

## U.S. Tariff-Rate Quotas for Peanuts

David Skully<sup>1</sup>

**Abstract:** The U.S. Tariff-rate quota (TRQ) for peanuts was created to meet the United States' obligations under the Uruguay Round Agreement of the WTO. This article traces the development of the U.S. peanut TRQ from its Section 22 quota origins. It explains how a TRQ operates in general and then explains the operation of the U.S. peanut TRQ, and its expansion and liberalization under the Uruguay Round. The influence of the TRQ on the volume, timing and country origin of U.S. peanut imports is examined. The U.S. TRQ for peanut butter and paste and the U.S. NAFTA TRQ for peanuts are also discussed. The article concludes with a discussion of potential issues in the next Round of WTO negotiations. In particular, it considers the various ways a TRQ can be liberalized.

**Keywords:** Tariff-rate quota, quota, peanuts, peanut imports, trade liberalization, WTO.

### Background to the U.S. Peanut TRQs

The U.S. tariff-rate quotas (TRQs) for peanuts and peanut butter are products of the domestic peanut program. The domestic peanut program, in attempting to increase producer prices, restricts the quantity of domestic peanuts that may be produced and marketed for human consumption in the United States. Because unrestricted imports of peanuts would have undermined the domestic price support program, imports were restricted by means of a quota. In the Uruguay Round Agreement on Agriculture, the United States and all other signatories agreed to a ban on 'quantitative restrictions' on imports. In other words, they agreed to give up the use of quotas.

The U.S. peanut TRQ stems from the *tariffication* of a Section 22 quantitative restriction. Section 22 of the Agricultural Adjustment Act of 1933 (as amended in 1935) allowed the President to impose fees or quantitative restrictions on imports of products that could materially interfere with the operation of domestic agricultural price support programs. Moreover, the legislation (as amended in 1948, 1950 and 1951) specified that the right to impose such restrictions could not be abridged by "any treaty or other international agreement to which the United States is or hereafter becomes a party." The decline in commodity prices following the Korean War triggered Section 22 actions. Quantitative trade restrictions on peanuts, among other agricultural products, were initiated on July 1, 1953. The restrictions were challenged in the General Agreement on Tariffs and Trade (GATT). In 1955, the GATT granted the United

States an indefinite waiver from its GATT obligations for actions taken under Section 22.<sup>2</sup>

Because Section 22 quotas were initially imposed to prevent disruption of domestic price support or production control programs, it was necessary to restrict not merely the controlled commodity, but also many of its processed derivatives and substitutes. The peanut program supports the price of raw, in-shell peanuts for human consumption, not for oil or meal or other uses. In contrast, the peanut TRQ covers raw, in-shell peanuts and shelled, blanched, and 'other' peanuts. There is also a separate TRQ for peanut butter.<sup>3</sup>

The North American Free Trade Agreement (NAFTA) and the Uruguay Round Agreement of the World Trade Organization (WTO) required changes to the U.S. peanut quotas. NAFTA grants preferential access to the products of Canada and Mexico. In addition, the United States has a free trade agreement with Israel, and preferential agreements with the Caribbean Basin and the Andean Pact trade groups. Finally, the United States has a bilateral agreement with Argentina on peanuts. All of these agreements as well as the WTO Uruguay Round Agreement on Agriculture are recognized and incorporated in the U.S. TRQs for peanuts and for peanut butter and

<sup>1</sup> Agricultural Economist, Market and Trade Economics Division, Economic Research Service, USDA.

<sup>2</sup> See Jackson (1969): 733-737. Besides peanuts, in 1951-55 other restrictions under Section 22 were in effect for: cotton and certain cotton waste; wheat and wheat products; dairy products, including dried milk, cheese, butter, chocolate crumb, and certain animal feed containing milk or milk derivatives; barley, rolled barley, and barley malt; oats and ground oats; shelled and prepared almonds; shelled filberts; peanut oil; flaxseed and linseed oil; and rye, rye flour, and meal.

<sup>3</sup> The peanut butter TRQ was not created under Section 22; see Borges (1995: 600 ff.) for an explanation of the convolutions of U.S. trade policy for peanut butter and paste.

paste. As the various obligations sometimes overlap, it leads to a complicated bundle of tariffs and preferences.

### How a Tariff-Rate Quota Operates

A tariff-rate quota is a two-tiered tariff. In a given period, a lower, in-quota tariff  $\{t\}$  is applied to the first  $Q$  units of imports and a higher over-quota tariff  $\{T\}$  is applied to all subsequent imports. From a legal point of view, tariff-rate quotas are not quantitative restrictions because they do not limit the quantity that may be imported. One may always import by paying the over-quota tariff. This opportunity is not available under a regular (or absolute) quota, which simply bans imports once the quota is filled. If the over-quota tariff is set at a sufficiently high rate, no importer will find it profitable to import beyond the quota, and it therefore yields exactly the same import volume as a traditional absolute quota. The over-quota tariffs for the U.S. peanut TRQ are not prohibitive: there are over-quota imports, see figure D-1.

Figure D-2 shows how a TRQ operates. It shows the stylized demand by the United States for imported peanuts. The import demand curve represents demand in excess of consumption of domestically produced peanuts. The supply curve is the supply of peanuts exported by other countries. The drawing assumes, as a simplification, that an infinite amount of peanuts is available for import at the world price, represented by 'W'. On the first  $Q^{TRQ}$  units of peanuts imported an in-quota tariff of  $t$  cents per unit is applied. Thus, the price a U.S. importer faces is  $W+t$  per unit, and the effective supply curve is the bold horizontal line at  $W+t$ . The effective supply curve has a vertical jump at the quantity  $Q^{TRQ}$ . The first unit in excess of the quota is charged the over-quota tariff of  $T$  cents per unit. Thus the supply curve continues at the horizontal line at  $W+T$ . Because one observes over-quota peanut imports, the over-quota tariff is not prohibitively high and the import demand curve intersects the over-quota horizontal segment of the supply curve

at the point marked 'A'. This means that the in-quota volume is not the binding constraint on peanut imports. Rather, the over-quota tariff determines the volume of trade. The over-quota tariff also determines the domestic price of peanuts. The domestic price equals the world price plus the over-quota tariff.

Three rectangles are shaded and labeled in figure D-2. In-quota tariff revenue is simply the in-quota import tax ( $t$ ) times the volume of in-quota imports. Over-quota tariff revenue is the over-quota import tax ( $T$ ) times the volume of over-quota imports. The sum of these two rectangles represents the amount of revenue collected by the U.S. Customs Service. The rectangle labeled RENT shows the profit gained by those importers who are able to import within the quota at the price  $W+t$  and sell on the domestic market at the price  $W+T$ . The rent per unit is simply  $T-t$ . As the next section documents, the right to import within the quota is valuable and there is considerable competition over gaining these rights. In fact, most of the disputes involving quotas and tariff-rate quotas concern how the quota import rights are distributed.

### The U.S. WTO Peanut TRQ

The formal specification of the U.S. TRQ for peanuts is found in Chapter 12, note 2b of the Harmonized Tariff Schedule of the United States [HTSUS]. The relevant information is reproduced here. First, the quota year for peanuts starts April 1 and ends March 31 of the following year. Second, the peanut TRQ includes four categories of peanuts. Their descriptions and tariff codes are listed in table D-1. In-quota imports have a different tariff code than over-quota imports. Thus shelled, (not roasted or otherwise cooked) peanuts in quota are designated 1202.20.40 and, if over quota, 1202.20.80. The different tariff lines correspond to the different forms and levels of tariff charged. In addition, they allow one to monitor the rate and level of quota fill.

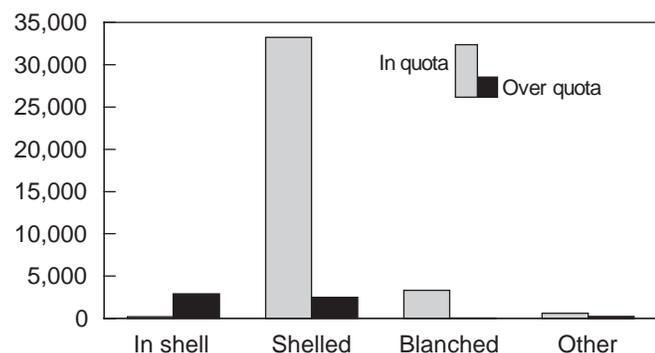
The third aspect of the TRQ is the volume of in-quota imports allowed. Table D-2 shows the initial tariffification of the Section 22 quota and its liberalization under the Uruguay Round Agreement on Agriculture. On April 1, 1995 the in-quota volume was set at 30,393 metric tons. The in-quota volume increases each year until April 1, 2000 when it reaches 52,906 metric tons.<sup>4</sup> Similarly, the initial over-quota tariffs for in-shell and all other peanuts were set at 192.7 percent and 155 percent. These rates are reduced by 15 percent over the course of 6 years to 131.8 percent and 163.8 percent in 2000. (A 15-percent reduction means the 2000 rate equals the initial rate times the factor,  $0.85 = 1.00 - 0.15$ .)

In-shell peanuts are measured at the rate of 75 lbs. per 100 pounds (one quarter of the weight is credited to shell).

Figure D-1

### Average Peanut Import Volumes: 1995/96-1998/99

Metric tons



Source: Economic Research Service, USDA.

<sup>4</sup> These volumes exclude peanuts from Mexico.

Figure D-2  
**Tariff-Rate Quota**

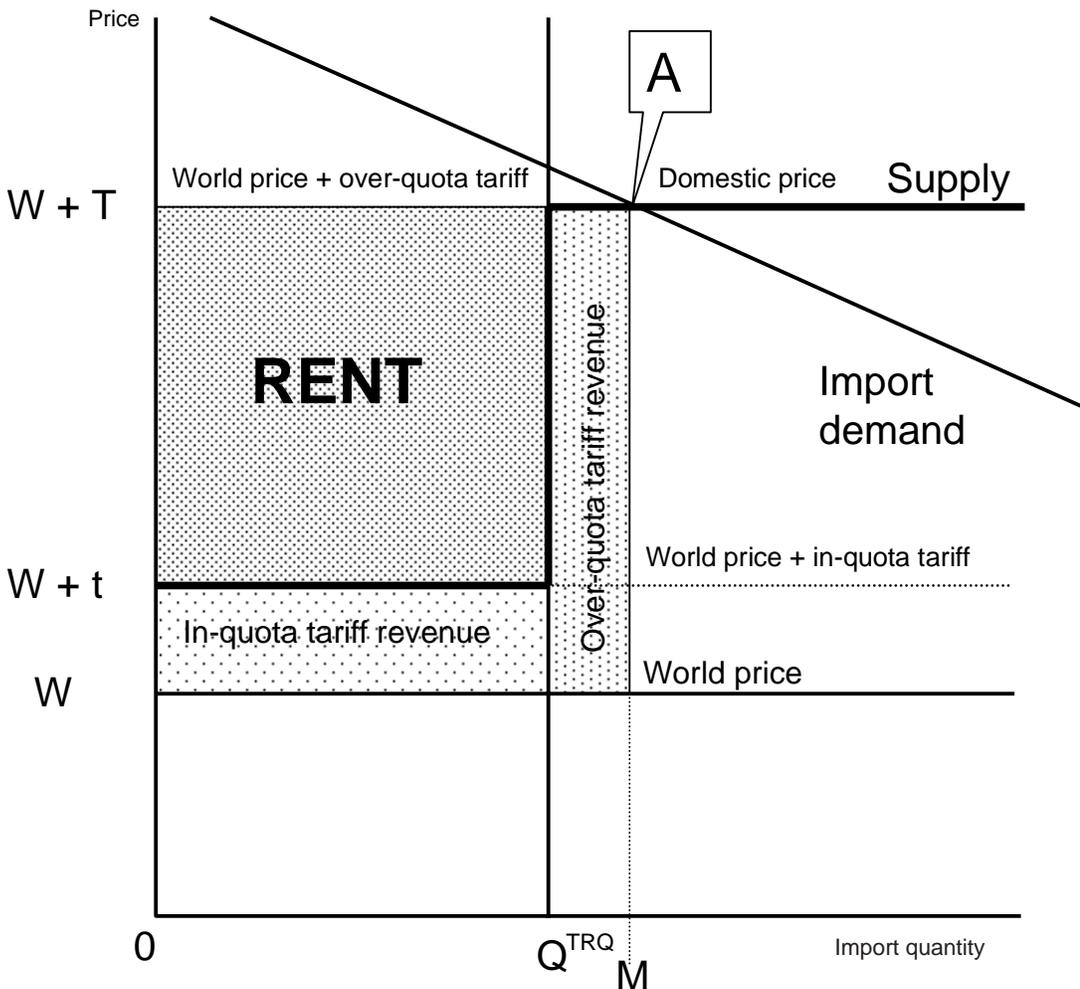


Table D-1 Peanut types and tariff codes under the peanut TRQ

In-quota	Product description	Over quota
1202.10.40	Peanuts not roasted or otherwise cooked, in shell	1202.10.80
1202.20.40	Peanuts not roasted or otherwise cooked, shelled	1202.20.80
2008.11.25	Blanched peanuts	2008.11.35
2008.11.45	Peanuts, other	2008.11.60

Fourth, the rules for administering the TRQ are outlined. The WTO grants member countries broad discretion over how they administer TRQs. This is a potentially contentious issue and one that is likely to be addressed in the upcoming round of trade negotiations.<sup>5</sup> The peanut TRQ is a hybrid of two general forms of TRQ administration: it mixes historical allocation—where specific countries are granted a fixed share or amount of the total in-quota volume—and first-

<sup>5</sup> See Skully (1999) for more detail on the economics of TRQ administration.

come first-served allocation—where access to the in-quota volume is granted to whomever imports first. The total in-quota volume is apportioned among several countries or groups of countries. In particular, the allocation respects a bilateral agreement between the United States and Argentina that guarantees Argentina 78 percent of the minimum access

Table D-2--The liberalization of the U.S. peanut tariff-rate quota

Year	Over quota tariff		In quota volume Metric tons
	In-shell peanuts	Shelled peanuts	
	Percent ad valorem		
Base	192.7	155.0	
1995	187.6	150.9	30,393
1996	182.5	146.8	34,896
1997	177.7	142.9	39,398
1998	172.9	139.1	43,901
1999	168.3	135.4	48,403
2000	163.8	131.8	52,906

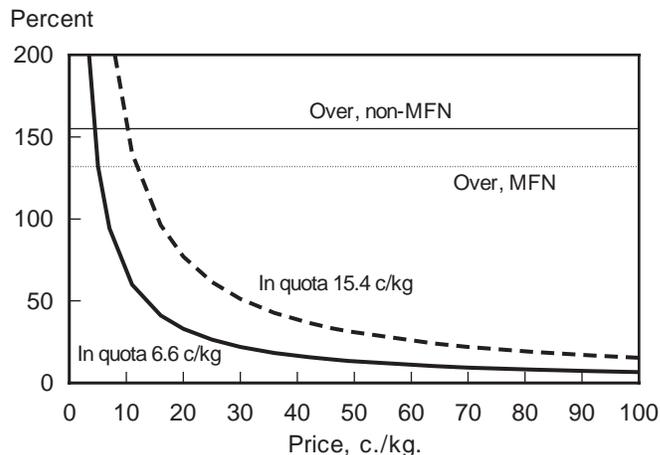
Source: Additional Note 2, Chapter 12 HTSUS.

(in-quota) volume. Similarly, the U.S.-Israel Free Trade Agreement is accommodated through an amount apportioned to Israel duty-free, and member nations of the Caribbean Basin and Andean Pact Trade Areas are accorded duty-free in-quota access. Peanuts from Mexico are excluded from the WTO peanut TRQ as Mexican peanuts have a separate TRQ. Finally, peanuts from all other WTO members and peanuts from nonmembers each face a separate set of tariffs. In sum, the peanut TRQ has four classes of peanuts, six countries or groups of countries, and distinct tariffs for in-quota and over-quota imports. Table D-3 displays the various tariffs for all potential imports for the quota year starting April 1, 2000.

Table D-3 also shows that both fixed (or specific) and *ad valorem* tariffs are used. Because almost all in-quota imports are of shelled peanuts, the discussion below focuses on this commodity. The TRQ has five tariffs for shelled peanuts, three fixed tariffs for in-quota imports—0, 6.6 and 15 cents per kilo—and two over-quota tariffs—131.8 percent and 155 percent. The rates are the same for blanched and other peanuts. Fixed tariffs (a fixed charge per kilo imported) are applied to in-quota imports while *ad valorem* tariffs (a fixed percentage of the unit value of the imported good) are applied to over-quota imports. Figure D-3 plots the *ad valorem* equivalent of the in-quota fixed tariffs for shelled peanuts for a range of import prices as well as the over-quota rates. The lower the import price, the higher the *ad valorem* equivalent tariff rate. At very low prices (less than 5 cents per kilo) the in-quota *ad valorem* equivalent of 6.6 cents per kilo is higher than the over-quota tariff rate of 131.8 percent. In recent years, however, the unit value of shelled peanut imports has been around 90 cents per kilo and yields a realized *ad valorem* equivalent of about 7 percent. Blanched peanuts have averaged about \$1.08 per kilo and ‘other’ peanuts about \$1.90.

The tariff-rate quota reserves fixed amounts for peanuts from Argentina and Israel. Peanuts from all other sources share access to the balance of the in-quota volume. The first-come first-served method of administration allocates the in-quota

Figure D-3  
Effective Ad Valorem Tariffs on Shelled Peanuts



Source: Economic Research Service, USDA.

volume to whomever imports first. Thus, there is a powerful incentive to import as early in the quota year as possible and, predictably, there is a surge of imports on April 1. The URAA allowed the United States to change the ‘quota year’ for peanuts from an August-July year, used under Section 22 to coincide with the domestic peanut marketing year, to an April-March year. The Section 22 quota was administered on a first-come first-served basis, which resulted in a surge of imports coinciding with the U.S. peanut harvest. The April-March year shifts the import surge to later in the domestic marketing year and occurs just after Argentina’s peanut harvest.

A vast majority of U.S. peanut imports (in quota) occurs in April, based upon a monthly distribution of quota fill for the U.S. peanut TRQ in the years 1996 through 1998. Virtually all the 1997 quota was filled in April. Here, in part, is how: In the first 3 months of 1997, North American Trading & Drayage warehoused 4.5 million pounds of peanuts from Argentina at its facility in Foreign Trade Zone 34 in Niagara County, NY.

Table D-3--Tariffs charged under the peanut TRQ

Peanuts	In quota volume	Peanuts, not roasted or otherwise cooked				Blanched and other	
		In-shell		Shelled		2008.11.25	2008.11.35
		In quota	Over quota	In quota	Over quota	In quota	Over quota
		Metric tons	Cents/kg	Percent	Cents/kg	Percent	Cents/kg
Total	52,906						
Argentina	43,901	9.35	163.8	6.6	131.8	6.6	131.8
All others, except Mexico	9,005						
Caribbean Basin, Andean Pact		Free	163.8	Free	131.8	Free	131.8
Canada		Free	163.8	Free	131.8	Free	131.8
Israel	113	Free	163.8	Free	131.8	Free	131.8
Others							
With MFN status		9.35	163.8	6.6	131.8	6.6	131.8
Without MFN status		9.35	192.7	15	155.0	15	155.0

The peanuts came from Argentina via Nutco Inc. of Markham, Ontario. The large-scale maker of peanut butter warehoused the nuts in the zone to meet a U.S. Department of Commerce quota limiting Argentine peanuts sold in the United States. When the peanut quota opened April 1, Nutco filed an application with the Commerce Department, enabling the company to sell 3.9 million of the 4.5 million pounds of nuts warehoused in the zone.

“I could not have applied if I had them sitting in my warehouse in Toronto,” said Dwight Dehne, Nutco president.

He said the zone’s proximity to Toronto is beneficial for his company. He plans to use it again, he said.<sup>6</sup>

Nutco’s 3.9 million pounds are about 6 percent of the Argentine quota [65.8 million pounds in 1997]. Taking the very conservative estimate of 5 cents per pound for the gap between the domestic and world prices for shelled edible peanuts yields a \$200,000 arbitrage rent.<sup>7</sup> This is a very profitable transaction—so profitable that such trades have ignited a minor trade dispute between the United States and Argentina. On January 8, 1998, the following WTO document was released. The text is reproduced here to give a flavor of how TRQ disputes are addressed to the WTO.<sup>8</sup>

The following communication, dated 19 December 1997, from the Permanent Mission of Argentina to the Permanent Mission of the United States and to the Dispute Settlement Body, is circulated in accordance with Article 4.4 of the DSU.

I have the honour to contact you on instruction from my Government to request consultations with the United States pursuant to Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), Article XXII:1 of the GATT 1994, Article 19 of the Agreement on Agriculture, Article 7 of the Agreement on Rules of Origin and Article 6 of the Agreement on Import Licensing Procedures with respect to the trade damage sustained by my country as a result of the way in which the United States administers the tariff-rate quota for the import of groundnuts (peanuts) for confectionary and peanut paste nego-

tiated between the two Governments during the Uruguay Round.

The Government of Argentina considers that the particularly narrow interpretation by the United States both of the obligation contained in its national schedule and of the requirements for Argentina to benefit fully from the concessions granted, nullifies or impairs the benefits accruing to Argentina directly or indirectly under the GATT 1994 and various WTO Agreements, and impedes its attainment of the objectives of those Agreements and of the GATT 1994.

In Argentina’s view, the way in which the quota is administered could be inconsistent with certain provisions including, but not limited to, the following:

- (a) Articles II, X and XIII of the GATT 1994;
- (b) Articles 1, 4 and 15 of the Agreement on Agriculture;
- (c) Article 2 of the Agreement on Rules of Origin; and
- (d) Article 1 of the Agreement on Import Licensing Procedures.

In the URAA, the United States allocated 78 percent of the in-quota TRQ volume to Argentina. What it did not do, however, is allocate the quota rights to the Government of Argentina or to particular Argentine organizations or firms. The U.S. tariff schedule merely specifies that only peanuts of Argentine origin are eligible to fill the Argentine share of the TRQ. If Nutco, Inc. procured peanuts from Argentina at the world price, imported them into the United States, and sold them at the domestic U.S. price, Nutco—not Argentina or Argentine firms—captured the rent on 3.9 million pounds. From the Government of Argentina’s point of view, the quota rights and the rents belong to Argentina or Argentine firms.

The U.S.-Argentine peanut dispute has not been resolved. The dispute is primarily over who should obtain the rents from the in-quota trade. While rents are at the heart of most TRQ disputes, the WTO is only concerned about whether member countries are abiding by their WTO obligations; it is indifferent to distribution of quota rents. WTO is principally concerned with whether in-quota imports are impeded and whether market access is allowed to all member nations on a non-discriminatory basis. However, the WTO also allows for and respects trade agreements among its member nations. The peanut TRQ is an example of how the principle of nondiscrimination and preferences among subsets of countries can conflict.

From the perspective of economic efficiency and nondiscrimination, the market shares of peanut exports to the

<sup>6</sup> Troester (1997).

<sup>7</sup> At about 37 cents per pound on the world market, the 5 cent margin gives a 13.5 percent return in less than 3 months. This conservative estimate generates an ample margin to cover storage, interest, and the risk of being too late in the queue.

<sup>8</sup> The document is cross-registered as: WT/DS111/1; G/L/217; G/AG/GEN/16; G/RO/D/2; G/LIC/D/16. These documents are available at <http://www.wto.org/wto/ddf/ep/public.html>

United States should be determined solely by competition: the least-cost suppliers (adjusting for quality) will supply the market. The various preferences established among trading partners conflict with pure competition. Consider first, the allocation of market shares under the TRQ. Argentina, for example, is one of the world's leading exporters of peanuts; it would almost certainly have a substantial share of U.S. imports no matter how the TRQ were administered. Suppose, for example, that the quota is unallocated, that is, there is no assignment of market shares. The present TRQ grants Argentina a 78-percent share of the in-quota market. Market conditions could lead Argentina to have a greater or lesser market share in different years, but the long-run average market share would probably not be 78 percent. So the allocated market share can be to or against Argentina's advantage, depending on competitive conditions. Tariff preferences—charging different tariffs to different suppliers—also bias trade away from a competitive market outcome. For example, there are three in-quota tariffs for shelled nuts. The tariff free access—zero tariff—allowed to imports from Canada, Israel, the Caribbean Basin and Andean Pact gives these suppliers a 6.6-cent per kilo advantage relative to other MFN trading partners, and a 15-cent per kilo advantage relative to non-MFN countries.

In 1997, the WTO found the administration of the banana TRQ of the European Union to be inconsistent with WTO principles. As yet it is not clear how the European Union will bring its banana TRQ into compliance with the WTO.<sup>9</sup> The banana case is complicated and involves a number of issues, several of which are not directly relevant to TRQ administration. One key issue is whether preferences granted to a subset of countries are consistent with non-discriminatory TRQ administration as required by Article XIII of the GATT. The European Union banana TRQ grants trade preferences to signatories of the Lomé agreement (essentially former colonies of France and the United Kingdom). The Lomé preferences are quantitative (select countries are apportioned shares of the in-quota volume) and tariff-based (Lomé countries face lower tariffs). The quantitative preferences effectively exclude bananas from non-Lomé Central and South American sources: The in-quota allocation has been determined to be inconsistent with the WTO. The tariff preferences, in contrast, are consistent with the WTO. How the European Union addresses the complaints of Central and South American banana exporters may provide a model for the resolution of future TRQ disputes. Because WTO disputes are resolved on a case by case basis, the banana case cannot be considered a strict precedent for future cases. However, it is likely to influence future decisions and frame much of the debate in the next round of negotiations.

<sup>9</sup> The European Union was to bring its Banana trade regime into compliance by January 1, 1999. The issue remains under discussion in Brussels and Geneva.

### The WTO Peanut Butter and Paste TRQ

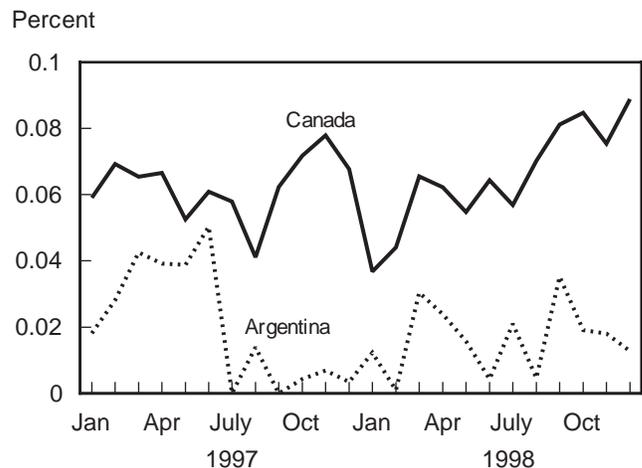
The formal specification of the U.S. TRQ for peanut butter and paste is found in Chapter 20, note 5 of the Harmonized Tariff Schedule of the United States. As of January 1, 2000, 20,000 metric tons are allowed in-quota access. The quota year for peanut butter and paste is the calendar year. The quota is apportioned among Canada, Argentina, countries granted Generalized System of Preference (GSP) status by the United States, and all other countries (table D-4). NAFTA gives special status to both Canada and Mexico regarding peanut butter and paste. Canada does not produce peanuts. Under NAFTA rules of origin, Canadian exports of peanut butter and paste to the United States may be made from peanuts of any country and still be considered to be of Canadian origin. This rule does not apply to blanched or otherwise cooked peanuts. Mexican peanut butter and paste must be made from peanuts of Mexican origin to qualify.

The rate of quota fill for peanut butter and paste is relatively steady year-round (figures D-4 and D-5). This contrasts with the annual April surge for in-quota peanut imports. The most likely explanation is that there are few Canadian or Argentine firms that manufacture peanut butter or paste and export it to the United States, and that these few firms are in a contractual arrangements with distributors or food manufacturers in the United States. Figures D-4 and D-5 plot the same underlying data: Each month's import volume is

Table D-4--Peanut butter and paste TRQ

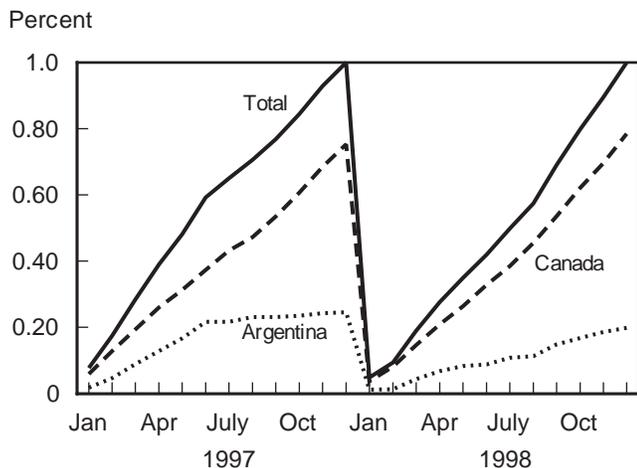
	Metric tons	2008.11.05	2008.11.15
		In quota	Over quota
		Cents/kg	Percent
TOTAL in quota volume	20,000		
Canada	14,500	Free	131.8
Argentina	3,650	Free	131.8
GSP	1,600	Free	131.8
Other	250	Free	131.8
If not MFN			155.0

Figure D-4  
Peanut Butter TRQ Fill Profile, Fill Density



Source: Economic Research Service, USDA.

Figure D-5  
**Peanut Butter TRQ Fill Profile, Cumulative Fill**



Source: Economic Research Service, USDA.

divided by the annual total. The upper figure plots these values—the density of imports by month. The lower figure plots the cumulative sum of imports for each month, thus December of each year equals 1.

**NAFTA TRQ for Peanuts of Mexican Origin**

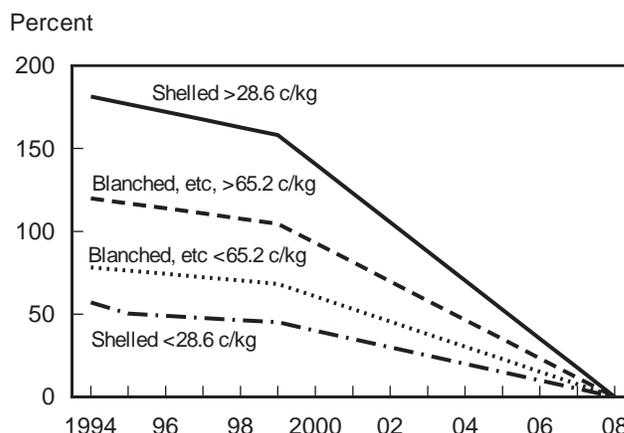
The long-run objective of NAFTA is the full economic integration of North America. Toward this end the degree of market access accorded to Canada and Mexico is greater than that allowed to non-NAFTA members. The NAFTA preference is particularly apparent in the case of the U.S. TRQ for Mexican peanuts. While the gradual liberalization of the WTO peanut TRQ ceases in April 2000, the NAFTA peanut TRQ for Mexico continues to liberalize. Indeed, the TRQ effectively vanishes in 2008, when imports of peanuts of Mexican origin are scheduled to be completely free.

The base in-quota volume for Mexico was 3,377 in 1994. This volume increases at 3 percent a year through 2007 when it reaches 4,959 tons. In 2008 the quota is removed. The over-quota tariffs are reduced in two phases. They are reduced 15 percent, in equal increments, during the first 6 years (i.e., in 1999 the applied rate = .85 times the base rate). Then, starting in 2000, the rates are reduced in equal increments, to zero over the 9 years ending in 2008. In-quota imports are free. The next section discusses the economic effects of liberalizing a tariff quota by expanding the quota and reducing the over-quota tariff. Figures D-6 and D-7 plot the reduction of the over-quota tariffs and the expansion of the in-quota volume.

**Potential Issues in the Next Round of WTO Negotiation**

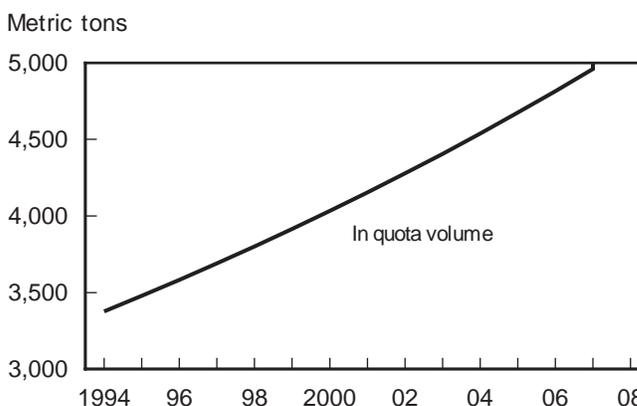
TRQ administration and TRQ liberalization are two topics that are likely to be the focus of negotiations for TRQ in the

Figure D-6  
**U.S. NAFTA Peanut TRQ for Peanuts of Mexican Origin**



Source: Economic Research Service, USDA.

Figure D-7  
**U.S. NAFTA Peanut TRQ for Peanuts of Mexican Origin**



Source: Economic Research Service, USDA.

next round of trade negotiations. TRQ administration is addressed above and primarily relates to how the opportunity to import in-quota is allocated. TRQ liberalization is discussed below. The nuts and bolts of liberalization are standard: How much a tariff should be reduced, over what period of time, and at what rate. The same three questions also apply to increasing the in-quota volume. What distinguishes TRQ liberalization is that the two instruments, tariffs and quotas, interact.

**Liberalization: Increasing Q and/or Reducing T**

There are two ways to liberalize a TRQ: 1) increase Q, the volume of imports charged the lower, in-quota tariff; and 2) decrease T, the over-quota tariff. The two methods can also be applied jointly. Indeed, the U.S. peanut TRQ was liberalized by both methods between 1995 and 2000. However, no

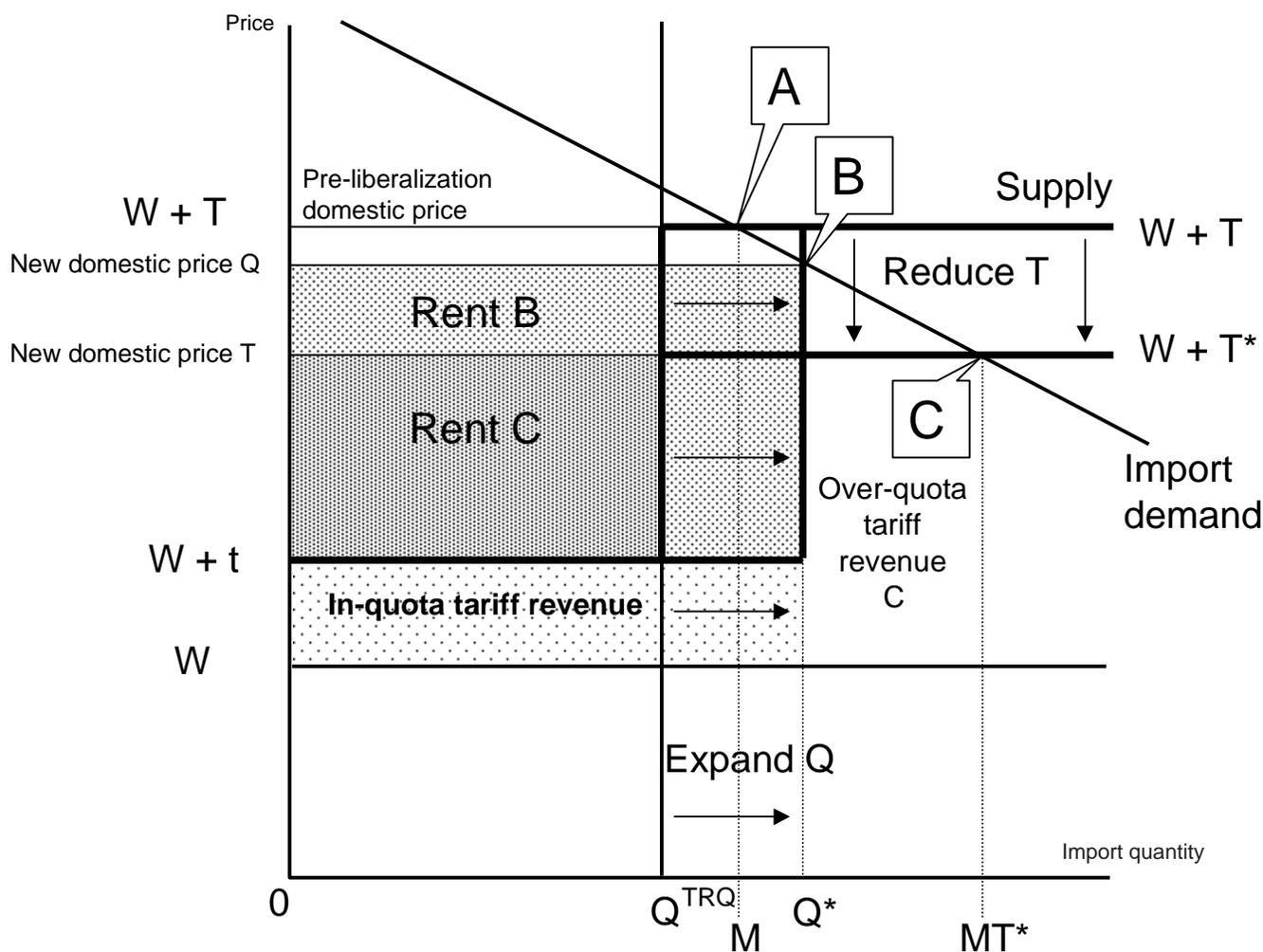
further liberalization has been negotiated for peanuts or peanut butter and paste. Figure D-8 shows how liberalization might affect peanut imports and the domestic peanut market. With the current peanut TRQ there are over-quota imports of the four kinds of peanuts in the TRQ, thus  $T$ , the over-quota tariff(s) is the binding constraint on imports. This situation is represented by point A. The volume of peanut imports equals  $M$ , because  $M$  is greater than  $Q^{TRQ}$ .  $Q$ , the quota component of the TRQ is not a binding constraint on imports. Imports of  $M$  cause the domestic price equal to the world price plus the over-quota tariff:  $W+T$ .<sup>10</sup>

<sup>10</sup> The domestic peanut program prevents domestic prices from falling below the support price and, with imports, provides a floor to import prices at the domestic support price less the over-quota tariff (adjusted for quality and transportation). See the previous article, "Issues Facing the U.S. Peanut Industry During the Seattle Round of the World Trade Organization."

Consider liberalizing the TRQ by increasing the in-quota volume  $Q^{TRQ}$  to  $Q^*$  (and hold  $t$  and  $T$  constant). Point B is the new equilibrium. The larger in-quota volume,  $Q^*$ , is now the binding constraint on trade. Imports increase from  $M$  to  $Q^*$ , and the domestic price falls from the  $W+T$  to the line marked "New Domestic Price  $Q$ ." The second liberalization method is to reduce  $T$  (and hold  $t$  and  $Q^{TRQ}$  constant at pre-liberalization levels). Call the new, lower over-quota tariff  $T^*$ . Reducing  $T$  to  $T^*$  shifts the equilibrium from A to C. Imports increase from  $M$  to  $MT^*$  and cause the domestic price to fall from  $W+T$  to  $W+T^*$  (also marked "New Domestic Price  $T$ "). If one increases  $Q$  and decreases  $T$ , the new equilibrium will also be at point C. This follows because the over-quota tariff is the binding constraint on trade.

The amount and distribution of rent also depends on how the TRQ is liberalized. If the quota is expanded, the amount

Figure D-8  
TRQ Liberalization



of rent increases.<sup>11</sup> The new rectangle of rent is labeled "Rent B." When the over-quota tariff is reduced, the block of rent decreases. The new rectangle of rent is labeled "Rent C." Finally, when the quota is increased and the over-quota tariff decreased, the rectangle of rent stretches "Rent C" horizontally so that it covers the length 0 to  $Q^*$ .

Finally, the amount of tariff revenue depends on how liberalization is implemented. For example, if point C is reached by both an expansion of  $Q$  to  $Q^*$  and a reduction of  $T$  to  $T^*$ , the over-quota tariff revenue will be represented by the shaded area labeled "over-quota tariff revenue 'C'." The in-quota revenue will be represented by the shared area labeled 'in-quota tariff revenue' extended to the length, 0 to  $Q^*$ . In contrast, if the in-quota volume is not expanded (if it remains fixed at  $Q^{TRQ}$ ) then the in-quota revenue is reduced to the length 0 to  $Q^{TRQ}$  and the over-quota revenue is increased to the length,  $Q^{TRQ}$  to  $MT^*$ .

Figure D-8 and the present discussion are based on a simplification of the stylized facts about the U.S. peanut TRQ. The two alternatives discussed are frankly arbitrary. A large expansion of the in-quota volume or a small decrease in the over-quota tariff would generate different results as would a different slope or placement of the import demand curve. Even with the foregoing caveats, the fact that over-quota imports occur indicates that the over-quota tariff is the bind-

<sup>11</sup> Rent will increase when import demand is elastic; if inelastic, it will decrease.

ing constraint on trade. Thus, reducing the over-quota tariff will have a proportionately greater effect on expanding market access than an increase in the in-quota volume. Also, quota rents are indicative of a distorted market, and the magnitude of quota rents is proportional to the degree of distortion. If one wishes to minimize market distortions, and this is an objective of the WTO, a policy that decreases quota rents should be preferred to a policy that increases them. By this criterion, reduction of the over-quota tariff is preferred to increasing the in-quota volume. Note however, that this conclusion holds only for this specific case and cannot necessarily be generalized to other TRQs.

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