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REPORT OF WORKING PARTY ON ARTICLE XXII:2
CONSULTATIONS ON UNITED STATES EXPORT
SUBSIDY ON UNMANUFACTURED TOBACCO

Introduction

1. The Working Party was established by the Council of Representatives, at the request of the Government of Malawi, with the following terms of reference:

"To conduct on behalf of the CONTRACTING PARTIES consultations under Article XXII:2 with respect to the export subsidy on unmanufactured tobacco introduced by the Government of the United States in June 1966 and to report to the CONTRACTING PARTIES."

2. The Working Party met on 11 November 1967 under the chairmanship of Mr. Mahmood (Pakistan). The Working Party had before it in conducting the consultations the report of Article XXII:1 consultations with the United States held in February 1967 at the request of Malawi and in which Canada, India and Turkey were associated.¹

Reasons for the introduction of the subsidy

3. The representative of the United States again explained the reasons for the introduction of a 5 cents per lb. export subsidy on most types of United States leaf in June 1966. There was a direct connexion between United States commercial policy as regards tobacco and the Government's domestic support policy with respect to this crop. In order to safeguard income levels of domestic producers, while achieving a reasonable relationship between supplies and requirements, a price support programme was in operation for tobacco in terms of which producers received prices in excess of what they would have been if determined by market forces. The pricing policy pursued by the United States Government had had the effect of stabilizing prices in the world market, which had benefited other tobacco producers particularly the less-developed exporting countries. In return for the high prices received, the United States producers were required to accept limitations on acreage that could be planted to tobacco. More recently, for certain types of tobacco, acreage-poundage restrictions had been instituted to encourage

¹The report on the February 1967 consultations will be distributed as L/2925/Add.1.

improvement in quality. As a result of the limitations imposed, United States production had remained relatively constant in relation to world production. Furthermore, despite the increase in world trade, the share of the United States exports substantially declined. The objective of the subsidy introduced in June 1966 was to restore the relative position of United States tobacco by making it more competitive in world markets. He noted, in this connexion, that the competitive position of the United States leaf was adversely affected in a number of important markets by the existence of preferences the United States did not enjoy. He emphasized that the United States sought only to regain an equitable share of the world market and that, as with other programmes, the United States had special regard for the trade interests of the developing countries. He concluded by stating that the United States considered that its tobacco export policy was fully consistent with the provisions of the GATT.

4. In reply to questions posed, the United States representative elaborated further on the elements of his Government's support policy on tobacco. The United States administration sought, within the limits imposed by legislation, to encourage production of leaf types and qualities in strong demand as contrasted to those, such as fire-cured, for which demand was stagnant or declining; but differences in soils and other natural conditions limited the degree to which it was possible to substitute production of one type for another. Poundage and acreage restrictions could only be imposed after referenda of producers. It was not possible under existing legislation to have differing domestic and export prices as was done in the case of wheat. Answering a question on the objective of the subsidy, the United States representative said that, whilst the subsidy was not specifically aimed at reducing stocks held by the Commodity Credit Corporation since it applied equally to purchases on the free market, it could obviously have the effect of bringing about a reduction in the CCC's stocks.

5. The representative of Malawi said that the subsidy had been introduced to alleviate a situation which resulted entirely from the domestic support policies pursued by the United States Government. Whilst he would not wish to question the social reasons for price support, the prices paid to producers had been continually augmented and had enabled producers, by increasing yields, to offset the acreage limitations imposed. The growing production of high-priced tobaccos had resulted in the accumulation of stocks which were difficult to dispose of without governmental assistance. By the use of subsidies, the United States was seeking to transfer the burden of disposing of its expensive tobacco on to the more efficient tobacco producers, most of whom were developing countries.

The representative of Canada pointed out that the subsidy was particularly regrettable because it had been introduced at a time when the international demand for flue-cured tobacco was very strong, and because this commodity had hitherto been relatively free of special governmental export measures. He observed that the preferences, cited by the United States representative as a reason for the introduction of the subsidy, had been a recognized element of the international trade framework, and should not be expected to be offset by export subsidies.

6. The United States representative stated that he could not accept the view that his Government, by subsidization, was attempting to shift the burden of its export programme on to other producers; the cost of the subsidization programme was borne in full by the United States tax payers. In the past, the United States alone among major producers had attempted to limit production so as to bring about a more satisfactory balance between supply and demand; it was unreasonable to expect it to continue to carry the burden of supply adjustment alone while other producers continued to expand production.

7. The representative of Malawi pointed out that his Government too had taken steps to ensure the observance of production targets, entailing a substantial reduction in income of producers, so as to ensure a better balance between supply and demand. The representative of the United States suggested that, because of stagnation in the market for fire-cured tobacco, Malawi was faced with a problem of adjustment which had in fact nothing to do with the subsidy; the United States could sympathize with Malawi because it also had to face declining demand for this type of tobacco, both at home and abroad.

8. The representative of Malawi noted that the subsidy was a further element in the aggressive sales policy pursued by the United States with respect to tobacco. Malawi had already lost exports in Africa as a result of disposals by the United States under Public Law 480 on terms which a country such as his own could not match. The representative of the United States pointed out that his Government was open and fair in operating surplus disposal and through the process of consultation provided interested governments the opportunity of expressing their views. The United States Government took due account of its own and other countries' commercial and trade interests before entering into agreements under Public Law 480 but had also to consider such factors as the ability of the recipient country to buy commercially.

The effects of the subsidy

9. The representative of Malawi stated that price formation on the Malawi auctions was determined by the quality and quantity of the domestic crop and the availability and prices of competing leaf. In the case of fire-cured in particular there was a direct relationship between prices received by Malawi and the prices at which the United States, the other major exporter, was offering. The subsidy could not, therefore, but have the effect of reducing the prices received for Malawi leaf. Other members of the Working Party representing tobacco exporting countries said that the subsidy had had a deleterious effect on their exports. They feared that the subsidy would lead to the replacement of their own leaf by United States leaf in manufactured tobaccos, a trend which, because of the conservatism of smokers, would be difficult to reverse in future. The representative of the United States pointed out that evolving consumer tastes was a phenomenon of many years standing and it would be illogical to blame the subsidy for this.

10. The representative of the United States observed that, although United States tobacco exports in 1966 had been at record levels, the share of United States in world trade was still well below the levels prevailing in 1955/59. Moreover, the gain in exports had been virtually restricted to flue-cured where the situation was abnormal because of the embargoes on Rhodesian leaf. Another factor in the improvement in the export performance of the United States in 1966, had been the better quality of the 1966 crop. United States exports of fire-cured had declined by 21 per cent in 1966 while those of Malawi were down by 13 per cent. Malawi's greatest export losses in 1966 were in the United Kingdom and Rhodesian markets where United States sales of fire-cured were insignificant; thus the subsidy could not possibly have been responsible for Malawi's losses. The United States Government would agree that the subsidy had had some effects in increasing exports in the second half of 1966, but its main impact was likely to have been with respect to flue-cured where price differentials between United States and competing leaf were greatest.

11. The Canadian representative stated that a recent estimate in his country had shown that, as a result of the international United States price leadership for flue-cured tobacco, the level of price Canadian farmers received from their exports and domestic sales had been reduced by approximately the amount of the subsidy and this in turn had significantly reduced their gross income. This effect is expected to be aggravated for the sales of the 1967 crop tobacco in the face of significantly lower prices on the current United States auctions. The United States representative was not aware of this matter but was confident that his Government would be prepared to give it its serious consideration.

12. The representative of Malawi said that according to statistics available to him, United States exports in the first six months of 1967 of Kentucky and Tennessee fire-cured, the types grown in Malawi, were 48 per cent higher than in the corresponding period of 1966. The representative of Canada pointed out that in 1967 the amount of flue-cured tobacco harvested in the United States was the highest for four years and there were indications that the total supply would reach record levels in spite of the highest tobacco export volume in nearly fifty years. There was also evidence that substantial quantities of the 1967 crop were being absorbed into CCC's stocks.

13. The representative of the United States replied that the official statistics published by the United States Department of Agriculture indicated a 25 per cent increase during the first seven months of 1967 for all fire- and sun-cured tobaccos, taken together. He did not have available separate figures for Kentucky-Tennessee fire-cured tobacco which was the type produced by Malawi. He doubted that firm conclusions should be drawn from part-year data.

14. The representative of Malawi said that in a situation where the market for flue-cured leaf was distorted by the absence of Rhodesia, it was difficult, on the basis of available data, to quantify the impact of the subsidy. Moreover, since it was the avowed aim of the subsidy introduced by the United States to restore the competitive position of United States tobacco in world markets by lowering the price differential between United States and competing leaf, this could only have the effect of either reducing the volume of Malawi leaf sold, or of lowering the prices received for this leaf. In the case of fire-cured, the situation was particularly acute because, in a static or even declining market, any gain by the United States would be at the expense of Malawi. The representative of the United States stated that he could not accept that any increase in sales of United States fire-cured would necessarily be at the expense of Malawi, since a number of other factors were involved. It was not the case, as had been stated by a Malawi spokesman in the Council, that "the expressed aim of the American action is to counteract the expansion of trade ofdeveloping countries.....". Nor was it correct that "the United States action in introducing the subsidy can, on the face of it, only be regarded as a direct attack by unfair means on a vital trade interest of Malawi and other developing countries"; rather, the United States gave special consideration to the interests of developing countries and conducted its export programme with restraint.

15. A member of the Working Party considered that, with the removal of Rhodesian supplies, the market for flue-cured tobacco was buoyant and prices were relatively high. This type accounted for as much as 80 per cent of United States exports of tobacco. On the other hand, fire-cured tobacco accounted for only a small part of United States exports of tobacco but accounted for the greater part of Malawi's exports. Any increase in exports brought about by the subsidy would, in view of the large domestic market in the United States, have little total effect on grower's incomes or on the overall size of the CCC inventory. Considering that Malawi was a least developed country heavily dependent on tobacco exports for her livelihood and particularly on fire-cured tobacco, he considered that every effort should be made to avoid action which could damage Malawi's trade in this product.

16. Certain members of the Working Party said that they could see little economic necessity for the action taken by the United States in introducing the subsidy.

Future United States policy as regards the subsidy

17. In reply to questions, the representative of the United States stated that he was not in a position to give an undertaking as to whether any changes would be introduced in the export payments programme. It was his opinion that changes were unlikely in the near future.

18. Certain members of the Working Party noted that Rhodesia was accumulating large stocks of tobacco, particularly flue-cured, and, in the event of that country's being in a position to sell freely on the world market, the very existence of these stocks would depress prices even if they were not rapidly run down. These members noted that, since the United States had introduced the 5 cents export subsidy at a time when the movement of the Rhodesian leaf on to the world market was restricted, it was logical to expect that pressures would be brought to bear on the United States Government to increase the level of subsidization to counter the fall in prices that would, in all probability, follow Rhodesia's re-entry into the market. The representative of Malawi pointed out that if the level of subsidization were increased to meet such a situation in the flue-cured market it would in all likelihood have to be extended to other types with grave results for fire-cured production in Malawi.

19. The representative of the United States said that it would depend on many factors which could not now be foreseen and that it was useless to speculate on his Government's policy in the hypothetical event of the return of Rhodesian leaf to the world market.

20. Some members of the Working Party observed that the future of the subsidy had to be viewed in the light of developments in the Kennedy Round which would seem to have improved the competitive position of United States leaf. The United Kingdom preference would be reduced if the United States were to remove the American Selling Price for chemicals and the Common External Tariff of the European Economic Community had been modified in a manner which would be advantageous to expensive leaf produced by the United States as compared with the cheaper leaf produced by most of its competitors. The spokesman for the European Economic Community stated that these changes would not discriminate as between different types and qualities of tobacco, taking into account foreseeable conditions on the market.

Legal issues

21. The representative of Malawi said that, in his view, Article XVI, read as a whole, was aimed at discouraging the use of export subsidies for primary products. To the extent that the Article condoned such practices, the operation of subsidies was limited by the provisions of paragraph 3 of Article XVI which provided that a subsidy "shall not be applied in a manner which results in the [subsidizing] contracting party having more than an equitable share of world export trade". It was difficult to define the concept of equitability in this context but it was his view that it did not refer to the maintenance by the subsidizing contracting party of a predetermined proportionate share of a growing world market. Moreover, particularly in view of the provisions of an Interpretative Note to paragraph 3 which allowed for the entry of new exporters, there were grounds for maintaining that "equitable shares" could vary. He noted that the United States exports, whilst declining as a proportion of world trade, had not diminished in volume and had actually increased in value. The lack of clarity as regards the provisions of Article XVI:3 would seem to call for the establishment of some ground rules by the CONTRACTING PARTIES. Another member of the Working Party noted that the Working Party on Other Barriers to Trade, established to conduct the review of the General Agreement in 1954, had agreed "that in determining what are equitable shares of world trade the CONTRACTING PARTIES should not lose sight of the desirability of facilitating the satisfaction of world requirements of the commodity concerned in the most economic and effective manner". (BISD, 3S, page 226). Other members of the Working Party also emphasized that the pattern of supply to world markets could not, particularly in the spirit of GATT, be regarded as static and should allow for changes in relative competitive positions.

22. The representative of the United States said that his Government regarded its action in introducing the subsidy as fully in conformity with the provisions of Article XVI. The United States Government shared the view of the Malawi Government that it would not be desirable to assume that a particular country's share of a market should remain static. It was not the intention of the United States to increase its share beyond an "equitable level" but it could not be expected to accept the continued erosion of its relative position. He agreed it was not possible to determine precisely what constituted an "equitable share", but the United States share had by 1965 declined in comparison with any previous "representative period". The Food and Agriculture Organization in its recently revised Agricultural Commodities Projections for 1975 and 1985 had concluded that, "... this secular decline /in the United States share/ has been due, on the one hand, to the strong competition offered by the larger supplies of cheaper leaf coming from developing countries, and on the other, to a change in manufacturers' requirements in importing countries. United States leaf is generally more expensive because of its better quality and also because of domestic farm price policies which aim at maintaining remunerative prices to producers ... It appears therefore that it may become increasingly difficult for the United States producers to keep up with foreign competition if there are no basic changes in their present price support policies, or in the commodity situation as such".

23. The representative of Malawi then referred to the provisions of Part IV of the General Agreement. He noted that Article XXXVI:3 provided that "there was need for positive efforts designed to ensure that less-developed contracting parties secure a share in the growth of international trade commensurate with the needs of their economic development". He suggested that this could be interpreted as meaning that the share of less-developed countries in world trade in a particular commodity could grow at a faster rate than world trade as a whole, and the rate of export growth by industrialized countries. The representative of Malawi also referred to the provisions of Article XXXVII:3(c) and, whilst noting that prior consultations were not explicitly required, they would enable a less-developed country concerned to express its views which might not otherwise be known to the industrialized country contemplating action. Other members of the Working Party expressed their support of this view.

24. The representative of the United States said that the action taken by his Government was fully in conformity with the provisions of Part IV. He noted, in this connexion, that the FAO study previously cited had found that the developing countries were competing successfully with the United States in the world tobacco market. As regards the provisions of Article XXXVII:3(c), the United States had carried out a thorough examination of alternative remedies and had concluded that the alternatives were less desirable. In this examination, the special interests of developing countries were taken into account. Article XXXVII:3(c) did not obligate a contracting party to hold consultations prior to the introduction of the subsidy.

25. Certain representatives pointed out that the subsidy introduced by the United States raised an important point of general principle and precedent concerning the provisions of Part IV which went far beyond the implications of the present matter. The representative of Malawi suggested that it might be useful to establish some conventions with respect to products in which industrialized and developing countries were competing, particularly as it was necessary to demonstrate that the provisions of Part IV were effective in safeguarding the interests of developing countries.

Conclusions

26. The other members of the Working Party thanked the representative of the United States for the full and frank manner with which he had dealt with the questions they had posed. The representative of the United States thanked the other representatives for the friendly and constructive spirit in which they had put their views during the consultations.

27. Although it was not possible, on the basis of the available evidence and in view of the many factors which affect levels of exports and prices to demonstrate conclusively that the trade interests of Malawi and the other countries which had joined with her in the consultations had been adversely effected, the representatives of Malawi, Canada, India, Jamaica and Turkey nevertheless reiterated their apprehension concerning the effects which the United States subsidy could have on the international tobacco market. In view of what they considered to be the adverse effects of the United States subsidy on the incomes of their respective tobacco industries these representatives requested that the subsidy be removed. In making this request the representatives of Malawi, India, Jamaica and Turkey referred in particular to the requirements of Part IV of the General Agreement. The representative of the United States stated that he was not in a position to give any formal undertaking in this regard.

28. The representatives of Malawi, Canada, India and Turkey also repeated the second representation made to the United States Government in February namely that, in the event of its considering the extension of the existing subsidy, it should consult, before taking action, with those governments whose export interests were chiefly affected. This representation was supported by certain other members of the Working Party. The representative of the United States stated that he was not in a position to give any formal undertaking in this regard, but would convey this request to the appropriate United States authorities with his recommendation that it be given sympathetic attention.