CHAPTER 7
INDUSTRIAL TARIFFS

Developing countries attach great importance to levels of and changes in industrial tariffs because industrial products—defined as all non-agricultural products—account for more than 70 per cent of their exports (UNCTAD, 2002; WTO, 1994; Michalopoulos, 1999). Especially for industrial products with high value added, tariff levels and changes determine developing countries' effective access to industrial country markets as well as the extent to which their industrial strategies translate trade into benefits for human development.

Although the Generalized System of Preferences can increase developing countries' market access, the system does not cover some important products—mainly in sensitive sectors such as fish products and textiles and clothing. As a result developing countries face peaks and escalation in industrial countries' most-favoured-nation tariffs for such exports. Moreover, some developing countries are excluded from the system. In addition, the preferences are significantly underused because many exports do not qualify under the rules of origin and because of onerous documentation requirements.

African, Caribbean and Pacific (ACP) countries have been granted duty-free access to EU markets for non-sensitive products. In addition, most products from the least developed countries (many of which are ACP members) benefit from duty-free access to Quad markets—Canada, the EU, Japan, the US—and from preferences in some developing countries although some products of critical importance to them (such as textiles and clothing) do not qualify. Some developing countries have also obtained duty-free access to industrial country markets as part of free trade agreements, as with many Arab countries under Euromed agreements and Mexico under the North American Free Trade Agreement (NAFTA) and EU free trade agreement. But in general the increase in free trade agreements and customs unions among industrial countries has led to considerable tariff discrimination against developing country exports.

Even with the completion of the Uruguay Round of trade negotiations, industrial tariffs are higher in developing countries (for industrial country exports) than in industrial countries (for developing country exports). But this disparity is not entirely unwarranted, and analysis of industrial trade between the two groups of countries must take into account two important issues:

- *Market access.* Tariff peaks and tariff escalation occur in industrial country markets, especially for exports of significant interest to developing countries. Yet in many developing countries applied tariffs are much lower than most-favoured-nation rates.
- *Policy space.* Higher industrial tariffs in developing countries can often be justified as safeguards against deindustrialization and as providing the policy space needed to achieve human development objectives.

Market access since the Uruguay Round

Market access depends largely on the tariffs imposed on a country's exports. Average tariffs are important, but tariff peaks and escalation can play an even more important role in determining the success and extent of industrial exports—both from and to developing and industrial countries.

Average tariffs

In industrial countries the average trade-weighted tariff on industrial imports fell to 15 per cent in the mid-1950s, 10 per cent in the late 1960s, 6 per cent in the late 1970s and about 4 per cent during the Uruguay Round. During the Uruguay Round developing countries also substantially reduced their industrial tariffs. India's average trade-weighted tariff on industrial products fell from 71 per cent to 32 per cent, Venezuela's from 50 per cent to 31 per cent, Mexico's from 46 per cent to 34 per cent, Brazil's from 41 per cent to 27 per cent and Chile's from 35 per cent to 25 per cent (Das 1998).

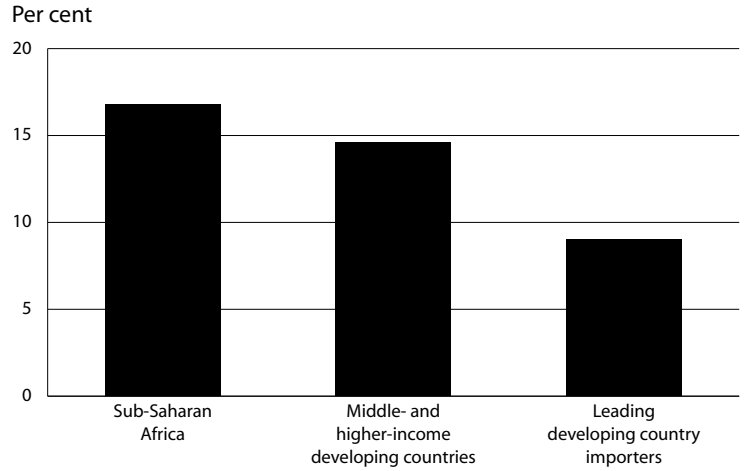
The average trade-weighted tariff on imports from industrial countries is about 11 per cent in developing countries, while the converse is approximately 5 per cent (OECD, 2001). Still, in OECD markets the trade-weighted, most-favoured-nation tariff for manufacturing exports from developing countries (3.4 per cent) is almost four times that for manufacturing exports from other OECD countries (Michalopoulos, 1999). Furthermore, during the Uruguay Round OECD countries cut their average tariff by nearly half for imports from other OECD countries—but by less than a third for imports from developing countries. This resulted in a 3 per cent average trade-weighted tariff on imports from other OECD members, compared with the 5 per cent (noted above) for developing countries (OECD, 2001).

Tariffs also vary among developing countries, especially for labour-intensive manufactured goods (though not in the form of full duty- and quota-free access). Average tariffs on manufactured goods fall as countries move from low- to middle- and higher income status (figure 7.1), and middle- and higher-income countries have lower levels of protection through tariffs and non-tariff measures. The leading developing country importers also have low tariffs (UNCTAD, 2002). Indeed, they all have tariffs lower than the low-income country average for products of relevance to them.

As economies grow and reach full employment, they become more willing to liberalize trade and lower tariffs. Yet many developing countries have been more

FIGURE 7.1

Simple tariffs on manufactured goods in three groups of developing countries



Source: UNCTAD, 2002.

active than OECD countries in cutting tariffs—and the speed and motivation for these cuts are a problem (box 7.1).

Indeed, many developing and transition economies are cutting tariffs much faster than is necessary or desirable from a human development perspective. Consider Mongolia. To conform to IMF loan conditions, it imposed a flat 5 per cent tariff in the second half of the 1990s—requiring abrupt, across the board cuts in its industrial tariffs. This change was not required under World Trade Organization (WTO) agreements and has impeded value addition and competitiveness in Mongolia's few areas of strategic advantage (such as cashmere production).

These trends, along with the evidence presented in box 7.1, should lead to a reconsideration of the view that trade restrictions among developing countries significantly contribute to fallacy of composition dilemmas and problems in increasing exports of traditional labour-intensive manufactures.

Tariff peaks and escalation

Despite the agreements reached during the Uruguay Round, industrial countries have maintained tariff peaks—defined as tariffs higher than 12 per cent—and tariff escalation on some industrial products of export interest to developing countries. Tariff peaks and escalation have undermined developing countries' efforts to export industrial products, produce and export processed raw materials and climb up the value-added chain for basic commodities.

Tariff peaks and escalation in industrial countries reflect the influence of domestic political forces opposed to import liberalization (VanGrasstek, 2001).

BOX 7.1 ARE INDUSTRIAL TARIFFS REALLY HIGHER IN DEVELOPING COUNTRIES? THE CASE OF LABOUR-INTENSIVE MANUFACTURING

Market access for labour-intensive exports is extremely important for developing countries because it mitigates the risk of 'fallacy of composition' (the view that what is good for one country is good for all countries) presented by these products. Yet most developing countries with the capacity and potential to expand labour-intensive exports have not gained much from Uruguay Round agreements and continue to face significant barriers especially in the markets of industrial countries.

Some analysts argue that developing country tariffs are too high and are responsible for many of the market access problems of developing countries, pointing out that 70 per cent of duties on developing country manufacturing exports are paid by other developing countries. But this argument becomes less convincing when trade patterns are examined more closely—particularly the variations among groups of developing countries.

Tariff and non-tariff measures are lower in middle- and higher-income developing countries than in low-income countries. For example, the 15–20 higher-income developing countries in Latin America and Asia have substantially liberalized trade. Relative to low-income countries, middle- and higher-income developing countries do not have a competitive edge in labour-intensive manufactures, and their import demand for such products is higher. Thus trade restrictions among developing countries do not play a central role in their market access and fallacy of composition problems.

Moreover, there is an imbalance between tariffs on labour-intensive manufactures in industrial and developing countries. First-tier newly industrialized economies apply lower tariffs to these products than do industrial countries. In addition, the tariffs imposed by many large developing country importers are similar to industrial country rates. And the 10 top developing country importers apply much lower tariffs to some labour-intensive manufactures (textiles and clothing, footwear, leather goods) from other developing countries than do high- and middle-income countries, including all the major industrial countries.

Looked at another way, industrial countries apply higher average most-favoured-nation tariffs to traditional labour-intensive manufactures—including textiles and clothing, footwear, and leather and travel goods—in which low-income developing countries have a stronger competitive position than they do to products of less interest to developing countries (such as computers and other office equipment and telecommunications, audio and video equipment). Thus the high industrial tariffs that industrial countries impose on critical industrial exports from developing countries are a crucial determinant of market access. This issue requires urgent discussion and resolution.

Source: UNCTAD, 2002, pp. 128–35.

The strength of this resistance is reflected in the classification of certain products as sensitive and subject to special internal procedures, as in the US Trade Act of 2002. Where such protection is not adequate, additional protection is often sought through anti-dumping duties and other forms of trade harassment.[1]

TARIFF PEAKS. Quad countries (Canada, the EU, Japan, the US) maintain numerous tariff peaks on industrial products, especially food industry products, textiles and clothing, footwear, leather and travel goods, automotive products and

consumer electronics and watches. Some of these peaks are as high as 900 per cent (Supper, 2000).[2]

On average, industrial countries—especially the Quad countries—grant high and generous tariff preferences to the least developed countries. Still, the preferences given by most Quad countries do not cover some products that would help the least developed countries develop their industrial sectors. These include textiles and clothing, footwear and leather products (Supper, 2000). Tariff peaks are particularly hurtful to the least developed countries because 11 per cent of their exports to the Quad countries are subject to the peaks, even though these constitute just 4 per cent of the Quad's total imports (Hoekman, Ng and Ollarreaga, 2001).

Tariff escalation. Tariff structures and levels form a barrier to market access in international trade. Tariff escalation raises the effective rate of protection on goods above the nominal tariff rate.[3] A study by the WTO concludes that bound tariffs since the Uruguay Round imply nominal tariff escalation in some sectors (cited in Supper, 2000).[4] Tariff escalation is particularly pronounced for products that offer developing countries the best chance of starting industrial exports—including food industry products, textiles and clothing, footwear, leather products, rubber products and wood industry products. For footwear, most-favoured-nation tariffs reach 260 per cent in Japan (for a pair of leather shoes valued at $25), and average 33–58 per cent for certain rubber, plastic and textile shoes in the US and 18 per cent for shoes in Canada (Supper, 2000, pp. 89–103).

Some of the products subject to tariff peaks or escalation (or both) are considered dynamic products of world trade. As a result developing countries' lack of market access constrains their human development possibilities by blocking their entry into dynamic industrial sectors—limiting their export earnings to traditional sectors. (box 7.2).

High tariffs in industrial countries also encourage developing country producers of labour-intensive manufactures to engage in wage competition—lower real wages, decreasing employment or both. Because women in developing countries are disproportionately employed in labour-intensive manufacturing, especially textiles and clothing, high tariffs seriously undermine their well-being.

Higher tariffs and policy space in developing countries

From a human development viewpoint, higher industrial tariffs in developing countries are justified for two main reasons. The first is to avoid deindustrialization and build competitiveness: Binding industrial tariffs at low levels in developing countries—where industries do not have the capacity to withstand competition from cheaper imports—creates difficulties for their manufacturing sectors. The rapid reduction in industrial tariffs in sub-Saharan Africa since 1980 has resulted in deindustrialization in some countries (box 7.3). Many tariff cuts in developing

BOX 7.2 BANGLADESH'S LOST OPPORTUNITIES FOR HUMAN DEVELOPMENT DUE TO HIGH TARIFFS IN INDUSTRIAL COUNTRIES

Among the least developed countries, Bangladesh would be the biggest beneficiary of duty-free access to all products in the Quad countries (Canada, the EU, Japan, the US). The country's export revenues would increase 45 per cent, with exports of textiles and clothing to Canada and the US rising by more than $700 million in both cases.

The implied financial losses resulting from existing trade barriers also have important implications for poverty reduction efforts. More than 1 million women work in Bangladesh's textiles sector. The sector is the engine of growth in manufacturing, and because production is labour-intensive it generates a wide range of benefits. Increased exports to Canada and the US resulting from the withdrawal of tariff peaks and other restrictions would not only substantially increase employment, they would also help finance investment that the industry needs to prepare for more intense competition.

Source: South Bulletin, 2002.

countries are driven by crises (rather than full employment and rapid growth) or required as a condition of loans from international financial institutions.

An important issue for middle- and higher-income developing countries in building competitiveness is how to move from labour-intensive manufactures to high-skill, technology-intensive products. Doing so requires a solid development strategy, which could involve tariff protection in certain strategic industries. In addition, better access to industrial country markets increases export earnings for developing country industries and supports faster industrialization.

Such developments are especially crucial for the least developed countries. With full preferential duty- and quota-free access to Quad markets for tariff peak products, exports from the least developed countries to these markets are projected to increase 11 per cent (or $2.5 billion)—with a 30–60 per cent increase in exports of tariff peak products (Hoekman, Ng and Ollarreaga, 2001). This does not appear to be a zero-sum game: losses due to trade diversion would be less than 0.1 per cent.

The second justification for higher industrial tariffs in developing countries is to support human development expenditures. To generate much-needed tariff revenue, developing countries—especially low-income and least developed countries—must have a certain threshold of tariff protection. Like all developing countries (box 7.4), the least developed countries are in desperate need of savings, which currently average some 15 per cent of their GDP. To conduct social and industrial policies geared towards human development goals and to generate resources for industrial upgrading, governments of low-income (as well as upper-middle-income) countries need tariff revenues (Rao, 1999).

THE WAY FORWARD

The WTO's new work programme is an important step in recognizing tariff peaks and escalations, along with high tariffs, as targets to be reduced (WTO, 2001).

BOX 7.3 DO REDUCTIONS IN INDUSTRIAL TARIFFS RESULT IN DEINDUSTRIALIZATION?

- Senegal experienced large job losses after a two-stage trade liberalization programme that reduced the average effective rate of protection from 165 per cent in 1985 to 90 per cent in 1988. By the early 1990s employment cuts had eliminated one-third of manufacturing jobs (Weissman, 1990; ADB, 1995, p. 84).
- Côte d'Ivoire's chemical, textiles, footwear and automobile assembly industries collapsed after tariffs were cut 40 per cent in 1986 (Stein, 1992). Similar problems have plagued liberalization attempts in Nigeria. Capacity use fell to 20–30 per cent, and harsh effects on employment and real wages provoked partial policy reversals in 1990, 1992 and 1994.
- In Sierra Leone, Sudan, Tanzania, Uganda, Zaire, and Zambia liberalization in the 1980s generated a huge surge in consumer imports and sharp cutbacks in foreign exchange available for purchases of intermediate inputs and capital goods—with devastating effects on industrial output and employment. In Uganda capacity use in the industrial sector languished at 22 per cent, while consumer imports absorbed 40–60 per cent of foreign exchange (Loxley, 1989).
- Kenya's beverages, tobacco, textiles, sugar, leather, cement and glass sectors have struggled to survive competition from imports since a major trade liberalization program was introduced in 1993. During 1993–97 growth in output fell to 2.6 per cent and growth in manufacturing employment fell to 2.2 per cent (ADB, 1998; Kenya Ministry of Planning and National Development, 1998, p. 164).
- In Ghana manufacturing output and employment grew rapidly after liberalization in 1983, and generous aid from the World Bank greatly increased access to imported inputs. But when liberalization spread to consumer imports, stiffer competition caused manufacturing employment to plunge from 78,700 in 1987 to 28,000 in 1993 (ADB, 1995, p. 397).
- In Zimbabwe formal sector job growth stalled and unemployment doubled to 20 per cent after trade liberalization in 1990. Adjustment in the 1990s was also difficult for the manufacturing sectors in Cameroon, Malawi, Mozambique, Tanzania and Zambia. Import competition caused sharp contractions in output and employment, with many firms closing down (ADB, 1998, pp. 45, 51).
- In the early 1990s liberalization caused large losses in formal sector jobs and substantially increased underemployment in Brazil, Ecuador, Nicaragua and Peru. Evidence from other parts of Latin America is similarly discouraging, with indications that liberalization in the region has caused sharp—and possibly long-lasting—deteriorations in the distribution of income (Berry, 1998, p. 4).

Source: Buffie, 2001, pp. 190–91

Recognizing the importance of taking into account the needs and interests of developing and least developed countries, the programme aims at reducing tariffs, with a focus on products of export interest to these countries (Das, 2002). These reductions are expected to occur with less than full reciprocity in the reduction commitments requested of developing countries. These changes should go into effect as soon as possible and should include complete and binding duty- and quota-free access to industrial country markets for exports from the least developed countries.

BOX 7.4 TRADE TAXES AND DEVELOPMENT POLICY

Trade taxes (import tariffs and export taxes) are important policy instruments not only because they protect import-competing sectors but also because they provide revenue. Problems in mobilizing public revenue often force developing countries to rely heavily on trade taxes. Though their share of total tax revenue has declined over the past two decades because of trade liberalization, trade taxes remain an important source of revenue for developing countries—especially the least developed countries. Between the 1970s and 1998 trade taxes accounted for 36 percent of tax revenue in low-income countries, 29 per cent in lower-middle-income countries, 19 per cent in upper-middle-income countries and just 3 per cent in high-income countries.

Governments tend to deal with revenue losses resulting from reduced import taxes by cutting public spending, though not by the same amount. Most of these cuts affect social spending such as public investments in infrastructure, education and credit and interest rate subsidies. Increases in trade taxes are correlated with higher gross domestic investment, demonstrating a 'crowding in' effect on domestic capital formation. Thus trade taxes and spending policies can have a significant impact on human development and poverty reduction efforts as well as growth outcomes (through their impact on domestic investment).

Source: Rao, 1999; Khattry and Rao, 2002; Chu, 1990.

By themselves, however, these changes will have limited impact, because enormous pressures remain for developing countries to liberalize industrial tariffs as part of initiatives to form free trade areas with industrial countries. These initiatives include the Free Trade Area of the Americas, the EU-Mercosur (Southern Common Market) free trade area and the follow-up to the Cotonou Agreement, through which African, Caribbean and Pacific countries are to form free trade areas with the EU. Thus it is of considerable importance that provisions for special and differential treatment be introduced into GATT article 24.

As discussed, countries that have effectively integrated with the global economy did not liberalize trade and cut tariffs until after they achieved high, sustained growth. Thus developing countries should be allowed to maintain higher tariffs to provide the flexibility they need as part of their industrial and development efforts. Higher tariffs are necessary to avoid deindustrialization, establish competitiveness in vulnerable domestic sectors and generate resources for social and human development. The empirical record suggests that tariff liberalization will occur once higher levels of human development have been achieved and developing countries integrate with the global economy on their own terms.

The policy flexibility to maintain higher industrial tariffs is also necessary for another important reason. A major difference between industrial and developing countries is that industrial countries have the capacity to provide safety nets for people whose jobs or regions are affected by the increased imports that result from tariff reductions. For example, the first 150 pages of the 2002 US Trade Act set out provisions for assistance to workers and communities that stand to be affected by possible US concessions granted under the tariff negotiating authority provided in

the act. Developing countries do not have such capacity. So, as a condition for further bound tariff liberalization, they should seek to establish financial windows that enable them to provide comparable safety nets.

Notes

1. The recent imposition of high tariffs on US steel imports illustrates the political strength of the forces supporting protection in the sector.

2. In addition, 22 per cent of the tariffs at the six-digit level of the Harmonized System face a most-favoured-nation tariff of more than 15 per cent in at least one Quad country (Hoekman, Ng and Ollarreaga, 2001). Moreover, about 30 per cent of the tariff peaks in Quad countries exceed 30 per cent (Supper, 2000). Finally, 60 per cent of the tariff peaks apply to exports from developing countries to the major industrial countries (UNCTAD, 1999; UNCTAD, 2001).

3. Tariff escalation occurs when tariffs on processed goods exceed those on raw materials in a country's tariff schedule. Thus tariff escalation gives additional protection to domestic processing industries.

4. The study covers the Quad countries, Brazil, Hungary, India, Indonesia, Malaysia and Poland.

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