless sheet. See *http://www.aiis.org*

- The 62 countries reporting to the International Iron and Steel Institute produced 745 million tons of crude steel during the first 8 months of 2004, an 8.5-percent increase over the same period in 2003. More than 25 percent of the total (188 million tons) was produced in China. Chinese production increased more than 21 percent compared to the first 8 months of 2003. See *http://www.worldsteel.org*

- Domestic steel mill capability utilization increased for the third consecutive quarter due to strong demand, even as imports increased during second quarter 2004 (figure A-2). See *http://www.steel.org*

Figure A-2
Steel mill products, all grades: Capability utilization continues upward trend during second quarter 2004



Note.--Capability utilization is the raw steel tonnage produced divided by the tonnage capability to produce raw steel for a sustained full order book

Source: American Iron and Steel Institute.

AUTOMOBILES

Table A-3
U.S. sales of new passenger vehicles (cars and light trucks), domestic and imported, and share of U.S. market accounted for by sales of total imports and Japanese imports, by specified periods, January 2003-June 2004

Item	Apr.-June 2004	Jan.-June 2004	Percentage change Apr.-June 2004 from Jan.-Mar. 2004	Percentage change Jan.-June 2004 from Jan.-June 2003
U.S. sales of domestic passenger vehicles (*1,000 units*)	3,606	6,755	14.5	2.5
U.S. sales of imported passenger vehicles (*1,000 units*)	895	1,657	17.4	1.0
Total U.S. sales (*1,000 units*)	4,501	8,412	15.1	2.2
Ratio of U.S. sales of imported passenger vehicles to total U.S. (*percent*)	19.9	19.7	[1]0.4	[1]-0.2
U.S. sales of Japanese imports as a share of the total U.S. sales	9.6	9.8	[1]-0.5	[1]0.7

[1] Percentage point change.

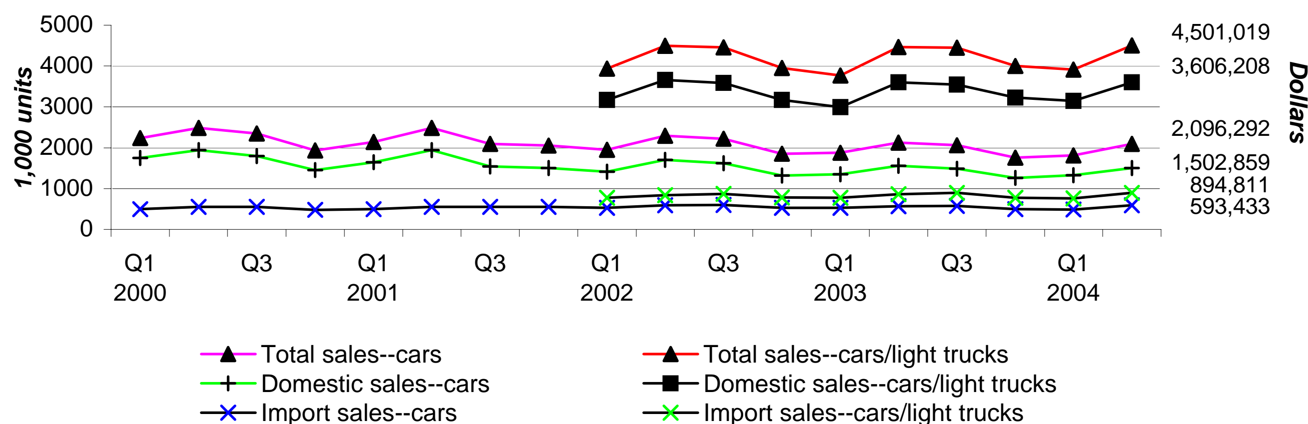
Note.—Domestic passenger vehicles include U.S.-, Canadian-, and Mexican-built cars and light trucks sold in the United States. Imported passenger vehicles do not include cars and light trucks supplied by Canada and Mexico.

- Despite high gasoline prices, U.S. passenger vehicle sales were at their highest for the year in May, up 15 percent over April sales, and up 3 percent over the year-ago May level.

- Sales of passenger vehicles were off in June, the first month in 2004 in which passenger vehicle sales fell below the year-ago month level. June was particularly disappointing for GM and Ford; their sales were down by 12 percent and 8 percent, respectively, over the year-ago month. By contrast, Honda was up by 5 percent, Nissan was up by 14 percent, and Toyota was up by 10 percent.

- Despite the June setback, the industry's sales were up 2.2 percent for the first 6 months of this year. However, this increase did not meet industry expectations, particularly in light of the fact that disposable income and consumer spending both grew by over 3.5 percent during the first half of 2004.

Figure A-3
U.S. sales of new passenger vehicles (cars and light trucks) increased in the second quarter 2004

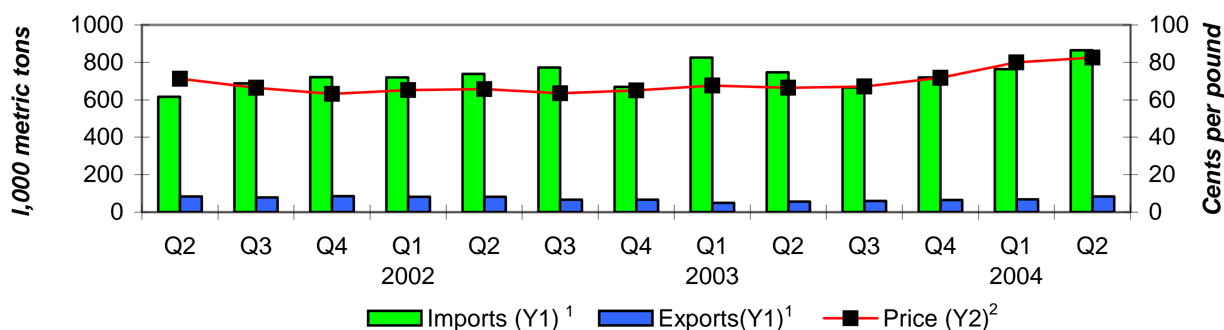


Note.—Domestic sales include U.S.- and Mexican-built vehicles sold in the United States; these same units are not included in import sales.

Source: *Automotive News*; prepared by the Office of Industries.

UNWROUGHT ALUMINUM[1]

Figure A-4
Price of primary aluminum rises 3 percent during second quarter 2004, due to tight supplies of alumina for smelters early in the quarter, along with capacity shutdown at one facility



[1] Unwrought aluminum and aluminum alloys.
[2] Quarterly average of the monthly U.S. market price of primary aluminum ingots.

Source: Compiled by USITC staff based on data obtained from the U.S. Geological Survey.

- Chinese aluminum production was further constrained in mid-second quarter 2004, as the central government tightened credit and refused loans to industrial sectors deemed "overheated." These steps helped ease the global supply-demand imbalance and contributed to lower prices for both alumina and aluminum scrap later in the quarter.
- Aluminum scrap prices came under further downward pressure; Western smelters took advantage of wider margins between scrap and ingot prices to accumulate larger-than-normal scrap inventories this past spring, and planned to buy less scrap in anticipation of the summer's seasonal slow-down and economic uncertainty for fall.
- In May 2004, Alcan Inc. announced plans to divest substantially all of its global rolled-products operations as a separate company to meet regulatory requirements of the U.S. Department of Justice for merging with Pechiney SA (France). Alcan will retain the smelting, refining, and packaging operations, along with certain former-Pechiney rolling operations, with ownership of the Ravenswood, WV, rolling mill yet to be resolved.

Table A-4
Continued robust worldwide demand in second quarter 2004 reflects continued drawdown of London Metal Exchange (LME) inventories from the peak level of fourth quarter 2003 and rising prices for primary aluminum since second quarter 2003

Item	Q2 2003	Q1 2004	Q2 2004	Percentage change: Q2 2004 from Q2 2003	Percentage change: Q2 2004 from Q1 2004
Primary production (*1,000 metric tons*)	674	635	630	-6.5	-0.8
Secondary recovery (*1,000 metric tons*)	738r	741r	755r	2.3	1.9
Imports (*1,000 metric tons*)	746	763	864	15.8	13.2
Import penetration (*percent*)	35.5	36.9	39.9	[1]4.4	[1]3.0
Exports (*1,000 metric tons*)	56	69	84	50.0	21.7
Average nominal price (*cents/lb*)	66.5	79.9	82.5	24.2	3.3
LME inventory level (*1,000 metric tons*)	1,142	1,227	940	-17.7	-23.4

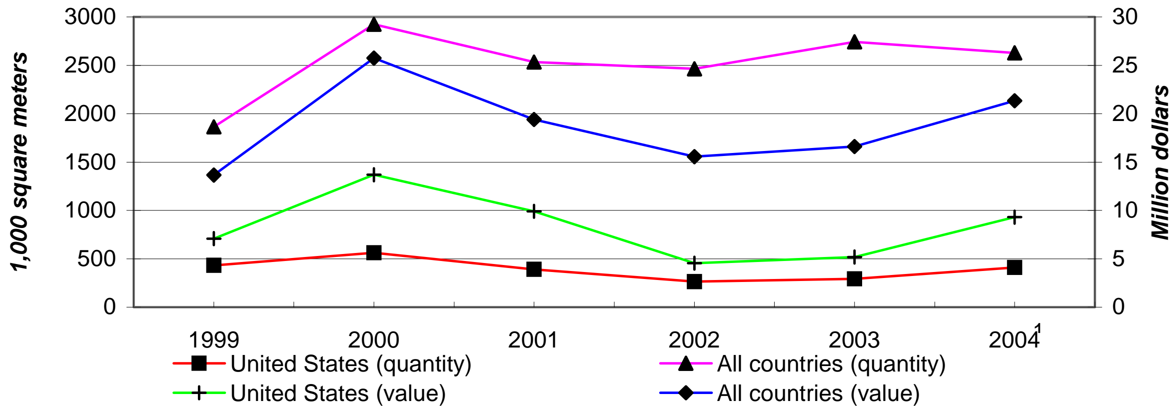
[1] Percent-point change.
Note.–Revised data indicated by "r."

Sources: Compiled from data obtained from U.S. Geological Survey and World Bureau of Metal Statistics.

[1]Product coverage includes only unwrought aluminum and certain aluminum alloys for improved data comparability.

FLAT GLASS

Figure A-5
Japanese monthly average imports from U.S. and World increased during first 7 months of 2004



[1] Data for Jan-July (Latest available data).

Source: Compiled from "World Trade Atlas: Japan" at http://www.globaltradeatlas.com, using official statistics provided by the Government of Japan.

Background

- Although the U.S.-Japanese agreement on Japanese market access for imports of flat glass, which sought to increase access and sales of foreign flat glass in Japan, expired on December 31, 1999,[1] the U.S. Government continues to engage the Japanese Government in discussions over access to the Japanese market. Most recently, in the 2003 Trade Forum discussion held in July 2003 under the U.S.-Japan Partnership for Economic Growth, the U.S. Government "highlighted the continuing problems that prevent market entry, including the need for tighter enforcement of rules against anticompetitive behavior."[2] The U.S. Government also urged Japan to modify regulations to facilitate use of energy-efficient glass in Japan.

- U.S. and Japanese negotiators have agreed that Japan's Ministry of Trade and Industry (now Ministry of Economy, Trade, and Industry (METI)), in conjunction with the Japan Fair Trade Commission (JFTC), should monitor Japanese flat-glass manufacturers and the glass distribution system in Japan to promote competition in the sector.[3]

Current

- As a result of increased economic growth in 2004, Japanese average monthly consumption for imported flat glass from all countries increased 5 percent for the first 7 months of 2004, to 2.6 million square meters, compared with the same period in 2003. The average monthly value of all Japanese flat-glass imports for the first 7 months of 2004 increased 20 percent, to $21.3 million, compared with the same period in 2003. In full-year 2003, the quantity of average monthly Japanese imports increased 8 percent compared with the same imports in 2002, and increased 7 percent in value during the same period.

- Average monthly Japanese imports from the United States increased by quantity and value during the first 7 months of 2004 compared with the same period in 2003 (up 28 percent to 409,000 square meters and up 56 percent to $9.3 million, respectively) due largely to increased demand in Japan for higher-value, architectural-grade coated and ultra-clear flat glass products from the United States, for construction-related applications. In full-year 2003, average monthly imports from the United States increased 10 percent in quantity and 16 percent in value compared with the same imports for 2002.

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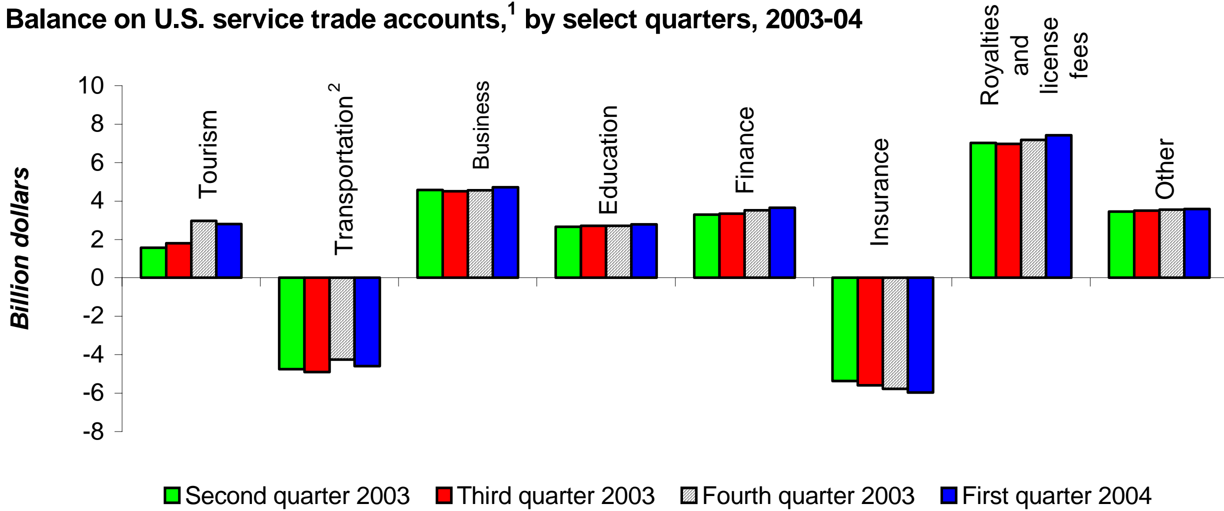
[1]Office of the United States Trade Representative (USTR), *The President's 1999 Annual Report on the Trade Agreements Program*, p. 227, found at *http://www.ustr.gov/reports/tpa/2000index.html*, retrieved Mar. 3, 2004.
[2]USTR, *2004 Trade Policy Agenda and 2003 Annual Report of the President of the United States on the Trade Agreements Program*, Mar. 2004, p. 182.
[3]USTR, *Fourth Annual Submission by the Government of the United States to the Government of Japan on Deregulation and Competition Policy*, Oct. 12, 2000, p. 32.

SERVICES

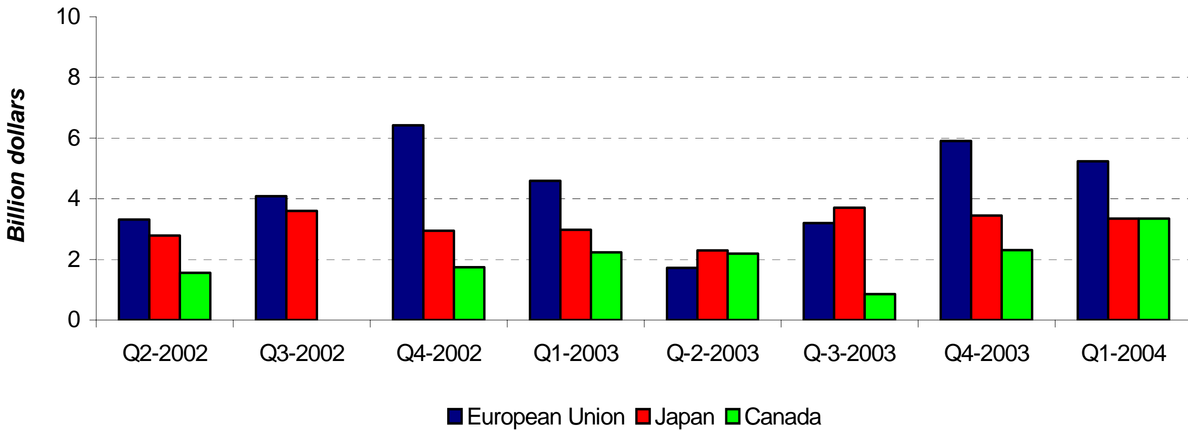
Figure A-6
Balance on U.S. service trade accounts,[1] by select quarters, 2003-04



[1] Data for telecommunication services are to small to be revealed graphically.
[2] Includes passenger fares, freight, and port services.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business,* July 2004, pp. 94-95.

Figure A-7
Surpluses on cross-border U.S. services transactions with selected partners, by select quarters, 2002-04[1]



[1] Private-sector transactions only; military shipments and other public-sector transactions have been excluded.

Source: U.S. Department of Commerce, Bueau of Economic Analysis, *Survey of Current Business*, July 2004, pp. 106-111.

NORTH AMERICAN TRADE HIGHLIGHTS

U.S. trade with its North American partners is highlighted in table A-5. The following is a summary of key developments during the first half of 2004. Trade shifts during the first half of 2004 are compared with the same period a year ago.

- Continued robust growth in the U.S. economy and escalating prices in the energy sector were the principal factors contributing to the 13-percent ($22.4-billion) rise in U.S. imports from NAFTA partners in the first half of 2004. Prices for U.S. imports of petroleum products rose by an average of 3.5 percent per month during January-June 2004, compared with 0.3 percent for non-petroleum products.[1] Petroleum price increases reflected temporary supply disruptions from Nigeria and Venezuela; concern about the security of Middle East petroleum fields; robust global demand, particularly in China and the United States; and constraints in world petroleum refining capacity.

- Canada and Mexico supply about one-third of U.S. imports of crude petroleum. The increased value of petroleum imports from Canada (by $2.3 billion, or 19 percent) and Mexico (by $1.8 billion, or 25 percent) accounted for 16 percent and 21 percent, respectively, of the rise in total U.S. imports from these NAFTA partners in the first 6 months of 2004.

- Rapid economic expansion in China contributed to tight supplies of raw materials and other industrial inputs worldwide, leading to higher commodity prices as reflected by increased import values from Canada of lumber, particle board, aluminum, nickel, gold, and copper. Imports of lumber, for example, rose by $1.1 billion (48 percent) in the first half of 2004 and particle board, by $1.0 billion (141 percent).

- Relatively low U.S. interest rates also sustained U.S. demand for Canadian lumber and particle board, as well as for manufactured goods. U.S. imports of passenger vehicles (primarily full-sized sedans) from Canada rose by $2.3 billion (16 percent) as did Canadian motor vehicle parts and internal combustion engines, by $890 million (14 percent).[2] However, concerns about the spread of "mad cow disease" muted the growth in U.S. imports of live cattle from Canada, which declined from $395 million to $1 million in the first half of 2004.

- By contrast, U.S. imports of passenger vehicles from Mexico fell by $607 million (10 percent) in the first half of 2004. The reduction in imports of passenger vehicles from Mexico, largely attributable to waning popularity of smaller-sized passenger models, was nearly offset by a $522-million (15-percent) increase in imports of Mexican-produced trucks and tractors. Given the North American industry's emphasis on reducing overall assembly costs, U.S. imports from Mexico (like Canada) of certain motor vehicle parts and of internal combustion engines and parts grew by $968 million (24 percent) during the period.

- North American television producers, whose plants are concentrated along the U.S.-Mexico border in San Diego, Tijuana, Mexicali, Ciudad Juarez, and Reynosa, have responded to increased competition from China by placing greater emphasis on higher value-added televisions with flat-screen, high-definition, LCD, and plasma technologies.[3] U.S. imports of televisions from Mexico grew by $1.1 billion (59 percent) in the first half of 2004, whereas imports of parts and related equipment, including cable boxes, nearly doubled, rising by $302 million.

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[1] Calculated by USITC staff from monthly indices published by the U.S. Bureau of Labor Statistics, found at *http://www.bls.gov/news.release/ximpim.nr0.htm,* retrieved Nov. 16, 2004.

[2] Canada traditionally has been a net exporter of assembled vehicles and a net importer of automotive components. Despite the recent upturn in U.S. imports of finished vehicles from Canada, exports of assembled vehicles from Canada generally have been on the decline since 1999. In an Oct. 2004 industry report, the Canadian Automotive Partnership Council recommended increased innovation and efforts to attract investment in the automotive industry so that Canada can restore its status as a major net exporter of finished vehicles. The report can be viewed at *http://capcinfo.ca/english/home-accueil.html*. Peter Menyasz, "Group Urges Canadian Government to End Barriers to Auto Trade With U.S.," *International Trade Daily*, Oct. 29, 2004, pp. 1-2.

[3] For examples of recent investments in production of higher-technology televisions, see "Maquiladora Focus: Factories Are Finally Out of the Woods, but the Export Landscape Has Changed," *Mexico Watch*, July 1, 2004, p. 8.

NORTH AMERICAN TRADE HIGHLIGHTS

Table A-5
North American trade, 1999-2003, January-June 2003, and January-June 2004

Item	1999	2000	2001	2002	2003	January-June 2003	January-June 2004	Percent change 2003/04
	Value *(million dollars)*							
U.S.-Mexico trade:								
Total imports from Mexico	109,018	134,734	130,509	134,121	137,199	67,194	75,557	12
U.S. imports under NAFTA:								
Total value	71,317	83,995	81,162	84,747	87,750	43,111	46,997	9
Percent of total imports	65	62	62	63	64	64	62	[1]-2
Total exports to Mexico	81,381	100,442	90,537	86,076	83,108	40,395	44,944	11
U.S. merchandise trade balance with Mexico[2]	-27,637	-34,292	-39,971	-48,045	-54,091	-26,799	-30,614	-14
U.S. -Canada trade:								
Total imports from Canada	198,242	229,060	216,836	210,518	224,016	111,878	125,900	13
U.S. imports under NAFTA:								
Total value	115,715	123,052	113,179	115,807	119,416	59,204	65,190	10
Percent of total imports	58	54	52	55	53	53	52	[1]-1
Total exports to Canada	145,731	155,601	144,621	142,543	148,749	75,965	81,533	7
U.S. merchandise trade balance with Canada[3]	-52,511	-73,459	-72,215	-67,975	-75,267	-35,913	-44,367	-24

[1] Percentage-point change.
[2] The negative (-) symbol indicates a loss or trade deficit. The $54.1-billion deficit in U.S. merchandise trade with Mexico in 2003 was partially offset by a $4.7-billion U.S. surplus in bilateral services trade, not seasonally adjusted.
[3] The $75.3-billion deficit in U.S. merchandise trade with Canada in 2003 was partially offset by a $7.6-billion U.S. surplus in bilateral services trade. During the first 2 quarters of 2004 the U.S. surplus in bilateral services trade totaled approximately $6.1 billion, not seasonally adjusted.

Source: Compiled by USITC staff from official statistics of the U.S. Department of Commerce. Statistics on U.S. services trade with Canada and Mexico are based on preliminary data provided in U.S. Department of Commerce, Bureau of Economic Analysis, "U.S. International Transactions Accounts Data," table 11, found at *http://www.BEA.DOC.GOV/BEA/International/BP_web/list.CFM?ANON=92.*

- U.S. export growth to NAFTA partners reflects the region's manufacturing integration, with production inputs for goods marketed throughout North America leading the expansion in U.S. exports to Canada (by $5.6 billion, or 7 percent)[4] and Mexico (by $4.5 billion, or 11 percent) in the first half of 2004 compared with the same period in 2003:
  - Leading the first-half rise in U.S. exports to Canada were certain motor vehicle parts, including engines and seats, which increased by $1.3 billion (12 percent). Exports of semiconductors and computer parts rose by $604 million (32 percent), and exports of natural gas and electricity expanded by $510 million (50 percent).
  - Computers and parts topped the growth in U.S. exports to Mexico, rising by $768 million (68 percent), as semiconductors increased by $436 million (24 percent) and parts of television and radio equipment, by $207 million (32 percent). Exports to Mexico of finished passenger vehicles and trucks rose by $440 million (27 percent), as exports of certain motor vehicle parts and parts of internal combustion engines climbed by $457 million (13 percent).

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[4] U.S. exports increased despite a slight depreciation of the Canadian dollar versus the U.S. dollar during the first half of 2004. The Canadian dollar depreciated 0.1 percent and 3 percent, respectively, in the first and second quarters of 2004, representing a reversal of the trend in valuation during 2003, but rebounded in the third quarter of 2004 to an 11-year high of 79.27 U.S. cents in Oct. 2004. Canadian Department of Foreign Affairs and International Trade, "Trade and Economic Analysis," *Quarterly Canadian Trade Review*, available at *http://www.dfait-maeci.gc.ca;* and Wojciech Szadurski, "What's Up With the Canadian Dollar?," found at *http://www.globalinsight.com* retrieved Oct. 15, 2004.