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A Small Step Forward: The Impact of Tokyo Round Concessions on U.S. Tobacco

When the U.S. Senate ratified the "Agreements Reached in the Tokyo Round of the Multilateral Trade Negotiations" in July 1979,¹ the United States had won some long-sought tariff and nontariff concessions for the agricultural sector of the U.S. economy. The concessions relating to U.S. tobacco exports negotiated with the European Community (EC) and other trading partners are of particular importance to the economy of North Carolina.² Although reductions in foreign tariff rates as a result of the negotiations should make U.S. tobacco more competitive, the concessions are not expected to lead to any gains in the U.S. share of the world market. At best, the concessions may only halt the steady, fifteen-year decline in the U.S. share of the world tobacco market.³ However, while the Tokyo Round gains may have come too late to reverse the U.S. market share decline, at least the removal of tariff barriers from the list of causes of this decline will force farmers, exporters and those with political authority to focus closer attention on other critical issues involved in the export of U.S. tobacco.

I. U.S. Tobacco Trade on World Markets

For many years the United States has been the largest producer and exporter of unmanufactured tobacco in the world.⁴ While several types of cigarette leaf are traded, flue-cured tobacco accounts for over eighty percent of the total U.S. unmanufactured exports. This is the principal tobacco produced in North Carolina, the largest producer and exporter of tobacco in the nation.⁵ Even though during 1976 and 1977 the United

¹ Trade Agreements Act of 1979, Pub. L. No. 96-39 (to be codified in scattered sections of 19, 26 U.S.C.). For legislative history and purpose, *see* S. REP. NO. 96-249, 96th Cong., 1st Sess., reprinted in [1979] U.S. CODE CONG. & AD. NEWS 381.

² In 1977, the last year for which complete statistics are available, North Carolina exported \$550 million in new leaf tobacco, representing approximately sixty percent of the state's total agricultural exports. U.S. DEPT OF COMMERCE, NORTH CAROLINA EXPORTS 3, 10 (1979). Further, exports of manufactured tobacco products totalled \$484 million in 1976, also the last year for which complete statistics are available, or almost twelve percent of the state's total production of manufactured goods. *Id.* at 4.

³ STAFF OF SENATE SUBCOMMITTEE ON INTERNATIONAL TRADE, SENATE COMMITTEE ON FINANCE, 96th CONG., 1st Sess., MTN STUDIES 1 RESULTS FOR U.S. AGRICULTURE (Comm. Print 1979) [hereinafter cited as MTN STUDIES].

⁴ MTN STUDIES, *supra* note 3, at 168.

⁵ *Id.*

States was also the world's largest importer of unmanufactured leaf,⁶ the international trade of tobacco has contributed to the reduction of the U.S. balance of trade deficit. For example, in 1978 exports of leaf tobacco and tobacco products were valued at \$2.1 billion and imports at \$428 million, creating a contribution of almost \$1.7 billion.⁷

U.S. tobacco exports are not faring as well as they had previously on world markets, however. The quantity of U.S. exports has decreased roughly seven million pounds per year,⁸ while the world export market has nearly doubled.⁹ Moreover, although total U.S. exports to the European Community, the largest market for U.S. tobacco, have stayed about the same, the U.S. share of the EC market has declined from an average of thirty-four percent in 1965-69 to about twenty-three percent in 1979.¹⁰ The largest EC markets, Germany and the United Kingdom, have come to absorb not only a decrease in the percentage of imports coming from the United States but also a decrease in the total quantity. In particular, the United Kingdom imported from the United States 165 million pounds representing fifty percent of their total imports in 1968; in 1977, that amount was down to 52 million pounds, only seventeen percent of the U.K. market.¹¹ The trend illustrated by these statistics may be particularly adverse to the North Carolina farmer of flue-cured tobacco. One out of every two acres of flue-cured tobacco produced in the United States is shipped overseas¹² and the U.S. share of world exports of flue-cured tobacco has dropped from sixty percent in 1966 to thirty-two percent in 1979.¹³

The decline in U.S. market share of world tobacco sales has been attributed to several factors. One is the higher tar and nicotine levels in the high quality U.S. leaf. Because of the worldwide shift to low tar and nicotine brands, foreign manufacturers have been able to substitute cheaper, lower quality tobacco to meet this new demand.¹⁴ A second factor is the use of less leaf per cigarette as manufacturers substitute stems, scrap and other fillers and improve their technical utilization of

⁶ *Id.* at 169.

⁷ H. Kiger, Foreign Trade—Key to an Expanding Flue-Cured Tobacco Economy, at 3 (1979)(unpublished article for the Leaf Tobacco Exporter Association)(copy on file at the *North Carolina Journal of International Law and Commercial Regulation*).

⁸ OFFICE OF THE SPECIAL TRADE REPRESENTATIVE, EXECUTIVE OFFICE OF THE PRESIDENT, VIRGINIA BENEFITS OF THE MTN 1 (1979).

⁹ H. Kiger, *supra* note 7, at 4, Table 7 app. (citing ECONOMIC STATISTICS AND COOPERATIVES SERVICE AND FOREIGN AGRICULTURAL SERVICE, U.S. DEP'T OF AGRICULTURE).

¹⁰ MTN STUDIES, *supra* note 3, at 171.

¹¹ H. Kiger, *supra* note 7, at 4, Table 8 app. (citing FOREIGN AGRICULTURAL SERVICE, U.S. DEP'T OF AGRICULTURE).

¹² H. Kiger, A More Open-Trading System for Tobacco, at 3 (Jan. 16, 1979)(unpublished address to the 28th Tobacco Workers' Conference, Orlando, Florida).

¹³ H. Kiger, *supra* note 7, at 4, Table 7 app. (citing ECONOMIC STATISTICS AND COOPERATIVES SERVICE AND FOREIGN AGRICULTURAL SERVICE, U.S. DEP'T OF AGRICULTURE).

¹⁴ H. Kiger, *supra* note 7, at 2-3. Domestic manufacturers have substituted cheaper, lower quality tobacco as well, stimulating an increase in imports.

tobacco.¹⁵ Nevertheless, by far the most cited reason for the decline is the high price of U.S. tobacco,¹⁶ one element of which has been the tariff. For years foreign and domestic customers have been willing to pay the premium required for U.S. leaf primarily because of its higher quality as compared with foreign competition. Recently, however, the price support program designed to support producers by controlling production, high labor costs, and tariff and nontariff restrictions have put U.S. export prices well above the average prices of competing nations.¹⁷ In fact, the price of U.S. flue-cured tobacco is approximately double the price of such competing exporters as Brazil, South Korea, India and Thailand.¹⁸

The tariff imposed by the EC has proved to be an important element in placing U.S. tobacco at a disadvantage. Much competition in the flue-cured market comes from some of the less developed countries, which not only enjoy much lower domestic labor costs but most of which also benefit from either duty-free status or generalized tariff preference rates granted by the EC.¹⁹ In addition, other competition comes from within the EC, in particular France and Italy which of course benefit from the duty-free status as members.

II. Objectives of U.S. Tobacco Interests

In many ways, the actual conduct of Multilateral Trade Negotiations with respect to agricultural products was an accomplishment. Historically, such negotiations have been kept to a minimum. Participating nations, other than the United States, have continually argued that their respective national and economic strength depends too greatly on their agricultural policies and capabilities to subject agricultural products to free trade.²⁰ So strong have been these sentiments that, in the Kennedy Round of Multilateral Trade Negotiations from 1963 to 1967, "members of the EC viewed attempts to negotiate agricultural policy as a threat to the EC itself."²¹ An additional problem is that most agricultural trading countries are almost exclusively either exporters or importers of major commodities. Thus, reaching agreement on "balanced" reductions is dif-

¹⁵ *Id.* at 2. Before manufacture, the tobacco leaf is sent through a "stripping" process by which the leaf is extracted from the stem. Over the years this process has been improved so that less leaf is lost, and thus the number of leaves per cigarette has declined.

¹⁶ MTN STUDIES, *supra* note 3, at 177-78.

¹⁷ *Id.* at 172. The thrust of the price support program is as follows: the USDA assigns acreage-poundage allotments each year to tobacco farmers. Any tobacco grown under these allotments qualified for the minimum price support, the level of which varies according to texture, position on stalk, color and other factors determined by USDA graders. In the warehouse auction, any qualifying bundle of tobacco is either brought by the government at that minimum level or by private companies at a higher level. In the last ten years the average price support level has risen from 66.6 cents per pound in 1970 to \$1.29 per pound in 1979, and an increase is expected for the coming year. H. Kiger, *supra* note 7, at Table 9 app. See U.S. DEP'T OF AGRICULTURE, AGRICULTURAL STATISTICS, at Table 146 (1979).

¹⁸ H. Kiger, *supra* note 7, at 7, Chart 2 app.

¹⁹ MTN STUDIES, *supra* note 3, at 171 (Table 12-III).

²⁰ *Id.* at 4.

²¹ *Id.* at 9.

ficult.²²

Despite historical precedent, the United States was determined to include the agricultural sector in all Tokyo Round trade negotiations. Although agricultural products were not to be subject to the general tariff formula, the participants in the negotiations did agree that tariff reductions would be negotiated bilaterally.²³ Presented with this opportunity, the tobacco interests in the United States formed ambitious objectives for the Tokyo Round, aimed primarily at the European Community: first, a tariff reduction to at least the level of the U.S. duty on tobacco imports;²⁴ second, a phase-out of the duty-free status and generalized tariff preference rates granted by the EC to the developing countries;²⁵ third, the adoption by the EC of a predominantly specific excise tax that would favor the sale of cigarettes made from high quality leaf;²⁶ and fourth, the elimination of export subsidies, auction sales for export, and import safeguards practiced by the EC.²⁷ Also, tobacco exporters sought tariff and nontariff concessions from other nations including the Phillipines, Mexico, Brazil and Australia.²⁸

III. Effects of the Tokyo Round

The most significant concessions resulting from the Tokyo Round which favored U.S. tobacco exports came from the European Community, Australia and New Zealand. The EC granted the rough equivalent of a nine cent per pound tariff reduction for the high-priced U.S. tobacco only.²⁹ Lower priced, competitive tobaccos will have the same duties as before.³⁰ Although this reduction falls five cents short of the U.S. objective, the Office of the Special Trade Representative [STR] expects U.S.

²² *Id.* at 4.

²³ Graham, *A Practitioner's Guide to the Tokyo Round Trade Negotiations*, 4 N.C.J. INT'L L. & COM. REG. 225, 232 n.26 (1979).

²⁴ H. Kiger, U.S. Tobacco Trade Problems as Related to the Tokyo Round Trade Negotiations, at 1 (1979)(unpublished article for the Leaf Tobacco Exporters Association). The U.S. duty on flue-cured and burley is 12.75 cents per pound. *Id.* This objective represented a reduction of almost fourteen cents per pound. MTN STUDIES, *supra* note 3, at 174.

²⁵ H. Kiger, U.S. Tobacco Trade Problems, *supra* note 24, at 1. Tobacco interests felt that at least "[u]nder no circumstances should [these preferences] be expanded." *Id.*

²⁶ *Id.* at 2. A specific tax is a flat rate per package; the current excise tax is ad valorem. The United States sought an excise tax in which seventy-five percent of the total was a specific tax. *Id.*

²⁷ *Id.* These practices by the EC have been particularly adverse to U.S. tobacco exports. "The high prices fixed under this policy—supported primarily by means of variable import levies—have prevented effective price competition and forced third countries into the position of residual suppliers. Furthermore, the Community has used export subsidies aggressively to dispose of surpluses produced under the stimulus of its high support prices." MTN STUDIES, *supra* note 3, at 5 (citing WILLIAMS COMMISSION, U.S. INTERNATIONAL ECONOMIC POLICY IN AN INTERDEPENDENT WORLD, REPORT TO THE PRESIDENT SUBMITTED BY THE COMMISSION ON INTERNATIONAL TRADE AND INVESTMENT POLICY 141 (July 1971)).

²⁸ H. Kiger, *supra* note 25, at 2.

²⁹ MTN STUDIES, *supra* note 3, at 2.

³⁰ *Id.*

exports to increase by \$75 million as a result of the concession.³¹ However, a Senate subcommittee estimates that this increase will only offset an otherwise annual decline and concludes that as EC consumption continues to increase, the U.S. share of that market will continue to decline.³²

The Australian concessions came in two forms. Australia reduced its duty on unmanufactured tobacco from sixty-four cents to twenty-four cents per pound, and it reduced its mixing requirement to fifty percent.³³ The mixing law, a nontariff barrier, requires that a minimum percentage of cigarette content be Australian tobacco; Australian manufacturers currently use fifty-six percent domestic tobacco.³⁴ The Office of the STR expects these concessions to increase U.S. exports by 7.7 million dollars a year,³⁵ or 1.8 million pounds.³⁶

Meanwhile, New Zealand reduced its duty from thirty-five to nineteen cents per pound.³⁷ The full impact of this reduction will be limited somewhat because of continued government pressure to use domestic tobacco, but the United States expects an increase of .1 million pounds worth .2 million dollars.³⁸

Thus, adding the concessions made by Finland, Canada and all other participants to those made by the EC, Australia and New Zealand, the total projected increase in U.S. tobacco exports at the end of the transition period³⁹ is estimated to be between forty-eight⁴⁰ and fifty-three million pounds,⁴¹ worth between 78.6⁴² and 86 million dollars.⁴³ U.S. concessions, on the other hand, were minimal. Nineteen countries requested concessions, but the United States granted only one, to Canada,⁴⁴ and this concession is not expected to have much impact on U.S. imports.⁴⁵

IV. Assessment

Certainly, the tariff and nontariff concessions will make U.S. tobacco more competitive than if the concessions had not been granted.

³¹ OFFICE OF THE SPECIAL TRADE REPRESENTATIVE, EXECUTIVE OFFICE OF THE PRESIDENT, KENTUCKY BENEFITS OF THE MTN 7 (1979).

³² MTN STUDIES, *supra* note 3, at 164.

³³ *Id.*

³⁴ *Id.*

³⁵ OFFICE OF THE SPECIAL TRADE REPRESENTATIVE, *supra* note 31, at 7.

³⁶ MTN STUDIES, *supra* note 3, at 164.

³⁷ *Id.*

³⁸ *Id.* at 164-65.

³⁹ The end of the transition period is 1987. MTN STUDIES, *supra* note 3, at 1.

⁴⁰ MTN STUDIES, *supra* note 3, at 166.

⁴¹ OFFICE OF THE SPECIAL TRADE REPRESENTATIVE, *supra* note 8, at 2.

⁴² MTN STUDIES, *supra* note 3, at 164.

⁴³ OFFICE OF THE SPECIAL TRADE REPRESENTATIVE, *supra* note 8, at 2.

⁴⁴ MTN STUDIES, *supra* note 3, at 165.

⁴⁵ Draft Report of the Agricultural Technical Advisory Committee for Tobacco on the Multilateral Trade Negotiations Agreements (June 13, 1979).

However, because of other factors, even the maintenance of current absolute levels of exports is unlikely in the absence of other measures. First, the average market price for U.S. flue-cured tobacco has increased by thirty-five percent over the last three years,⁴⁶ and that trend is expected to continue. If this rate of increase persists, the next annual jump in support prices will cancel out the nine cent tariff reduction.⁴⁷

Second, although the U.S. tobacco interests sought to persuade the EC to drop its preferential treatment of developing countries, this objective was unrealistic. The United States itself grants and sanctions the preferential treatment of less developed countries and, thus, cannot complain when the policy stimulates adverse competition.

A third discouraging factor is the return of Rhodesia into the world market following the lifting of U.N. sanctions. Prior to the sanctions, Rhodesia was second only to the United States as the largest exporter of flue-cured tobacco.⁴⁸ Because of the high labor requirements for today's tobacco production, Rhodesia, like many of the developing countries, has a comparative advantage over the United States in production costs. Add to this the duty-free status granted by the EC, and Rhodesia threatens considerable price competition for U.S. tobacco.

As mentioned earlier, a Senate subcommittee has estimated that the tariff reduction could at best allow the United States to maintain its current absolute level of exports to the EC. An even more discouraging possibility is that the concessions will have no impact whatsoever. Because prices for high-quality U.S. tobacco have been so high for a number of years, manufacturers throughout the world have been delicately and gradually reducing the quality of cigarettes, without much notice from consumers.⁴⁹ Having achieved consumer acceptance of this lower quality cigarette, manufacturers will be even less willing to alter their blends to reincorporate the most "competitive" but still highly priced American leaf.⁵⁰ The result may be a continued substantial annual decline in the quantity of U.S. tobacco exports world-wide, as foreign competitors continue to increase their share of the world market.

The concessions achieved by the Tokyo Round of the Multilateral Trade Negotiations may not reverse or halt the steady decline in the U.S. share of either world or EC markets. Nevertheless, the agreements reached in the Tokyo Round have eliminated tariff barriers as one of the major obstacles to the sale of U.S. tobacco on world markets. Attention

⁴⁶ U.S. DEP'T OF AGRICULTURE, TOBACCO SITUATION, at Table 141 (1978).

⁴⁷ See note 17, *supra*.

⁴⁸ Guyon, *Return of Rhodesian Tobacco to Markets Blows Smoke over U.S. Exporters' Hopes*, Wall St. J., Feb. 14, 1980, at 38, col. 2.

⁴⁹ MTN STUDIES, *supra* note 3, at 178.

⁵⁰ *Id.*

can now focus on other factors affecting the competitiveness of U.S. tobacco in international trade.

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