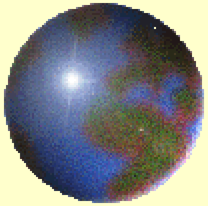
"Normalizing Trade Relations with Cuba: GATT-compliant Options for the Allocation of the U.S. Sugar Tariff-rate Quota"



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Overview

I. History of U.S.-Cuba relationship with respect to sugar;

II. U.S. obligations under the GATT following the removal of sanctions;

III. Options for allocating U.S. sugar tariff-rate quota (TRQ) to Cuba;

IV. Timing for removal of sanctions by selected policy events; and

V. Policy implications of allocation options.

History of U.S.-Cuba relationship

Pre-sanctions

- The United States and Cuba were interdependent with respect to sugar.
- Cuba supplied about 35% of U.S. domestic consumption.
- The United States served as Cuba's primary export market for sugar, receiving over 50% of Cuba's annual exports.
- The United States allocated approximately 72% of the U.S. sugar import quota to Cuba.
- Cuba faced a preferential tariff rate of 20% below the general rate of duty.

History of U.S.-Cuba relationship

Post-sanctions

- U.S. refiners were forced to seek alternative suppliers.
- Cuba’s portion of the U.S. sugar quota was reallocated to other foreign suppliers and to U.S. cane and beet producers.
- Cuba lost an estimated $120 million annually in economic rents.
- Cuba supplied most of its sugar to the Soviet Union, mainly bartered for oil.

History of U.S.-Cuba relationship

Since 1960, there have been drastic changes in the structure of the sugar industry and in domestic policies in both countries.

- United States
  - Domestic sugar production has expanded greatly.
  - The import quota level for raw sugar has been drastically reduced.
  - The absolute import quota was converted to a TRQ in 1990.
  - The TRQ has been allocated among 40 countries.

- Cuba
  - Deterioration in sugar industry infrastructure.
  - Lack of necessary inputs (e.g., fertilizer and machinery).

U.S. obligations under the GATT

- The United States would be required to grant MFN status to Cuba.
- The United States would be required to apply MFN tariff rates to imports from Cuba.
- The United States would be obligated to open its sugar TRQ system to imports from Cuba.
- The United States would need to allocate a TRQ amount to Cuba that reflects trade shares in the absence of trade restrictions.

Options for allocating U.S. Sugar TRQ

- We choose to discuss six, GATT-compliant allocation options:

    1. Globalizing the TRQ;
    2. Auctioning the TRQ;
    3. Redistributing the TRQ;
    4. Increasing the TRQ;
    5. “Tariffying” the TRQ; and
    6. Inclusion of Cuba in an <u>existing</u> Free Trade Agreement (FTA) or create a separate bilateral FTA.

Options for allocating U.S. Sugar TRQ

Option 1: Globalizing the TRQ

- Terminate all country-specific allocations and grant in-quota tariff access on a first-come, first-served (FCFS) basis.
- No over-quota imports allowed until TRQ fills.
- Overall level of the TRQ remains unchanged.
- United States would not grant Cuba a specific share of the TRQ.
- Cuba would compete with other exporting nations for access to the U.S. market.
- Leads to economic inefficiencies (e.g., “run for the border”).

Option 2: Auctioning the TRQ

- Opens the TRQ to a competitive bidding process that would allow exporters to purchase the right to export.
- Similar to globalizing the TRQ in that exporters compete for access.
- Monopolization of rights and imperfect competition could lead to inefficient allocation of the TRQ.
- Auctioning would require significant administrative effort.
- Cuba would likely not gain access to the TRQ under this method of allocation, as more efficient producers would prevail.

Options for allocating U.S. Sugar TRQ

Option 3: Redistributing the TRQ

- Reduce quota allocated to current holders and distribute TRQ shares to Cuba.
- Overall level of TRQ remains unchanged, but relative shares change.
- Use a “formula approach” is problematic in determining Cuba’s TRQ share.
- United States may cite ‘special factors’ (i.e., sanctions) as affecting trade in sugar and seek alternative factors other than base period for determining TRQ shares.

Options for allocating U.S. Sugar TRQ

Option 4: Increasing the TRQ

- Increase the level of the TRQ and allocate the extra quantity to Cuba.

- Overall size of TRQ increases, prorated levels are altered, absolute sizes of TRQ shares remains unchanged.

- Amount allocated to Cuba should mirror the share of total imports Cuba would likely capture given the absence of the quantitative restriction.

- Could rely on the ‘special factor’ clause to justify allocation to Cuba.

Options for allocating U.S. Sugar TRQ

<u>Option 5: ‘Tariffying’ the TRQ</u>

- Replace the TRQ with a single tariff.
- Set the tariff equal to the tariff equivalent created by the import quota, so imports would continue to equal the TRQ level.
- The tariff equivalent is lower than the bound over-quota tariff rate.
- Removes the need to allocate TRQ shares and allows competition to prevail.
- In the short run, Cuba would likely not be competitive in the world market.

Options for allocating U.S. Sugar TRQ

<u>Option 6: Inclusion in an existing FTA or creation of a separate bilateral FTA</u>

- Include Cuba in a preferential trade agreement such as NAFTA or Free Trade Area of the Americas (FTAA).
- Agreement must include ‘substantially all trade,’ not just trade in sugar.
- Possible allocation of separate TRQ to Cuba (as was the case with Mexico under NAFTA).
- Increases overall level of the TRQ.

Timing for removal of sanctions

- Effects on Cuba's access to the U.S. sugar market could hinge on whether sanctions are removed *before* or *after* critical policy events:

   1. WTO negotiations for agriculture;

   2. FTAA in 2005 (?); and

   3. Common market for sugar with Mexico in 2008.

Policy implications of allocation options

- GATT viability of options differs from political viability.
- Welfare effects highlight economic and political implications of each allocation option.
- Three options maintain the size of the TRQ and three increase the size of the TRQ.
- Maintaining the size of the TRQ only affects distribution of quota rents and tariff revenue.
- Increasing the size of the TRQ results in U.S. producers and taxpayers bearing the burden of the policy change and U.S. consumers slightly benefiting.

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