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5. The four scenarios

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5. THE FOUR SCENARIOS

In this section four alternative scenarios of trade liberalization for non-agricultural products are presented: free trade, Hard WTO, Soft WTO and "Simple" mix. The scenarios have been selected to enable a comparison of the economic implications of the proposals on the negotiating table. The four scenarios are based on proposals made by member States in the WTO Working Group. The proposals have been slightly modified to best suit the modelling purpose and to permit a better comparison of their implications. All scenarios include a fixed reduction in tariffs on resources (coal, oil, gas and unprocessed minerals), services and agriculture. These sectors are responsible for an estimated 30 per cent of the total distortions impeding goods and services trade. As part of the single undertaking in the negotiations some of these distortions are likely to be removed along with reductions in tariffs on non-agricultural goods. If these are not removed, resources may flow out of a protected sector such as textiles into an even more distorted sector such as agriculture, worsening the overall efficiency with which resources are used in an economy. For this reason the scenarios include reductions in tariffs on services and agriculture, but these are the same in each of the scenarios to facilitate comparison of the impacts on the non-agricultural sectors.

The first scenario, free trade, draws from the United States' proposal to the WTO Working Group in December 2002. It plainly means that all tariffs are reduced to zero for all non-agricultural products for all WTO members unanimously. For this scenario all countries bind their non-agricultural tariffs and reduce them to zero.

The second and third scenarios, so-called Hard and Soft WTO, are two variations from the proposal by the Chairman of the WTO Working Group for non-agricultural tariff reductions. These two scenarios cover the following elements:

1. Tariff reduction formula
2. Sensitive items
3. Binding coverage
4. Level of binding
5. Sectoral elimination

Both the Hard and Soft approaches are based on the WTO proposed harmonizing formula:

$$T_1 = \frac{B \times ta \times T_0}{B \times ta + T_0}$$

where *ta* is the national average of the base rates, T_0 is the initial rate, T_1 is the final rate, and B is the coefficient, yet to be negotiated, reflecting the level of ambition.

This formula reduces tariffs according to a Swiss formula with maximum coefficient equal to country average, achieving the progressive effect of proportionately greater reductions in higher initial tariffs. This coefficient in the Swiss formula represents the maximum tariff after the application of the tariff reduction formula. In previous applications B and *ta* were represented as a single coefficient common to all members. The Swiss formula was used for industrial products during the Tokyo Round with a maximum coefficient of 16 per cent.

In the WTO Chairman's proposal the B coefficient would be common to all countries. B set at 1 implies that the average bound rates become the maximum. The so-called Hard version of the WTO proposal builds upon a B coefficient equal to 0.5. Under this scenario, developed and developing countries with the same average initial tariffs would make the same percentage reduction. In this sense, the proposal does not contain any specific and differential component. However, an element of special and differentiated treatment for developing countries derives from the observation that most of them have higher initial tariffs than developed countries.

In contrast to the Hard WTO scenario in which B equals 0.5, the Soft scenario incorporates a B coefficient differentiated between developed and developing countries. B takes two values, 1 for developed countries and 2 for developing countries. This differentiation of the B coefficient is based on the principle of special and differential treatment and the less than full reciprocity concept for developing countries mandated in paragraph 16 of the Doha Ministerial Declaration.

Both WTO scenarios and the "Simple" mix include a special clause for sensitive products, which will be left unbound, and no tariff cut formula would be applied to them. For modelling purposes, sensitive products are defined as the 5 per cent of the all-tariff lines generating the most revenue and unbound, or all unbound lines, whichever is less.[13] In modelling this scenario it is assumed that tariff lines gathering the greatest amount of tariff revenue are excluded first. These items have high tariffs, or high trade flows or, most likely, a combination of both. For these tariff lines countries neither bind nor cut their tariffs.

Both Hard and Soft scenarios specify that 95 per cent of the tariffs be bound. However, in the former it would be done at twice the applied rate and in the latter at either twice the applied rate or 50 per cent, whichever is higher. In the Hard scenario tariffs are bound and then the tariff reduction formula is applied. In the Soft scenario unbound tariffs are bound only and are not subject to reductions.

The Hard WTO scenario includes sectoral elimination. This implies the elimination of tariffs for electronics and electrical goods, fish and fish products, textiles, clothing, footwear, leather goods, motor vehicle parts and components, stones, gems and precious metals. The Soft scenario includes sectoral elimination for developed countries only and presumes that developing countries will not carry out the elimination of tariffs in these sectors.

The last scenario analysed, "Simple" mix, draws from a linear cut formula with a cap for tariff peaks and escalation. Different linear coefficients are applied for developed and developing countries. This capping element harmonizes tariffs and has an effect similar to that of the Swiss formula. It is therefore particularly useful in reducing tariff peaks and tariff escalation. The capping formula specifies that no tariff will be higher than three times the national average. This scenario does not include sectoral elimination of tariffs.

As in the Soft WTO scenario, in the "Simple" mix scenario 95 per cent of tariffs are bound at either twice the applied rate or 50 per cent, whichever is higher. No tariff-cutting formula is applied to tariffs after binding them.

The four scenarios are compared in table A3 in the Appendix.[14]

[13] For some countries the number of unbound tariff lines are less than 5 per cent of their tariff universe, hence these unbound items are taken as sensitive products.

[14] For a comprehensive description of the various proposals presented in the WTO Working Group on NAMA, see Laird, Fernández de Córdoba and Vanzetti (2003).