

The Doha Development Agenda: Tariffs and Trade

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Introduction

The opening of markets has boosted trade and economic growth worldwide in the past few decades. Yet tariffs – taxes imposed by importing countries on foreign goods – still remain a key obstacle to market access. The potential benefits of further reducing this obstacle are significant. OECD estimates indicate that scrapping all tariffs on merchandise trade and reducing trade costs by 1% of the value of trade worldwide would boost global welfare by more than USD 170 billion dollars a year. These gains would contribute a boost to regions around the world, adding the equivalent of up to 2% to the present annual gross domestic product (GDP) in some areas. No wonder that both developed and developing countries consider substantial tariff reductions as a central goal of the current multilateral trade talks in the World Trade Organization (WTO).

A key question is how these gains would be shared. The Doha Development Agenda agreed in November 2001 by WTO ministers provides a roadmap for the current multilateral trade talks, calling for achievement of substantial improvements in market access, particularly for developing countries. A new OECD study considers the contribution that tariff liberalisation and reductions in trading costs can make to gains in welfare (stemming from changes in income and prices). The results of simulations suggest that, even using conservative assumptions, significant welfare gains accrue to developing and developed countries alike. Under many of the scenarios, developing countries as a group can expect to experience greater welfare gains than the developed countries. The study also shows that if tariff reductions are combined with substantial progress on reduction of trade costs (e.g. through more efficient customs procedures) all regions stand to gain. ■

What is the current tariff situation?

Successive rounds of multilateral trade negotiations have helped achieve deep cumulative reductions in import duties. Progress has been most impressive in the case of industrial goods. Average tariff rates on industrial products were roughly 40% at end of World War II. By 1979, at the end of the Tokyo Round of multilateral trade negotiations, the figure was reduced to 6%. Once all tariff reductions agreed in the last round of world trade talks (the Uruguay Round, 1986 to 1994) are completed by 2005, this figure will fall to about 4%. In addition, Uruguay Round commitments “bound” the vast majority of the tariff lines for these goods in OECD countries and in many developing countries. This means that these tariff rates can no longer be arbitrarily increased above an agreed level. The Uruguay Round agreements, once totally fulfilled, will also result in expanded tariff-free trade for some goods, such as some information technology products.

Nevertheless, tariffs continue to influence trade patterns both through the absolute levels of protection they afford to importing countries and through distortions associated with the structure of tariffs. By making products more expensive to consumers, tariffs hamper demand for imports. They also alter relative prices of products, which affects the allocation of resources among different productive activities. These distortions are particularly pronounced in many non-OECD countries where tariffs remain substantially higher than in the OECD area. Average tariff rates on industrial goods traded between non-OECD countries are often more than twice as high as for similar goods traded between OECD countries. In part, this situation is the result of the inability of some developing countries to engage fully in the negotiating process, an issue that was recognised in the Doha Development Agenda.

Tariffs on agricultural products are on average much higher than those on industrial products. But, there is considerable diversity among countries. In agriculture, the situation is complicated by the frequent use of tariffs coupled with quotas, whereby a country sets a

tariff, say, of 10% on the first 10,000 units of imported grain, but raises the tariff to 100% on additional imports. One OECD study on the effect of the Uruguay Round found that mean bound tariffs in agriculture amounted to 36% for OECD countries and 63% for selected non-OECD countries (based on out-of-quota rates, where applicable). In comparison, the mean bound tariff rates for *all* products were 15% for OECD countries and 43% for the non-OECD countries.

Even when tariffs have been reduced, the way they are structured continues to pose problems in both agriculture and industry. Problems exist with tariff peaks, tariff escalation, low “nuisance” tariffs and high tariff dispersion. An OECD assessment of OECD country tariff peaks (*i.e.* tariffs of 15% or more) found they often apply to products of particular concern to developing countries such as textiles and clothing; leather, rubber and footwear; travel goods; and certain transport equipment. Tariff escalation – whereby tariff rates increase according to the degree of processing – often affects developing country products such as tobacco, leather, cocoa, cotton, wood or paper.

The multilateral trading system provides developing countries with a number of provisions for special and differential treatment. One is the Generalised System of Preferences, which is intended to increase trade opportunities by permitting unilateral exemptions for developing country exports from duties agreed multilaterally. Designated industrial products can receive preferences, often amounting to up to 100% tariff reductions. However, benefits under this measure are often restricted in terms of country coverage, product coverage, ceilings, rules of origin or uncertainty associated with the length of period for which preferences are granted.

Environmental goods (*e.g.* catalytic converters or air filters), textiles and clothing have been the focus of special attention recently in the multilateral trading system. Environmental goods were targeted under the Doha Development Agenda with a specific commitment to negotiate reductions in the corresponding tariffs. While these tariffs tend to follow the general

pattern as for other industrial goods – quite low in OECD countries with higher rates in developing country markets – WTO members have singled them out for special consideration in view of the multiple benefits that increased trade may bring. Tariff reduction in this sector may reduce costs of such goods, thereby helping to stretch scarce resources for environmental protection and provide greater access to a wider choice of environmental technologies.

The relative importance of tariffs as a form of protection in the textile and clothing sector will increase with the phase-out of quotas under the Multi-Fiber Arrangement (MFA) by 2005, as agreed in the Uruguay Round. According to some estimates, world trade in these products may increase by as much as 34% to 60% once the MFA phase-out is completed. Still, many of these products will remain subject to relatively high tariffs. The average tariff charged by OECD member countries on textile and clothing imports from non-OECD countries amounts to about 12%. This compares to a low-tariff sector such as metals, where imports face a mean tariff of just 1%. Moreover, tariff peaks remain a particular problem for textile and clothing products entering the OECD area. Some 28% of these imports enter OECD markets at duties in excess of 15%. ■

Who gains from tariff reduction?

From an economic perspective, non-discriminatory tariff reduction is a win-win scenario for both developed and developing countries. Improved market access extends consumer choice, with more products and a wider price range. It also encourages improved allocative efficiency with respect to resources both in developing and developed countries (*i.e.* price distortions are reduced, so a country's use of resources across sectors shifts to be more in line with areas of comparative advantage). For developing countries, improved resource allocation and higher export revenue contribute to national income and increase the pool of resources available for development-related investment. In turn, economic development in these countries broadens the potential markets for

OECD products. In addition, there can be a number of other benefits from expanding trade such as increased cultural exchange, addressing of humanitarian concerns, or improvement of international relations.

An OECD review of 14 recent economic studies points to the benefits from reducing tariff protection and facilitating trade in goods and services. The studies tend to confirm the large potential benefits to developing countries. Some also suggest that the developing countries that stand to gain most from reducing their tariffs are those with the highest initial rates. While there may be adjustment costs associated with trade liberalisation in these countries (*e.g.* economic and social costs associated with transition of labour from one activity to another), there are indications that these costs tend to be short-term and outweighed on average by the potential welfare gains from trade liberalisation. Complementary macroeconomic, social or labour market policies can help ease the pain of adjustment and boost the effectiveness of trade liberalisation in promoting growth. ■

How large are the potential gains?

The recent OECD study looks at the potential gains from trade liberalisation involving tariff cuts and a uniform reduction in trade costs. A variety of scenarios are considered, from complete abolition of all tariffs to specific formulas for tariff reductions similar to those considered in the ongoing WTO negotiations. The study also takes account of a key negotiating reality in the WTO that has not been fully reflected in previous studies: the fact that while negotiations focus on bound tariffs, in real life what counts in most cases are the actually applied tariffs.

At the time of the Uruguay Round, some of the potential gains from trade liberalisation were overestimated. This was partly because researchers assumed that if reductions were agreed in terms of bound tariffs (the multilaterally-agreed maximum tariff allowed on an item), then countries would proportionately cut the tariffs they actually applied even if they were already

within the new ceiling. In developing countries, applied rates tend to be set at levels substantially below the bound rates. But in fact cuts in bound tariffs did not always result in similar cuts in the applied tariff rates that traders actually face. In order to address this issue, the new OECD study looks at the effect that changes in bound tariff rates would have on the corresponding applied tariff rates. The welfare gains resulting under various scenarios are then estimated.

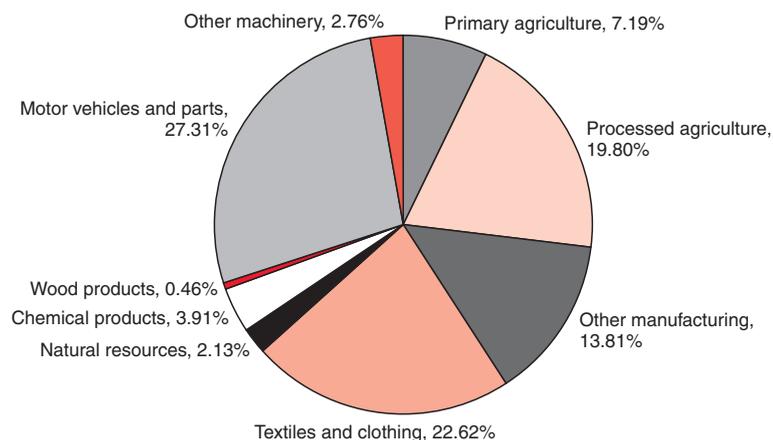
Taking the fully implemented Uruguay Round as a starting point, eight scenarios are presented reflecting different levels of tariff reduction and the uniform reduction in trade costs (amounting to 1% of the value of trade). The least beneficial scenario considered involves a 50% cut in tariffs overall and the uniform reduction in trade costs, which nonetheless yields annual global gains of USD 117 billion. A greater boost results from a “Swiss formula” approach with a coefficient of 5% (which reduces high tariffs by a higher proportion and results in a maximum after-reform tariff of 5% on any item) and

the uniform reduction in trade costs, yielding global gains of USD 158.5 billion; this scenario has the advantage that all regions gain from the tariff reduction. The largest overall gains result from a complete abolition of all merchandise tariffs and the uniform reduction in trade costs, which would boost the world economy by USD 173.5 per year. ■

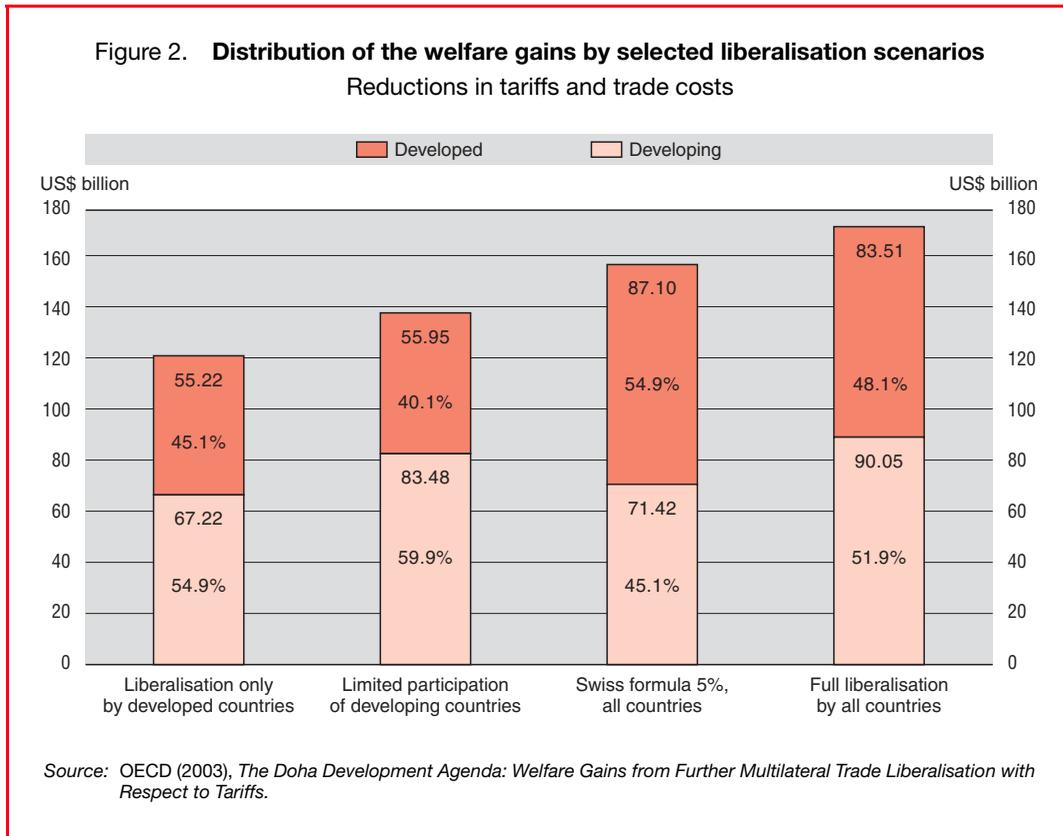
And how are the gains shared out?

A combined package of complete tariff elimination and a reduction in trade costs would bring welfare gains equivalent to 1.37% of annual GDP in developing countries and 0.37% in developed countries. More than half (52%) of the benefit would accrue to developing countries if tariffs were eliminated. Under the “Swiss formula” scenario their share would be 45% and if tariffs were halved, it would be 60%. While there may well be a loss of tariff revenue to some countries – an important source of government revenue in some cases – the study found that certain scenarios can minimise tariff revenue loss while still

Figure 1. Sources of developing countries' welfare gains from full reduction of tariffs
Percentages by sector



Source: OECD (2003), *The Doha Development Agenda: Welfare Gains from Further Multilateral Trade Liberalisation with Respect to Tariffs*.



delivering significant welfare gains. For example, this can be accomplished using a Swiss Formula approach that cuts relatively high tariffs the most. The sectoral sources of welfare gains from tariff reductions reflect significant contributions from both industry and agriculture (Figure 1). However, roughly two-thirds of the developing country welfare gains come from removal of tariff-related distortions in just three sectors: motor vehicles and parts; textiles and clothing; and processed agricultural products (under a full liberalisation scenario). It is worth stressing that while developing countries could benefit from liberalisation limited primarily to developed countries, they would benefit even more in absolute terms if they liberalised as well (Figure 2). ■

Conclusion

The results of the latest OECD study point to the importance of market access for all regions, particularly developing countries. Tariff reductions are an extremely important element in this, not only for developing country access to OECD markets but also for market access among developing countries. The results of the study further underscore the importance to *all* countries of the engagement of developing countries in making substantive commitments under the Doha Development Agenda. Overall, the stakes involved are very high and the outcome could influence development prospects for years into the future. ■

For further information

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Featured study

- OECD (2003), **The Doha Development Agenda: Welfare Gains from Further Multilateral Trade Liberalisation with Respect to Tariffs**, available at: www.oecd.org/trade under Publications and Documents/Reports.

For further reading

- OECD (2003), **Global Forum on Trade: the Market Access Challenge in the Doha Development Agenda: Background Documentation**, 5-6 June, available at: www.oecd.org/trade under Trade Policy Dialogue, follow link to Relevant OECD Work.
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