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**BABCOCK INSTITUTE DISCUSSION PAPER
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**THE STATUS OF MULTILATERAL AND
BILATERAL TRADE TALKS—IMPLICATIONS FOR
THE U.S. DAIRY INDUSTRY**

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Table of Contents

Executive Summary	1
Why Trade Negotiations Are Important.....	2
A Brief Account of the Rocky Course of Trade Negotiations.....	2
The Start of the Doha WTO Round.....	3
The Cancun Ministerial Meetings.....	3
The Doha Round is Not Dead	4
New Emphasis by the U.S. on Bilateral and Regional Trade Agreements.....	4
The CAFTA.....	5
The FTAA.....	5
The U.S.-Australia FTA.....	6
Why Can the U.S. Sugar Lobby Strongly Influence FTA Negotiations?.....	6
What Has Been Done to Restart the Doha Round WTO Negotiations?	6
A Wild Card in the WTO Negotiations.....	7
The Perils of “Creeping or Galloping Protectionism”	8
Creeping Protectionism.....	8
Galloping Protectionism.....	9
Views of New Zealanders and Australians on Prospects for Dairy Trade Liberalization.....	10
Fonterra’s Views Regarding Trade Negotiations.....	10
Views of Australia’s Dairy Industry Regarding the U.S.-Australia FTA.....	12
The Bottom Line on the Status of Bilateral and Multilateral Trade Negotiations.....	13
References	15
Appendix: Key Trade Terms.....	16

List of Tables

Table 1:	U.S. Agricultural Exports, Imports, and Trade Balance, 1995-2004.....	2
Table 2:	Status of Free Trade Agreements with the United States.....	4
Table 3:	Maximum quantities of dairy products that can be exported with subsidies by the U.S. and EU under the Uruguay Round WTO Agreement, 2000/01	7

**THE STATUS OF MULTILATERAL AND BILATERAL
TRADE TALKS—IMPLICATIONS FOR THE U.S. DAIRY INDUSTRY**
William D. Dobson*

Executive Summary

This paper provides an overview of the status of multilateral and bilateral trade talks affecting the U.S. economy, U.S. agriculture, and the U.S. dairy industry as of June 2004. The trade negotiations discussed in the paper reveal how economic and political issues have become intertwined in complex ways. The main observations and conclusions of the paper are as follows:

- Agricultural trade is important to the U.S. economy. Prospects for expansion of U.S. agricultural exports and for increases in the amount of access given to U.S. markets will depend heavily on the outcome of these trade negotiations.
- Despite a rocky start, multilateral trade talks under the Doha Round of the World Trade Organization (WTO) are not dead. However, the WTO's ruling on U.S. cotton subsidies has tossed a "wild card" into the Doha Round negotiations.
- U.S. negotiators have resorted to bilateral and regional free trade agreement (FTA) negotiations to bring balky countries back to the multilateral free trade talks. Contributions that FTAs can make to freer agricultural trade and the limitations that the U.S. faces in making expanded use of the devices are described.
- Positive comments in the paper about prospects for progress in trade negotiations assume that the "creeping protectionism" that Federal Reserve Chairman, Alan Greenspan, warns about does not turn into "galloping protectionism."
- Progress in the trade negotiations will depend importantly on the outcome of the Presidential and Congressional elections in the fall of 2004. If the Bush Administration is turned out and/or Democrats regain control of the House or Senate, progress on the trade negotiations will delay or move in unknown directions.
- Conclusions are included in the paper based on a country study that Professors Edward Jesse, Louis Armentano, Norman Olson and the author completed on the dairy industries of New Zealand and Australia in February 2004 for the Babcock Institute. How Fonterra of New Zealand, the world's largest private dairy exporting company, views current dairy trade negotiations and how Australia's dairy industry views the U.S.-Australia Free Trade agreement are discussed in this segment.
- Finally, the bottom line is that agricultural trade liberalization is unlikely to produce the amount of U.S. agricultural exports predicted in the mid-1990s.

The remainder of the paper discusses the basis for these observations and conclusions.

* William D. Dobson is an Agribusiness Economist with the Babcock Institute. This paper represents an expanded version of a talk presented by the author at the Minnesota-Wisconsin Dairy Policy Conference in La Crosse, Wisconsin on April 5, 2004.

THE STATUS OF MULTILATERAL AND BILATERAL TRADE TALKS—IMPLICATIONS FOR THE U.S. DAIRY INDUSTRY

William D. Dobson

Why Trade Negotiations Are Important

Agricultural trade is important to the U.S. economy. As noted in Table 1, U.S. agricultural exports are forecast to increase to \$61.5 billion in fiscal 2004, eclipsing the record levels of fiscal 1996. Moreover, agriculture is a sector that maintains a positive trade balance. How much more U.S. agricultural exports will expand in the years ahead and whether the trend toward a shrinking positive agricultural trade balance can be reversed will depend partly on the outcome of current trade negotiations.

Table 1: U.S. Agricultural Exports, Imports, and Trade Balance, 1995-2004*

Fiscal Year	Exports	Imports	Agricultural Trade Balance
	\$Billion		
1995	\$54.7	\$29.9	\$24.8
1996	59.9	32.6	27.3
1997	57.4	35.8	21.6
1998	53.7	37.0	16.7
1999	49.1	37.3	11.8
2000	50.7	38.9	11.9
2001	52.7	39.0	13.7
2002	53.3	41.0	12.3
2003	56.2	45.7	10.5
2004 (Forecast)	61.5	51.5	10.0

* Sources: FAS News Release, May 26, 2004 [9], other FAS Press Releases and Agricultural Outlook, ERS-USDA, Various Issues 1998-2000.

Nuances for individual products are, of course, obscured by the aggregate figures in Table 1. The U.S. dairy industry, for example, which has recorded exports exceeding \$1 billion per year, typically has a negative trade balance. Thus, the concerns of the U.S. dairy industry regarding the negotiations relate heavily to how much additional access to the U.S. dairy market is likely to be given up in the trade negotiations.

A Brief Account of the Rocky Course of Trade Negotiations

As is well known, multilateral WTO trade negotiations have gotten off to a rocky start in the current Doha Round. The shaky start of the multilateral trade negotiations has spawned an expansion of bilateral and regional trade negotiations as well as predictions of failure of trade talks.

How did the U.S. reach the present rocky situation regarding WTO trade negotiations? The U.S. hosted the start of what it hoped would be fruitful WTO negotiations on trade liberalization in Seattle, Washington in late 1999. These negotiations broke up when protestors staged disruptive demonstrations and caused millions of dollars of property damage while protesting against trade liberalization and globalization. U.S. government negotiators bear part of the blame for this messy, abortive attempt at starting a new WTO round. U.S. negotiators were poorly prepared for the Seattle meetings, partly because they were exhausted from negotiations with China. Jagdish Bhagwati, a prominent Columbia University trade economist, describes the situation this way [3, p.55]:

(President) Clinton had ...(been working) hard to secure normal trade status for China and to smooth its entry into the WTO; in fact, Charlene Barshefsky, then USTR, had arrived breathless in Seattle just two weeks after concluding a marathon trade negotiation in Beijing. She and Clinton seemed far more focused on China than on the talks in Washington State.

Agricultural trade negotiations under the WTO were opened in Geneva, Switzerland in March 2000. These preliminary negotiations addressed national agricultural policies relating to market access limitations (tariffs, tariff rate quotas, and other trade barriers), domestic support to agricultural producers, and export subsidies. (See the Appendix for definitions of key trade terms used in the paper.) Progress was made in identifying agricultural issues for consideration in the WTO ministerial meetings that were to be opened later on a full range of trade issues.

The Start of the Doha WTO Round

The full WTO negotiations were re-started in November 2001 in Doha, Qatar—a location less accessible and less hospitable to anti-trade liberalization and anti-globalization demonstrators. In Doha, an agenda was established for negotiating further reductions in barriers to agricultural and nonagricultural trade, protection of intellectual property, and related issues under the WTO. In preparation for additional negotiations under the Doha Round, U.S. and EU trade negotiators developed a framework relating to agricultural trade to increase market access, reduce-trade distorting domestic price supports, and reduce agricultural export subsidies.

The Cancun Ministerial Meetings

Trade ministers meeting held in Cancun, Mexico in September 2003 were supposed to provide a blueprint for completing the Doha Round WTO trade agreement. One trade official likened the Cancun Ministerial meetings to a golf match. Participants in the Cancun Ministerial meetings said they had made good drives and had only to make good approach shots to place the ball on the green and make a short putt to complete the round. But the ministers ended up whiffing the ball on the fairway in Cancun and went home in disappointment before completing the round.

Agricultural issues turned out to be a major impediment to progress in the Cancun meetings. Brazil, India, South Africa and China led a group of 22 developing countries in opposition to measures to safeguard intellectual property, reduce industrial tariffs and other barriers to trade and foreign direct investment until the U.S. and EU agreed to substantial further agricultural trade liberalization. The U.S. came under scathing criticism for passing the 2002 Farm Act that, it was argued, represented a U-turn by the U.S. away from agricultural policy reform and agricultural trade liberalization.

U.S. negotiators found many demands of the developing countries—especially those relating to market access, trade-distorting domestic price supports, and other agricultural trade issues—to be unacceptable. In addition, U.S. negotiators logically might have thought that the complaints from Brazil and India about U.S. agricultural protectionism were excessive in view of the agricultural tariff protection employed by these countries. Brazil's tariffs on agricultural products average 37% and those for India average 112%, while those of the U.S. average 12% [3, p.59].

Luis Derbez, Mexico's Foreign Minister and chairman of the Cancun meetings, gave up any hope of immediate progress and terminated the meetings. U.S. agricultural industry participants in the Cancun meetings had mixed feelings about the outcome and were frequently heard to say, "no agreement is better than a bad agreement."

Many issues were involved in the breakup of the Cancun WTO Ministerial negotiations. Brazil's new President, Luiz Inacio Lula da Silva, was keen to give Brazil a bigger role on the world stage. Tweaking the nose of the big players, especially the U.S. and EU, was useful for advancing Brazil's agenda and played especially well in Brazil and certain other Latin American countries. However, the actions of the Group of 22 in the Cancun meetings were not entirely political. The developing countries do have a legitimate case regarding the harmful effects of U.S., EU and other developed country agricultural subsidies. According to the USDA's Economic Research Service,

nearly 80% of world agricultural price distortions are accounted for by practices of developed countries.

Efforts have been made to get big players in the WTO—e.g., the EU, U.S., Japan, and China—to get behind measures to restart the meetings. However, the powerful players—encouraged to drag their feet by industry groups who benefit from existing programs and border protection—until very recently seemed to be in no hurry to restart the negotiations.

The Doha Round is Not Dead

This does not mean that the Doha Round is dead. Indeed, delegates from WTO member countries began meetings on March 22, 2004 in Geneva, Switzerland to restart the Doha Round and work out positions on cutting agricultural trade barriers. But it does mean that the Doha Round will not be completed by the original January 2005 deadline. Such delays are not unusual. After all, the Tokyo GATT Round took more than five years to complete and the Uruguay Round that followed took more than seven [3]. The Uruguay Round had collapses of its own in Montreal in 1988 and in Brussels in 1990.

Collapse of the Cancun WTO Ministerial meetings did spawn an upsurge in U.S. participation in bilateral and multilateral trade negotiations. However, as will be apparent from the discussion of such negotiations, bilateral and regional trade agreements are not likely to deliver results for agriculture that the big players seek. Bhagwati explains the shortcomings of FTAs as follows [3, p.63]:

Most of them (FTAs) today exempt agriculture, and few exist between countries with competing farm sectors. Besides production subsidies cannot be cut preferentially for favored nations. So the G-22, the EU, the United States, and Japan have only one real option: multilateralism.

New Emphasis by the U.S. on Bilateral and Regional Trade Agreements

What led to the emergence of new emphasis on bilateral and regional trade agreements?

Table 2: Status of Free Trade Agreements with the United States*

Country or Region	Status
Israel	In effect since April 22, 1985
Mexico and Canada (NAFTA)	In effect since January 1, 1994
Jordan	In effect since December 17, 2001
Singapore	In effect since January 1, 2004
Chile	In effect since January 1, 2004
Australia	Negotiations concluded on February 8, 2004. Ratified by U.S. Congress in July 2004
Morocco	Negotiations concluded March 2, 2004
Central America (CAFTA)	
El Salvador, Guatemala, Honduras and Nicaragua	Negotiations concluded December 17, 2003
Costa Rica	Negotiations concluded January 25, 2004
Dominican Republic	Negotiations concluded March 15, 2004
Bahrain	Negotiations concluded May 27, 2004
Southern African Customs Union	
Botswana, Lesotho, Namibia, South Africa and Swaziland	In negotiation
34 Western Hemisphere Countries (FTAA)	In negotiation
Panama and Ecuador	In negotiation
Thailand	Intention to negotiate announced
Colombia, Peru and Bolivia	Intention to negotiate announced

* Source: Council of Economic Advisors [6] and Wall Street Journal various issues.

Bhagwati speculates plausibly that the decision by Mexico's Foreign Minister to pull the plug on the Cancun meetings was made with the approval of U.S. Trade Representative, Robert Zoellick. Mr. Zoellick likely believed that the hardball tactic of canceling the WTO Ministerial meeting and emphasizing bilateral trade negotiations would force balky nations back to the multilateral negotiating table. However, as noted later, Zoellick kept his options open by simultaneously working on re-opening the Doha Round WTO talks.

However, bilateral agreements are more than devices to force balky negotiators back to the WTO negotiating table. Zoellick is said to be in the "competitive liberalization" camp that holds that well-designed bilateral or regional free trade agreements can be building blocks rather than "stumbling blocks" to broader liberalization efforts [19]. For example, this camp might argue that successes under the NAFTA and the 1983 Closer Economic Relationship Agreement between Australia and New Zealand support the notion that FTAs foster broader trade liberalization efforts. The former has produced a major expansion of U.S.-Mexico trade and the latter agreement has produced essentially free trade in goods and services between Australia and New Zealand.

Moreover, Zoellick's emphasis on bilateral and regional agreements continues a practice that has gained prominence as a U.S. negotiating practice (Table 2). The status of U.S. negotiations on bilateral and regional trade agreements and implications of those negotiations for the U.S. economy, U.S. agriculture and the U.S. dairy sector are noted below.

The CAFTA

The U.S. has concluded negotiations for the Central American Free Trade Agreement (CAFTA). While the Central American parties to this agreement (Nicaragua, Costa Rica, Honduras, Guatemala, El Salvador, and the Dominican Republic) have small economies, the importance of the agreement should not be minimized. Costa Rica has a rapidly developing economy that represents a substantial market for U.S. agricultural and nonagricultural products and U.S. foreign direct investment. El Salvador, which adopted the U.S. dollar as its currency two years ago, is emerging as a banking and investment leader for Central America, which will hasten development of markets in the region. Moreover, U.S. imports of products from Central America are expected to increase under the CAFTA. Specifically, exports of specialty dairy and livestock products to the U.S. from Nicaragua can be expected to rise.

In addition, the CAFTA may encourage Latin American countries that have balked at entering a meaningful Free Trade Agreement of the Americas (FTAA) to reconsider. A pair of Latin American countries recently began negotiations with the U.S. on FTAs. U.S.-Panama FTA negotiations began in late April 2004. Negotiations on the U.S.-Ecuador FTA began in mid-May 2004 and are scheduled to be completed in 2005. The intention of the U.S. to negotiate FTAs with Colombia, Peru, and Bolivia may provide additional encouragement for balky parties to negotiate a FTAA.

The FTAA

The FTAA negotiations held in Miami in November 2003 exhibited characteristics like those of the Cancun WTO meetings. Brazil pressed the U.S. for additional market access and other agricultural trade concessions but agreed to smooth over differences with the U.S. to prevent a breakdown of the talks. The November meeting and a subsequent meeting of Deputy Trade Ministers in Puebla, Mexico in February 2004 came up with an outline for an accord that has been dubbed "FTAA-lite." Specifically, the main result of the Miami and Puebla FTAA meetings was a watered-down agenda for future discussions under which countries would select a core set of trade principles that they would agree to live with and could opt out of second-tier commitments they don't like. However, it has proven difficult for the 34 countries to arrive at core principles that all could agree upon.

In the Miami and Puebla meetings, U.S. negotiators said that agricultural trade liberalization issues had to be considered in the broader WTO framework. Otherwise, it was claimed, the U.S.

would end up unilaterally disarming while the EU and Japan, in particular, would be allowed to keep their trade-distorting domestic agriculture price supports and existing border protection.

The U.S.-Australia FTA

The U.S.-Australia FTA is a landmark agreement for two reasons. First, *it is one of the few bilateral agreements involving two countries with strongly competing agricultural sectors.* Specifically, Australian farmers produce a number of products—including dairy products, beef and sugar—that compete directly with U.S. farm products. Secondly, it is an agreement where an important commodity, sugar, was excluded from the final agreement. This was an important exclusion. It sets a bad precedent when one country can successfully demand that an important, sensitive commodity be taken off the negotiating table.

Why Can the U.S. Sugar Lobby Strongly Influence FTA Negotiations?

The U.S. sugar industry, is not a huge industry yet it has exercised substantial influence over the FTA negotiations. Why can the U.S. sugar lobby exercise so much power? The political contributions made by the U.S. sugar lobby to both major political parties explain part of it. For example, the *Wall Street Journal* reported in a February 3, 2004 article that 15 U.S. sugar associations had made contributions totaling \$722,000 to date in the 2004 U.S. election cycle, divided about equally between GOP and Democratic lawmakers [17]. Apparently such contributions secure for the lobby an abundance of attention and political power. Moreover, Florida—a key state in the 2004 Presidential elections—has a large sugar industry, which causes the Bush Administration to look favorably on wishes of the lobby.

The U.S. sugar lobby will attempt to influence the Congressional votes on the FTAs. Thus, the fact that sugar was taken off the table in the U.S.-Australia FTA negotiations undoubtedly made it easier to secure ratification of the agreement by the U.S. Congress in July 2004. It should be noted that sugar provisions remained in the CAFTA—and would potentially open 1% to 2% of the U.S. sugar market to CAFTA exporters in the first year of the agreement. This will lessen the chances for Congressional ratification of that FTA.

While much can be said about the benefits of bilateral and regional trade agreements, Mr. Zoellick, in particular, has undoubtedly found that FTAs represent a lot of work for a relatively small payoff and that FTAs are not up to the task of providing much in the way of agricultural trade liberalization, hence, the incentives to restart the Doha Round successfully.

What Has Been Done to Restart the Doha Round WTO Negotiations?

In a letter sent in early January 2004 to all 148 WTO member nations, U.S. Trade Representative Robert Zoellick proposed quickly eliminating all farm export subsidies quickly and slashing tariffs on goods and food imports [14, p.A2]. WTO Chief, Supachai Panitchpakdi, supported the effort and said that he hoped that WTO members could put together a rough negotiating framework known as modalities—a document showing in what areas agriculture could be liberalized, but largely without specific numbers [15]. He wanted to see a modalities document developed by mid-2004. The EU has said it is willing to work toward phasing out farm assistance, but has rejected efforts to set a firm deadline for doing so.

While the U.S. and other major players have incentives to make progress on the WTO negotiations, it is not clear how much progress will be made this year. A key uncertainty regarding chances for a successful restart of the Doha Round resides with the EU. The Group of 20 (a reconfigured group of developing countries) and the 17-member Cairns group of agricultural exporters appear to be adamant about eliminating all export subsidies via the Doha Round. Furthermore, the Group of 20 and Cairns group define export subsidies broadly to include export credits, food aid operations, and activities of State Trading Enterprises. EU trade negotiators have agreed to eliminate agricultural export subsidies if the U.S., Canada, and others do the same. However, France has expressed strong reservations about this proposal and it is unclear whether the EU proposal can weather the internal opposition by the French. U.S. negotiators have advocated

elimination of export subsidies, but it is unclear whether the U.S. definition of export subsidies is as broad as the one advanced by the Group of 20 and Cairns group.

It is remarkable that the EU would make even a conditional offer to eliminate its agricultural export subsidies. The U.S. and EU might reasonably have very different attitudes toward proposals to eliminate agricultural export subsidies, a point that can be illustrated with figures on WTO limits on subsidized exports of dairy products established under the Uruguay Round of WTO negotiations (Table 3). (The WTO limits on subsidized exports of dairy products for 2000/01 will apply until new limits negotiated under the Doha Round become effective.) Because the U.S. had relatively small subsidized exports of dairy products during the 1986-90 base period used to establish the limits in Table 3, the U.S. finds itself permitted to export with subsidies only a relatively small percentage of the comparable totals for the EU. Indeed, nonfat dry milk (NDM) is the only product that the U.S. is permitted to export with subsidies in quantity (68,000 metric tons per year) under the Uruguay Round WTO agreement. The U.S. could give up the privilege of exporting with subsidy dairy products more readily than the EU. However, the EU has not always exported the maximum quantities of product permitted by the Uruguay Round WTO agreement. Hence, the Union might have little reluctance to give up some of its dairy export subsidy allotments. If the EU actually agrees to give up all dairy export subsidies in the Doha Round, this would substantially reduce trade distortions in international dairy markets and increase world prices for dairy products.

Table 3: Maximum quantities of dairy products that can be exported with subsidies by the U.S. and EU under the Uruguay Round WTO Agreement, 2000/01*

Country	Butter	NFDM	Cheese
1,000 metric tons			
United States	21.1	68.2	3.0
European Union	366.1	243.3	305.0
U.S. as % of EU (Maximum Quantities)	5.8%	28.0%	1.0%

* Source: USDA, "Dairy: World Markets and Trade," FD 1-94, March 1994.

As a result of reforms of the Common Agricultural Policy agreed to in 2003, EU negotiators have argued that a much larger proportion of EU agricultural policies would fall in the "Green Box" of non-trade distorting programs. If trade negotiators from other countries accept this view of impacts of the EU's Common Agricultural Policy, it would make it simpler for the EU to reach acceptable agreements regarding agriculture in the Doha Round. However, developing countries appear less than optimistic about how much trade distortions would be reduced by such a EU initiative. Timothy Josling, a Stanford University agricultural trade authority, describes the views of developing countries on this matter as follows [12]:

The whole of the thrust of analytical work on trade impacts of domestic farm programs since the early 1980s has emphasized the notion that one could move policy to 'non-trade distorting' means of support.

Developing countries have now implicitly rejected this notion, and adopted an alternative view, that agricultural support to developed countries has a negative impact on their own farmers regardless of the 'box' in which such support is placed in the WTO.

Both the EU and the U.S. are likely to encounter strong requests from developing countries for greater access to their agricultural product markets under the Doha Round. It appears that the precise form that these requests will take has not been fully worked out.

A Wild Card in the WTO Negotiations

In an interim ruling issued on April 26, 2004, the WTO dropped a wild card into the Doha Round of trade negotiations. In this interim ruling, the WTO sided with Brazil in declaring that

certain cotton subsidies used by the U.S. were illegal under world trade rules. The Economist summarized the WTO action as follows [8]:

In September 2002, Brazil complained formally to the WTO about America's cotton subsidies. The Brazilians argued that these violated the "peace clause" on agricultural subsidies that was negotiated under the Uruguay Round a decade ago. According to this clause, countries promised not to file complaints to the WTO on farm support—provided that support did not exceed 1992 levels. The Brazilians claimed that America's cotton subsidies were higher than allowed and that they harmed Brazilian producers by lowering prices in world markets. Without subsidies, they argued, American exports would have been lower and world cotton prices higher."

This ruling is important because it represents the first time that a country has been challenged under the WTO over its domestic agricultural subsidies, and the first case that looks at the effect of export subsidies on agricultural products. Many other countries are closely following the case and its ultimate outcome to determine whether to bring their own challenges against substantial subsidies paid to farmers in the U.S., EU, Japan and other countries.

If the final WTO ruling is the same as the interim ruling, the U.S. plans to appeal the decision, claiming that its cotton subsidies are within the limits allowed by the WTO. If the U.S. does appeal the decision, it will be months—perhaps years—before a final ruling is made by the WTO on the U.S. cotton subsidies. However, the interim ruling is likely to encourage developing countries and non-subsidizing exporters to push hard for greater reductions in domestic support for agriculture by the U.S., EU and Japan in the Doha Round. U.S. and EU farm export subsidies would be vulnerable to reduction or elimination as a result of such efforts. The push to reduce developed country farm subsidies that the WTO's interim ruling on cotton produces may delay completion of the Doha Round and increase the contentiousness of the negotiations.

The Perils of "Creeping or Galloping Protectionism"

Protectionism—particularly as it relates to preserving U.S. jobs—may have a strong influence on the outcome of trade negotiations entered into by the U.S. Virulent protectionism could sharply reduce chances for additional trade liberalization and for Congressional ratification of trade agreements.

Creeping Protectionism

Federal Reserve Chairman, Alan Greenspan, has been warning the U.S. against engaging in "creeping protectionism" since late 2003. The seeds of this warning may have originated from Greenspan's concerns over the higher steel tariffs imposed by President Bush in March 2002. The higher tariffs of up to 30% on certain imported steel products—scheduled to last for three years—were supposed to allow the U.S. steel industry to restructure and become more competitive. The tariff increase was also expected to increase employment in Pennsylvania, West Virginia and other states, generating benefits for President Bush in the 2004 elections. The tariff increase was far from successful. In particular, the higher tariffs raised U.S. steel prices and damaged U.S. steel users. Given the economic damage to U.S. steel users, it is not even clear that the tariffs increased aggregate employment in the U.S.

While certain foreign steel products were excluded from the higher tariffs, exporters still protested vigorously and took the U.S. to the WTO for violating the trade agreement. WTO dispute settlement panels found that the U.S. had violated trade provisions. The EU reacted saying that it would impose additional duties on some \$2.2 billion of annual U.S. exports to the EU if the U.S. did not eliminate the increase in steel tariffs. Arguing that the tariffs had accomplished their purposes and fearing the EU retaliation, President Bush eliminated the higher steel tariffs in early December 2003. Foreign steel exporters and others heralded this action as a victory for the WTO. The reasoning was that if a big player like the U.S. could be forced to back down by the WTO, the organization must still have teeth.

Chairman Greenspan complained of creeping protectionism in connection with the U.S. action to limit imports of Chinese made bras, bathrobes, and fabric in November 2003. This decision angered the Chinese who were sensitive to any trade restrictions because they have been repeatedly exhorted by the U.S. to allow the Chinese currency—currently pegged at 8.28 yuan to one U.S. dollar—to appreciate. (Certain U.S. companies have argued that an undervalued Chinese currency is responsible for much of the \$124 billion U.S. bilateral trade deficit with China for 2003.) The Chinese reaction to the limit on textile imports and other U.S. trade threats was muted but it did have implications for agriculture. China postponed a buying mission headed for the U.S. grain and soybean belt. China later rescheduled the visit by the soybean and grain buyers.

In mid-March 2004, Greenspan pointedly warned that imposing U.S. trade standards on our trading partners would harm the U.S. In particular, he criticized the notion of holding other countries to higher standards of labor law or human rights as a condition for trading with the U.S., saying [11, p.A2]:

We are an ethical people and I think we ought to essentially try to spread that around the world, but not use ethics as a guise for protectionism, which I fear in too many instances is really what it's all about.

Galloping Protectionism

Bhagwati warns of what can be labeled “galloping protectionism,” observing that the U.S. is entering an election season and the Democrats are staking out “fiercely irresponsible antitrade positions [3, p.62].” However, protectionist proposals are not the exclusive province of Democrats, as indicated below [23, p. A20]:

...(The) first (evidence of strong protectionism) is an amendment that Democratic Senator Chris Dodd attached to a trade bill this month with the help of 25 Republicans, including Majority Leader Bill Frist. It would not only prohibit the federal government from awarding contracts to companies that outsource part of the work overseas, it would impose the same restriction on federal funds spent by the states. Similar ‘Buy America’ initiatives are making their way through state legislatures...

Then there is the Tom Daschle-Ted Kennedy Jobs for America Act, introduced to capitalize on White House Economic Adviser Greg Mankiw’s recent defense of free trade. Co-sponsored by John Kerry, it makes employers jump through more hoops before they can lay off employees. Instead of having to notify workers and the government before firing 500 or more workers, the threshold would be just 50. In the case of outsourcing jobs abroad, the number could be as low as 15. And the notification period would be extended to 90 days from the present 60.

Part of Economic Adviser Mankiw’s defense of free trade alluded to in the immediately preceding quote was as follows [6, p. 229]: “*When a good or service is produced more cheaply abroad, it makes more sense to import it than to make or provide it domestically* (emphasis supplied).” This comment, which appeared in the 2004 Economic Report of the President, makes good sense to a trade economist, but it was red meat to Democratic critics of the Bush Administration. In addition, Republican Speaker of the House, Dennis Hastert, joined Democrats in rebuking Mankiw for the comment, and the Bush White House gave Mankiw only lukewarm support over this issue. The lack of White House support was not surprising since President Bush had recently signed a bill forbidding the outsourcing of federal contracts overseas. Thus, it may burnish Mankiw’s academic credentials to make the comment, but it suggests that he has a political tin ear.

Senator Kerry, in addition to placing more stringent notification requirements on employers planning layoffs or outsourcing of labor, would place all trade deals under a 120-day review [2]. It is not fully clear what the scope of such reviews would be. Legal and trade experts warn that reviews advocated by Senator Kerry could open a can of worms.

Why so much concern about protectionism? One reason is that if the world's leading economic power indulges in protectionism, others figure it is safe to do the same. This is not an idle concern since it could jeopardize legitimate uses of safeguard provisions. As noted earlier, the U.S. used safeguard provisions to justify higher tariffs to protect the U.S. steel industry. Such safeguard provisions, when properly and transparently used, are helpful for defending a domestic industry when imports increase unexpectedly and sharply. However, U.S. steel imports in the year prior to the imposition of the higher tariffs by the Bush Administration actually decreased by a fifth and domestic steel prices were buoyant, hence, the WTO rulings that the higher tariffs were not justified.

Contrast the increase in steel tariffs to those used by the U.S. to protect the cheese market in 2002. Under the Uruguay Round of the WTO agreement the U.S. is entitled to apply an additional duty on imports of American-type cheeses when imports exceed a trigger of 36 million pounds per year. In the first nine months of 2002, U.S. imports of American-type cheese had increased to 48 million pounds and were depressing domestic cheese prices. In response, the U.S. increased over-quota tariffs on American-type cheese imports by \$0.17 per pound (to \$0.64 per pound in total) from mid-November through December 31, 2002 to protect the U.S. cheese industry. This application of higher cheese tariffs attracted no challenge under the WTO. Indeed, this is undoubtedly the kind of application that trade negotiators had in mind when they included safeguard provisions in the Uruguay Round WTO Agreement.

Finally, other countries can be expected to point to U.S. protectionism to justify questionable trade negotiating practices. Witness how Brazil and India have used the U.S. U-turn on farm programs as a partial justification for delaying trade liberalization negotiations under the WTO. If such actions snowball, expect the demonstrated benefits of freer trade to be jeopardized.

Views of New Zealanders and Australians on Prospects for Dairy Trade Liberalization

Why are views of the New Zealanders and Australians noteworthy regarding trade liberalization? In part, it is because the dairy industries of both countries are heavily dependent on exports—New Zealand and Australia, export the equivalent of about 95% and 60% of their milk production respectively. Thus, the dairy industries of both countries prosper or experience difficulties depending on the strength of the dairy export market. Accordingly, dairy industry people in New Zealand and Australia pay close attention to trade matters and have views on dairy trade prospects that are worth noting.

Fonterra's Views Regarding Trade Negotiations

Fonterra is the world's largest dairy exporting company. The Cooperative firm was established in October 2001 by the merger of the New Zealand Dairy Group, Kiwi Cooperative, and the New Zealand Dairy Board (NZDB). The Cooperative receives milk from about 12,600 producers. It accounts for about 20% of New Zealand's exports and about seven percent of the country's GDP. Fonterra accounts for approximately one-third of world dairy exports.

Fonterra officials believe that the Doha Round of WTO negotiations will be restarted successfully and that there are good prospects for elimination of, or substantial reductions in, dairy export subsidies. For reasons noted earlier, it is not clear how much the EU, in particular, will actually reduce dairy export subsidies, but the Fonterra people close to the trade negotiations argue that the EU will obtain concessions in the Doha Round that will make it feasible for the Union to eliminate or substantially reduce dairy export subsidies.

The Cooperative's officers argue that the EU will not need dairy export subsidies after the Union implements the 2003 rural development-oriented policy reforms that reduce incentives for EU milk production. However, there appears to be great diversity in the way that the EU policy reforms will be implemented in different countries of the Union, making it difficult to assess whether the EU will have a markedly lower need for dairy export subsidies.

Fonterra is protected in the event additional dairy trade liberalization fails to materialize. In particular, the Cooperative retains full or partial rights to the dairy quota markets of the U.S. and EU for up to 10 years. This is a privilege previously enjoyed by the NZDB that New Zealand's parliament passed along to Fonterra when the Board was stripped of its monopoly exporting privilege in 2001. This gives Fonterra valuable access to protected, high-priced U.S. and European markets for cheese and other dairy products. Thus, Fonterra might have mixed feelings about negotiations that jeopardize any of this preferred access.

It is useful to look at what Fonterra is doing rather than at what Fonterra is saying to obtain a full appreciation for the Cooperative's views regarding prospects for dairy trade liberalization. Fonterra is involved in important foreign alliances, agreements, and foreign direct investments. The alliances include the DairyConcepts joint venture with Dairy Farmers of America in the U.S., and Nestle in its Dairy Partners Americas alliance in South America. Fonterra has also entered into an important agreement (the DairyAmerica Agreement) with seven U.S. dairy cooperatives.

The Cooperative's foreign direct investments include its 2001 purchases of the La Mesa and Eugenia businesses in Mexico, establishing Fonterra as the number one player in Mexico's cheese market [10]. Additional foreign direct investment has been made in Australia, notably the acquisition of a 50% equity interest in Bonlac Cooperative.

Fonterra has used the foreign alliances, agreements, and direct investments in foreign dairy businesses for a number of reasons. One is to guarantee access to foreign dairy markets in an environment where it is uncertain whether there will be further appreciable liberalization of dairy trade in the next few years. Another is to use the firm's excess capacity in management and marketing to advantage in foreign markets. A third might be lumped in the category of pre-emptive strategies, designed to preserve important export markets.

The DairyAmerica Agreement shows the nature of Fonterra's efforts at market preservation in an uncertain trade and business environment. In 2001, New Zealand Milk Products (NZMP—a business unit of Fonterra) signed an agreement with DairyAmerica that made it the largest exporter of U.S. NDM [7]. DairyAmerica is an association of seven U.S. producer-owned dairy cooperatives, namely: Dairy Farmers of America, California Dairies, Land O'Lakes, Agri-Mark, United Dairymen of Arizona, O-At-KA Milk Producers, and Maryland and Virginia Milk Producers. Under the NZMP-DairyAmerica Agreement, NZMP receives a commission from DairyAmerica for NDM sold in export markets on behalf of the federated marketing company.

NZMP has unquestioned ability as an exporter of NDM. In most situations, NZMP should be able to secure nearly the highest available prices for DairyAmerica's NDM. Mr. Jay Waldvogel, Fonterra's Chief Operating Officer, added that the agreement is advantageous for DairyAmerica since it allows the U.S. cooperatives to shift the job of exporting to Fonterra and to concentrate on doing what they do best—to market dairy products in the U.S. domestic market [21]. The agreement appears to be particularly favorable for Fonterra since it gives the cooperative greater control over world milk powder markets and prevents U.S. NDM from undercutting prices in Fonterra's Asian markets in particular. Recall that in years past New Zealand's dairy industry complained about losses of market to subsidized U.S. exports of milk powder into Asia under the U.S.'s Dairy Export Incentive Program (DEIP). As a result of the NZMP-DairyAmerica Agreement, Fonterra undoubtedly no longer suffers such loss of sales in its important Asian markets.

The arrangement could be a win-win proposition for both the U.S. cooperatives and Fonterra. It appears to be an unambiguously good arrangement for Fonterra. It also may be a good arrangement for U.S. cooperatives if they get good value for the commission they pay to Fonterra for handling NDM exports. But questions have been raised about the size of the commission the seven U.S. cooperatives pay to NZMP for exporting the cooperatives' NDM given the apparently large benefits that the arrangement conveys to Fonterra.

The material on the alliances and agreements suggests that Fonterra's strategies have expanded from orthodox efforts to increase exports of differentiated dairy products, to a more nuanced

strategy that also emphasizes pursuit of profits by applying the industry's management expertise in the dairy industries of other countries via alliances and agreements. Fonterra's management expertise is not subject to tariff barriers of other countries.

History explains why Fonterra has diversified its strategies to lessen emphasis on expanding exports of differentiated dairy products. For example, in 1989, Mr. Dryden Spring, then Chairman of the NZDB, said that the core strategy of the firm for dealing with industry problems was to "lift the 30 or 40% of (New Zealand) milk which is sold as value-added (differentiated) products to as close to 100% as we can get as soon as possible [18]."

The strategy Dryden Spring describes has been difficult to implement successfully in the face of New Zealand's increasing milk production, which approximately doubled from 1989-1990 to 2002-2003. A recent study commissioned by New Zealand Trade and Enterprise indicated that the value-added component for New Zealand dairy exports was about 35%. Thus, New Zealand's dairy industry has kept the percentage of milk sold as differentiated products approximately constant while milk production doubled. It is remarkable that New Zealand's dairy industry could achieve this result while witnessing about a 100% increase in milk production. However, it also underscores how difficult it will be for Fonterra to sell a substantially larger percentage of the milk supplied by Fonterra's members in the form of differentiated products, particularly if milk production continues to increase strongly.

Fonterra's pre-emptive strategies include one that protects the firm's access to the Australian market that the Cooperative considers to be part of its domestic market. Fonterra increased its ownership stake in Bonlac of Australia from 25% to 50% in 2003. This prevented competitor consolidation from jeopardizing Fonterra's strategic position in Australia. Among other things, it foreclosed the opportunity for a Bonlac-Murray Goulburn merger, which would have controlled 80% of Australia's dairy exports and 50% of Australia's milk production. Bonlac has been financially troubled and will require an infusion of financial resources from Fonterra if it is to deliver strong financial results. Fonterra apparently believes that protecting its access to the Australian market makes it worthwhile to invest in financially-troubled Bonlac.

Views of Australia's Dairy Industry Regarding the U.S.-Australia FTA

Australia's dairy industry appears to be modestly pleased with the dairy provisions of the U.S.-Australia FTA. Of course, the Australians issued comments about the miserly U.S. concessions regarding dairy. A few Australians also made caustic comments about the "horror stories" presented by certain U.S. dairy groups regarding the impact of the agreement on the U.S. dairy industry. They were particularly miffed by the comments from U.S. milk producers who claimed that 150,000 jobs and US\$23 billion (over nine years) were at risk from the U.S.-Australia Free Trade Agreement [16]. These stories, the Australians charged, must have assumed that the U.S. market would become nearly completely open to Australian dairy imports. It was pointed out that Australia does not have the capacity in its dairy industry to produce the damage charged in some U.S. accounts. However, the angriest comments by Australia's farmers were reserved for the U.S. sugar lobby that succeeded in keeping sugar provisions out of the agreement.

After venting such comments, a number of Australian dairy groups issued comments such as those made by the United Dairyfarmers of Australia, which identified the following key benefits of the FTA for Australia's dairy industry [20]:

1. In total it will deliver extra trade of between AU\$55 (US\$41) and AU\$65 (US\$49) million per year. It's estimated that this will bring direct income benefits each year of around AU\$25 (US\$19) million to Australian dairy farmers and a further AU\$10 (US\$7.5) million in indirect benefits through improved market security and export returns.
2. In real terms, this will mean around an extra AU\$3500 (US\$2600) per annum for every dairy farmer. In addition, this will grow by 5% per year.
3. The benefits will be available to dairy farming families every year starting in 2005 and will grow by about five percent each year from the initial base. This five percent annual access

growth is about double Australia's long-term production growth, so the U.S. market will have increasing importance.

4. It will increase access for all dairy products currently restricted by quotas, providing new market opportunities for the Australian dairy industry.
5. The deal is likely to triple Australia's quota access into the world's second biggest dairy market.
6. It is important to note that the FTA must be agreed upon by the Australian Parliament and U.S. Congress before it takes effect. As noted earlier, the U.S. Congress has approved the agreement.

The United Dairyfarmers of Victoria said, "Your dairy farm leaders will work hard to encourage all MPs [Members of Parliament] to support the FTA [20]." This appears to be an action that would be taken by a group that is fairly well pleased with the dairy provisions of the U.S.-Australia-FTA.

The Bottom Line on the Status of Bilateral and Multilateral Trade Negotiations

The bottom line is a conditional one. If there is a Kerry Administration and/or the Democrats obtain control of one or both houses of the Congress all bets are off for any near-term Congressional approval of additional FTAs and completion of the Doha Round.

This comment is not meant to suggest that Senator Kerry is completely protectionist on trade issues. For example, he has spoken in support of the NAFTA. However, he has rebuked U.S. companies for sending jobs overseas and for moving corporate headquarters to foreign countries. If Senator Kerry wins, it may be in part because his job protection ideas have obtained traction and possibly that his proposal to review all trade agreements has been accepted as a useful idea. Thus, a Kerry Administration would presumably have an inclination to follow up on such campaign promises with action.

In addition, even if Kerry should wish to expedite approval of trade agreements it is unclear whether he could do so. The "Fast Track" trade negotiating authority obtained from the Congress by the Bush Administration expires in mid-2005. It is unclear whether the Kerry Administration would receive this authority from the Congress in a fashion that would permit a seamless continuation of negotiations on the Doha Round and Congressional approval for FTAs that have been negotiated but not yet ratified.

While President Bush probably would not be mistaken for a free trader, immediate progress toward completion of the negotiations on the Doha Round and Congressional approval of certain free trade agreements is more likely under a second Bush Administration. The outcome under a second Bush Administration would probably include the following components:

1. Negotiations under the WTO Doha Round negotiations will ultimately provide some agricultural trade liberalization much like the liberalization that occurred under the Uruguay Round. However, there is essentially no chance that the Doha Round will be completed by January 2005. The more likely dates for completion are now 2006 or later.
2. The U.S. will agree to provide some additional market access for foreign dairy products, especially cheese, in return for trade concessions from WTO trading partners.
3. Export subsidies appear likely to be changed the most under the Doha Round. Thus, the DEIP dairy export subsidies may be gone or largely eliminated. USDA credit subsidies for dairy exporters are also likely to be eliminated or substantially reduced. EU dairy export subsidies are likely to be reduced substantially or eliminated.
4. The so-called rollover provisions on export subsidies permitted under the Uruguay Round WTO Agreement are likely to be eliminated. The rollover provisions allowed unused export subsidy quantities from one year to be rolled over until the next year during the

implementation period for the Uruguay Round Agreement. This provision has drawn sharp criticism from non-subsidizing dairy exporting countries.

5. Trade-distorting domestic price support programs in the U.S. are likely to be curtailed to some unknown extent. This has become more likely as a result of the WTO dispute panel's interim ruling in April 2004 on the trade-distorting effects of U.S. cotton programs [8]. While the U.S. will appeal this ruling, it seems to provide a basis for developing countries to attack a range of developed country domestic farm price support programs in the Doha Round as being trade distorting.
6. Bilateral or regional trade agreements entered into by the U.S. may make it more likely that a FTAA will materialize. However, the negotiations for the FTAA have become so contentious that the chances such an agreement will materialize appear to be diminishing. Moreover, Brazil and Argentina have entered into negotiations with the EU which may lessen the incentives of those large countries to enter such an agreement.

The rocky course of trade negotiations under the Doha Round and the FTAA underscores once again that “food is different.” While trade agreements help to expand agricultural trade, the opportunities for expanded agricultural exports by most countries will be determined substantially by how good the crop and livestock raising conditions are in the world. Countries prefer to produce their own food and will do so if conditions permit. Partly this is because governments encourage self-sufficiency in food production even though their countries may not be efficient food and livestock producers.

In the mid-1990s, a few analysts predicted that U.S. farm exports would expand to \$100 billion per year by the early 2000s. Many policymakers believed that U.S. farm exports would be so strong that exports would eliminate the need for high farm price supports. Even U.S. dairy price supports were scheduled for elimination at the end of 1999, in part because it was believed that a reasonably strong domestic supply-demand balance and border protection provided by tariffs under the Uruguay Round WTO agreement would provide strength for the domestic dairy market. Hence, the 1996 Farm Act was developed, which sharply curtailed farm price supports. A different assessment of the role of farm exports now prevails. The forecasts of \$100 billion U.S. annual farm exports are now viewed as wildly optimistic.

The restrictive impact of the “food is different” ideas on agricultural trade undoubtedly will be reinforced by the outbreaks in recent years in different countries of hoof and mouth disease, mad cow disease, and bird flu in various countries.

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Appendix: Key Trade Terms*

Above-quota tariff: The tariff rate that applies to quantities imported in excess of the tariff rate quota quantity.

Amber box support: The total value of support to agriculture subject to agreed reductions. Amber box support for agriculture as a whole is measured by the *Aggregate Measurement of Support* and is equal to the sum of price support and any payments that are not exempted from cuts, less any levies.

Applied tariff rate: The actual tariff that is applied at a particular time.

Blue box support: Payments that are made in conjunction with production-limiting arrangements and are exempted from reductions under the WTO Agreement on Agriculture. Blue box support includes payments that are based on fixed area and yields or are provided on less than 85% of base production, or are based on a fixed number of animals.

Bound tariff rate: The maximum rate that a WTO member undertakes to apply. The bound rate provides a ceiling that applied tariff rates cannot exceed, except by negotiation, with compensation to the affected trading partners.

Green box support: Forms of subsidies or expenditures that are exempted from reductions or limits because they are considered to be *minimally market distorting*. “Decoupled” payments, payments not related to current production, prices or inputs, are included in the green box.

In-quota tariff: The reduced tariff that applies for specified quantities that enter within a tariff quota.

Minimum access: Under the Uruguay Round WTO Agreement, members were required to ensure minimum access opportunities equal to three percent of base period (1986-88) consumption in 1995, rising to five percent of base period consumption by 2000.

Tariff rate quota: The use of a reduced tariff rate for a specified volume of imports, while imports beyond these volumes face a higher tariff rate.

*Source: ABARE [1]