

## Chair's Reference Paper<sup>1</sup>

### SENSITIVE PRODUCTS

#### ***Background***

Paragraph 7 of the Hong Kong Ministerial Declaration (WT/MIN(05)/DEC) states, *inter alia*, that:

"... We recognize the need to agree on treatment of sensitive products, taking into account all the elements involved."

Paragraphs 31-34 of the Agreed Framework (Annex A of WT/L/579) states that:

#### "Selection

Without undermining the overall objective of the tiered approach, Members may designate an appropriate number, to be negotiated, of tariff lines to be treated as sensitive, taking account of existing commitments for these products.

#### Treatment

The principle of 'substantial improvement' will apply to each product.

"Substantial improvement" will be achieved through combinations of tariff quota commitments and tariff reductions applying to each product. However, balance in this negotiation will be found only if the final negotiated result also reflects the sensitivity of the product concerned.

Some MFN-based tariff quota expansion will be required for all such products. A base for such an expansion will be established, taking account of coherent and equitable criteria to be developed in the negotiations. In order not to undermine the objective of the tiered approach, for all such products, MFN based tariff quota expansion will be provided under specific rules to be negotiated taking into account deviations from the tariff formula."

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<sup>1</sup> The headings used in this reference paper are indicative only.

## **Structure for Discussion**

### ***Introduction***

1. The issue of sensitive products is a critical element of the Market Access pillar and hence of the agriculture negotiations. Successful resolution of this issue is essential if complete modalities are to be established, which means resolving the two core components of modalities for sensitive products: selection and treatment. So far, despite intensive engagement, genuine progress, several proposals and a number of attempts by Members to find compromise solutions it has not been possible to achieve a robust basis for moving to convergence on these two components. This is what we have to do in the next short period.

### ***Selection***

2. The Agreed Framework states that Members may designate an appropriate number, to be negotiated, of tariff lines to be treated as sensitive, taking account of existing commitments for these products.

3. It seems clear to me that the range of numbers for this issue are still too far apart, and it is clear to me also that we must begin to narrow that range to a more manageable level. Current proposals range from 1% of dutiable tariff lines to 15%. That is a chasm, and it has been there for a lengthy period. But I must confess that I have detected no willingness to seriously do so despite the lateness of the stage we are at. My own frank view is that convergence is better done to some extent in an iterative way: expecting to throw a bridge over this gap in one go is not, in my view, a wise way to go. We would be better to start narrowing the parameters now. I suspect that there are few Members that have not heard private conversations that talk of much more convergent number ranges. Be that as it may, no-one has shown preparedness to start shedding their negotiating padding at this point in more open negotiating contexts.

4. As the Chair I have to say at this point, that the negotiating credibility of these extremes are starting to wear just a bit thin - at least as they stand. For instance, the facts show that the upper levels potentially allow Members to shelter a large proportion of the value of trade from the brunt of tariff-cutting. Just looking at two examples of major developed Members shows that 15% of dutiable tariff lines could represent 88.1% of the value of current trade for the first and 84.3% for the second. Of course, just as for selection of Special Products by developing countries, this is not to presume that Members would actually choose their sensitive products based on the value of trade. Moreover, there is a requirement under the July Framework to actually provide for trade to occur for such sheltered items (but, as we will see below, we remain far apart about what that would amount to, concretely). This is simply to point out the reality that 15% of tariff lines could potentially affect most trade in agriculture products.

5. Looking at it from the other end of the telescope, is it realistic to believe that everybody is going to constrain themselves down to as low a number as under 20 sensitive tariff lines being sensitive (which is what one percent comes to – at least in some Members' schedules)? I think it is high time that we at least start to get more ruthlessly realistic and frank about what real bottom lines are. When one sees that (just to take one random example) sugar alone constitutes 44 tariff lines at 8 digit level – or 2.5% of tariff lines-in one Member's schedule – one is surely entitled to wonder whether we are ever going to get down to just one percent.

6. I emphasize this to underline that we cannot shrink from the reality of this issue and the need to converge on it. We cannot just shelve it. Having said that, I do think we have no choice but to focus our immediate efforts primarily on the treatment question. If we can get to greater clarity about how we would want that to be done it should follow that we are all in a better position to judge whether the tolerance level is going to go up or down when it comes to the overall number for sensitive products.

### *Treatment*

7. The Agreed Framework states that "substantial improvement will be achieved through combinations of tariff quota commitments and tariff reductions applying to each product. However, balance in this negotiation will be found only if the final negotiated result also reflects the sensitivity of the product concerned".

8. I must confess that, it is hard to get away from the plain language of this statement. In particular, I cannot easily see how the word "combination" can be read out of the text. That being so, it seems to me at least a floor to our negotiation that, whatever else one debates about what the extent of commitment and reduction will be, there will have to be at least a certain quantum of *both* tariff quota expansion and tariff reduction for each product. Were it not for one developed Member's demurral, we could, I feel, at least start going along the operational road to trying to reach certain small steps toward convergence.

### *Deviation*

9. For instance, I would like to suggest that we could start to make practical progress by starting to "top and tail" what the upper and lower limits of tariff deviation should be for any given sensitive product. That one Member at least apart, are we able to say – at least at this point - that the range could be somewhere between, say, 25% and 75% of whatever the "normal" cut would otherwise be (it being understood that we go on from here to see if we can get still closer within this outer range)? I am well aware that this is not a position that you as Members share precisely right now - although I sense that some at least are getting to this sort of zone. My point is simply that if we don't *start* trying to take working steps such as this we will, to be honest, just get nowhere. I cannot see that it is realistic to keep a potential sliding-scale wide open like this and expect, for example, Ministers to magically come up with one number, or even a floor and ceiling range, from a standing start. If that happens we will have a bidding war of all sorts of numbers and we will not have time to broker a compromise.

10. I know that one can also take the view that this could or should be something that is self-determined and open-ended. All I can say is that is difficult to imagine as a practical matter that we can get to modalities on a matter as important as this without any definition to this - and that would be irrespective of whether one is "offensive" or "defensive" on this. Predictability surely has to be the name of the game. Now is the time (indeed it is well beyond time) that we start to get to a more convergent zone. If you as Members are not ready to narrow your differences when will you be ready? Time is running out.

### *Tariff Quota Expansion*

11. While the Agreed Framework is clear that "some MFN-based tariff quota expansion will be required for all such products", discussions have, however, failed to reach a mutually acceptable interpretation of this statement. Some Members interpret the Framework as implying that all sensitive products should have a "core" or minimum level of tariff quota expansion with an additional amount based on the size of the deviation from the general tariff cut. Other Members disagree, arguing that tariff quota expansion is primarily a function of the deviation from the reduction under the tiered formula and that it could not lead to an access commitment that would be higher than what would have been presumed to occur should there have been no shelter from the full tariff cut.

12. The discussion to date has focused on three different basic approaches to tariff quota expansion for sensitive products – (i) current levels of domestic consumption; (ii) existing bound tariff quota commitments; and (iii) current import volumes. Each approach has its proponents and critics and all delegations acknowledged that no particular method is perfect.

## (i) Domestic consumption

13. Using current levels of domestic consumption was the basis used for creation of tariff quotas in the Uruguay Round and its proponents in this round argue that it is the only method that will yield equitable results in line with the mandate. While the majority of those that favour this approach propose that the increase should be *by* a percentage of domestic consumption there are those that argue that it should be an increase *to* a percentage of domestic consumption.

14. Those that disagree with the approach of using domestic consumption have stated that the resulting tariff quota increases using this method are much larger than could be justified as compensation for deviation from the tariff reduction formula. In addition, they argue that there are significant problems getting consumption data at tariff line level.

## (ii) Current tariff quotas

15. There are those that argue for a *pro rata* increase in current tariff quota commitments for these products, supporting this with the view that it would avoid the alleged consumption data problem as these data are already in Members' Schedules. Others have responded that some tariff quotas established as a result of the Uruguay Round were very small compared to domestic consumption. Even applying an additional increase to these relatively small tariff quotas may not represent a significant opportunity for exporters. Furthermore, the base of 1986 to 1988 used to establish minimum access commitments in the Uruguay Round is now quite old and in some cases may need to be updated.

## (iii) Current import levels

16. The proposal to use the current import levels of sensitive products as the base is justified on the basis that the increase in the tariff quota should be viewed conceptually as compensation for not applying the formula reduction in tariffs. That is, the growth in imports would be less than if the full formula cut was applied and needs to be compensated for through the expansion in tariff quota. Therefore, the tariff quota increase should be a function of current import levels, the elasticity of import demand and the degree of compensation. The proponents have stated that the degree of compensation and the elasticities are negotiable but the former should be less than 100% and the later is about 1.

17. Opponents of this view have made several critical points but principally object because, in some cases, current imports are at very low levels. Furthermore, in some cases import licensing systems or other factors associated with administration of tariff quotas may be acting to restrict import volumes and thus in some instances the existing import levels are lower than the quota volumes themselves. Therefore, current import levels are not representative of true demand in many cases and, anyway, the import elasticity is often much greater than 1. In an effort to react to this criticism, proponents have also suggested using a co-efficient based on (shadowing) domestic consumption that would require greater increases for tariff quotas that represent low levels of domestic consumption and lesser increases for tariff quotas that represent high levels of domestic consumption.

*Comment*

18. I do not underestimate the gaps that these divergences in approach represent. They cannot be brushed under the carpet. Ultimately we need to resolve this. But it is also clear that this is not going to be resolved in a matter of days. I also don't see us as having to be completely hostage to this divergence in the meantime. If we are prepared to do so, we can still make progress while this divergence is worked on.

19. There are at least some signs of structural convergence that we need to acknowledge and see if we can work on. It does appear, for instance, that there is - albeit at a general level - an acceptance that "relatively" more should be done to allow for imports where the levels are relatively low. Thus, the "consumption basis" approach is aimed at getting access up to some level (at least 5% for instance). The "tariff deviation/increase imports by a percentage" approach recognizes in its own way that that approach can lead to an artificially low import level at the "bottom end". Hence it has suggested adjustments that, interestingly enough, are in fact connected to a domestic consumption concept. In a parallel manner, the pure consumption expansion proponents do recognize that there can be situations where, with "high" imports already, that this can lead to import levels that are rather difficult to reconcile with any realistic sense of how "sensitive" products would be treated. Thus there is an openness to adopt a more "tapering" methodology in such cases.

20. In process terms it seems to me that it might be worth attending immediately to these "ends of the spectrum" to see how much further convergence might be possible. This reflects my sense at least that we cannot realistically divorce structure entirely from numbers. We all necessarily have specific tonnages for specific products in mind when we deal with this issue. While we cannot decide such matters now, we need to be able to keep them in sight as we go. For instance, by my reckoning there is a range of about 10:1 in the proposals so far in terms of the proposed level of ambition. That is to say that where one proposal would result in additional quotas amounting to 10,000 tonnes for a particular product, another would result in additional quotas amounting to 100,000 tonnes for the same product. There are always going to be differences in view in terms of ambition, but in my view it is in fact valuable to be able to correlate what structures might deliver what outcomes in order to advance on this.

21. Thus, notionally a hypothetical straight 5% of domestic consumption approach gives a rough and ready sense of what imports would be involved at one end of the spectrum. It seems to me, conceptually at least, this can be notionally compared with a tariff deviation/import percentage approach using e.g. the shadow import approach for the "lower end" situation. The variables involved (e.g. the elasticities or the adjustment coefficient) can be varied (hypothetically) to envision how variable the outcomes would be. These can be tabulated in a way that gives a kind of sensitivity analysis in comparison to a "pure consumption" approach. Ditto for the "upper end" situation. It might at least add transparency to the exercise. Based on that transparency, it might even suggest where more tailored supplementary or hybrid elements could be introduced to bridge differences.

#### *Tariff Quota Creation*

22. Given the Framework language regarding "combinations of tariff quota commitments and tariff reductions" the question has been raised regarding how to handle situations where no tariff quota exists for products designated as sensitive. Many Members have made it clear that they do not support the idea of tariff quota creation and that any such creation would be a step backwards in the liberalization process. At this stage, while other Members remain open to the possibility of creating new tariff quotas, they have indicated a willingness to look at other possible options which may avoid the need for such creation. Of course, it depends on what the alternatives to tariff quota creation are. Suggestions have been put forward for handling such situations, such as achieving tariff cuts in shorter implementation periods or providing longer implementation periods for the full tariff cut required by the tiered formula. More consideration needs to be given to this issue and to what may be an acceptable alternative to creating tariff quotas. At the very least, I do not have the sense that any Member wishes to see a plethora of new tariff quotas.

#### *Special and Differential Treatment*

23. Discussions have also noted the need to take into account special and differential provisions for sensitive products. Some suggestions have included the "two-thirds rule" for the treatment elements for developing countries as well as the possibility that they be allowed to designate 50 percent more tariff lines than the absolute number designated by the developed country Member with the highest

number of such tariff lines. While special and differential treatment is of course an integral element of our work, it is difficult to move ahead on this issue until we have determined the "core disciplines", but it is important that we keep this in mind during our work.

24. I would note also that some developing countries have suggested that rather than declaring some products as "sensitive" they would prefer the option of being able to declare a higher proportion of products as "Special".

***Other Issues***

25. A number of other issues have been raised in the discussion – tariff quota administration and commitments on in-quota tariff rate for example. I have the sense that the latter is seen increasingly as being an integral and, indeed facilitating, part of the exercise of resolving the modalities on sensitive product treatment. That has been a relatively recent development, but it is increasingly coming to the forefront. As an essentially numbers-oriented matter it may indeed be an element that we can realistically expect to deal with in the modalities timeframe, albeit that I would have doubted that a month ago. The former is, undoubtedly, formally part of the modalities. Given the time we have remaining I do not easily see how we can realistically expect to achieve finality on it, given the considerable complexities involved and the other pressing matters we have to deal with. In addition, the paragraphs in the July 2004 Framework concerning tropical products, tariff escalation, commodities and the treatment of long-standing preferences may clearly enough impact on - and certainly have relevance to - the treatment of sensitive products.

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