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SMOKE AND MIRRORS: MAKING SENSE OF THE WTO INDUSTRIAL TARIFF NEGOTIATIONS

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1. Introduction

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1. INTRODUCTION

The WTO negotiations on industrial tariffs raise a number of important development-related issues. A major issue is the extent to which they address barriers that face the key exports of developing countries as they try to expand and diversify their production and trade. This problem has been well documented in the past by the IMF, UNCTAD, the World Bank and the WTO, but much remains to be done to tackle high tariffs and tariff escalation, not to mention non-tariff and market entry barriers.

A second issue arising from the WTO negotiations is the extent to which commitments that are being sought from the developing countries contribute to their economic development. While economists generally agree that, at least in the longer term, trade liberalization is beneficial to economic development, there is considerable controversy about the relative importance of openness and institutions. There is also debate about whether certain forms of intervention may be justified on the basis of protection for infant industries or in the presence of externalities,[1] with Rodrik (2001) in particular noting that the developed countries used such intervention at earlier stages of their own industrialization. There is somewhat less debate - and comparatively little knowledge - regarding the process of adjustment, with citations of cases where rapid adjustment seems to have created few problems while in other cases there have been major disruptions.

From Doha to Hong Kong

WTO Ministers meeting in Doha in 2001 seemed to take these issues on board, declaring "international trade can play a major role in the promotion of economic development and the alleviation of poverty". Ministers also sought "to place...needs and interests [of the developing countries] at the heart of the Work Programme adopted in…[the Doha] Declaration". In relation to industrial tariffs, they agreed "by modalities to be agreed, to reduce or as appropriate eliminate tariffs, including the reduction or elimination of tariff peaks, high tariffs, and tariff escalation, as well as non-tariff barriers, in particular on products of export interest to developing countries. Product coverage shall be comprehensive and without a priori exclusions" (Doha Ministerial Declaration, para. 16). Full account was to be taken of the special needs and interests of developing and least-developed country participants, "including through less than full reciprocity in reduction commitments, in accordance with the relevant provisions of Article XXVIII bis of GATT 1994".

The Hong Kong, China, Ministerial Conference in December 2005 confirmed an approach based on the so-called "July Package" adopted by the General Council of WTO in August 2004 (referred to as the "NAMA Framework" in the Hong Kong, China, Ministerial Declaration). In itself the "July Package" in its Annex B of Decision of 1 August 2004 by the WTO General Council (WT/L/579) provides the framework for

[1] Externalities refer to beneficial or harmful effects occurring in production, distribution or consumption of a good or service that are not captured by the buyer or seller. Externalities exist because of high transaction costs or the absence of property rights. This implies that no market exists or that markets function poorly. Smoke from steel production is an example of a negative externality, whereas the building of a road has benefits that are difficult for the owner to capture. The appropriate policy is a tax (or subsidy in the case of positive externalities). However, because of the absence of a market, externalities are difficult to value and the appropriate tax or subsidy is difficult to determine.

future work in the NAMA negotiations that in many respects varies little from the Derbez text presented in Cancún. However, a key modification was the insertion of a new initial paragraph that states that the framework "contains the initial elements for future work on modalities" by the non-agricultural market access (NAMA) negotiating group. The framework also states that additional negotiations are required in order to reach agreement on the specifics of some of these elements, such as the treatment of unbound tariffs, flexibilities for developing countries, participation in the sectoral tariff component and preferences.

For some developing countries, the reference to "initial elements" is taken to mean that the modalities issue is wide open, and that all options are on the table. No doubt others will disagree, and negotiations will continue to be difficult as to the degree of ambition and flexibilities for developing countries.

Given the mandate of the Doha Declaration to reduce or eliminate tariffs, including tariff peaks, high tariffs and tariff escalation, in particular on products of export interest to developing countries, much attention has inevitably focused on harmonizing approaches that cut high rates more than proportionately (to be supplemented by request-and-offer and sectoral negotiations). However, some developing countries see harmonizing approaches as running counter to the Doha requirement of allowing less than full reciprocity for developing countries. Many of these countries feel that they need some policy space to use tariffs for industrial development purposes, to mitigate the impact of liberalization on output and employment in key sectors and to avoid the resort to alternative WTO measures, such as anti-dumping.

While Hong Kong and the July agreement has helped to restore momentum to the Doha Round negotiations, meeting the varied objectives of participants in the NAMA negotiations will not be easy. Among the key issues to be resolved are the following: (i) a formula has yet to be selected; (ii) consensus on participation in sectoral elimination still eludes the group; and (iii) the provisions for special and differential treatment for developing countries need to be clarified.

On the whole, a formula approach has certain advantages in simplifying negotiating procedures, and reducing the advantages that large countries have in bilateral request-and-offer negotiations. However, beyond the overall level of ambition the question remains as to the precise formula and its parameters. If these details are not worked out on a satisfactory basis, some countries may consider supporting alternative approaches, such as request-and-offer, using the phrase "initial elements" in the first paragraph as the basis for starting afresh.

Certain elements of the framework suggest that the aims are ambitious, but much depends on how these elements and the terms for developing countries are elaborated. The agreement provides for further work by the negotiating group on the reduction of tariffs by means of "a non-linear formula applied on a line by line basis". All of the pre-Hong Kong proposals on modalities would still be on the negotiating table. Even proposals such as the Indian one could be broadly described as non-linear since the core linear percentage cuts on individual lines are modulated by limiting rates to no more than three times the national average. Discussion has focused on a Swiss-style formula based on each country's national average, multiplied by another factor (the "B coefficient") that could be more or less than unity and vary by country group.

One problem regarding this approach is that it is relatively difficult for any country to compute what it has to do and to assess what others are doing — that is, it is difficult to compute the balance of concessions. This seems unnecessarily burdensome, since from an economic perspective it is possible to tailor non-linear and linear approaches to achieve very similar results for trade, welfare, output, employment and revenues, while a linear approach would be simpler and more transparent.

Beyond the formula component, the new framework also foresees possibilities for more ambitious tariff cuts/elimination for certain sectors, including those of interest for developing countries (so-called sectoral initiatives), where participation now seems to be voluntary.

Another area of ambition in the text is the proposal for increasing the binding coverage in non-agricultural products. Some developing countries have a high proportion of unbound tariffs. In the framework, it is proposed that Members would bind currently unbound rates at "[two] times the MFN applied rate". (The use of square brackets implies that the precise multiple is to be negotiated.) For countries that have low applied rates, acceptance of this formulation would lock them into a low rate regime.

Some flexibility is provided for countries that currently have a very low binding coverage. Thus, paragraph 6 of the framework states that Members with a binding coverage of less than [35%] would be exempt from making tariff reductions. Instead, they would bind [100%] tariff lines at the average tariffs for all developing countries. However, the text does not state which average would be used under this paragraph. Here the issue is whether this would be the simple or trade-weighted average (as was normally used in earlier GATT negotiations on industrial tariffs). Since the simple average is some 28% and the weighted average 12%, this choice makes a big difference.

LDCs would be exempt from tariff reductions. However, this does not imply that LDCs will have a free round, as they and some others are likely to be negatively affected by the erosion of preferences.

A range of proposals

A large number of proposals have been made in the WTO negotiating Group on Non-agricultural Products, of which six proposals had a formula as a core element. These proposals and their overall economic impact have already been examined in Laird, Fernández de Córdoba and Vanzetti (2003), who estimate that the potential static global annual welfare gains in the current WTO NAMA negotiations are around \$30–\$40 billion, with perhaps a third of these potential gains accruing to developing countries.[2]

However, our current analysis, which looks in some detail at estimated sectoral changes, shows that the generally modest overall results conceal important changes in trade and output in individual sectors. Some countries will achieve important gains in some key sectors, but in other countries some sectors face important adjustments. Moreover, the estimated tariff revenue losses could have a strong negative impact on government revenues in a number of countries. Finally, while preferences are included in the modified database and would be eroded as a result of MFN liberalization, our estimates do not produce any negative effects on trade for any of the developing regions in the model, although sub-Saharan Africa shows a very small decline in welfare according to some scenarios. Of course, the results in some specific countries within our regional groups could be different and there may also be some variations in specific sectors.

[2] Other studies, which introduce assumptions of imperfect competition and encompass services, generate much larger results (Brown, Deardorff and Stern, 2001). In the present study we also include services and agriculture, as explained below, but we retain the more conservative assumptions of perfect competition and constant returns to scale.

This paper elaborates on our recent analysis (Laird, Fernández de Córdoba and Vanzetti, 2003) by looking in some detail at the main implications for trade flows, tariff revenues, welfare and sectoral output for various countries and regions under proposals currently being considered in the WTO.

In order to assess the potential impact of the various proposals under consideration in the WTO, we have selected four scenarios that do not entirely correspond to specific proposals, but rather have been chosen to highlight the spread of policy options. These four scenarios we call "free trade" (full tariff liberalization in the non-agricultural sector), Hard and Soft WTO and "simple mix". The free trade proposal was presented in December 2002 by the United States in the WTO Working Group on Non-Agriculture Market Access as the second phase of a two-stage implementation process. The second and third scenarios are specific variations of the proposals included in the Framework for Establishing Modalities in Market Access for Non-Agricultural Products (Annex B of the draft Cancún Declaration, a text by the Chairman of the WTO General Council, not agreed by WTO Members), which in turn draws on the draft text by the Chairman of the NAMA Group. This Framework text places the emphasis on a non-linear formula approach to tariff-cutting, to be supplemented by sectoral tariff elimination for products of export interest to developing countries and possibly also by zero-for-zero, sectoral elimination and request-and-offer negotiations. However, the Framework text lacks specific numbers, and here we have analysed some possible variations in the key coefficient (B) in the NAMA Chairman's Draft, including the possibility of different coefficients (and hence different depth of cuts) for different groups of countries. In essence, the Soft scenario introduces important elements of special and differential treatment that are not present in the Hard scenario. The last scenario analysed, "simple mix", draws from a linear cut formula with a capping for tariff peaks and escalation, and also has elements of special and differential treatment similar to those in the Soft scenario, except for the formula component. We have also taken account of proposals for sectoral elimination on a non-voluntary or voluntary (opt-out) basis, exceptions for sensitive products, proposals to extend binding coverage, and proposals to address tariff peaks. This spread of scenarios is intended to give an indication of the development dimensions associated with the kind of ideas that are driving the negotiations, and is intended to help countries determine where their interests lie. At the time of writing, all proposals remain on the table.

The paper is structured as follows. The next section looks at the definition of adjustment costs and the fiscal implications of tariff reform. In section 3 the state of play regarding the WTO trade negotiations is explained and the various proposals on the table are described. Subsequently, the existing level of protection for world trade is analysed. Section 4 also includes some estimates of the implications of the various scenarios for tariff peaks, tariff escalation and binding coverage. In section 5 the four modelling scenarios of trade liberalization are defined in some detail, and their implications for existing bound and applied tariffs are shown in section 6. In section 7 the general equilibrium model is described and the results of the simulations of four scenarios are presented and discussed. The paper concludes with a discussion of the implications of the analysis. Potential gains from bringing the unemployed into the labour force are shown to have an impact far greater than the efficiency gains that result from an improved allocation of resources. Many developing countries might face difficulties in implementing the more ambitious tariff reductions proposed in this round of negotiations. This is something that needs further consideration in order to develop appropriate support measures to facilitate the implementation of the final agreement and to minimize the burden of adjustment.