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The WTO Negotiations on Non-Agricultural Market Access: A Development Perspective

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Third World Network

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1 Introduction

LIBERALISATION of trade in industrial products is a major part of the World Trade Organisation (WTO)'s Doha work programme.

Negotiations on "non-agricultural market access" (NAMA) are mandated under Paragraph 16 of the Doha Ministerial Declaration (November 2001) which states:

"We agree to negotiations which shall aim, 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. The negotiations shall take fully into account 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 and the provisions cited in Paragraph 50 below. To this end, the modalities to be agreed will include appropriate studies and capacity-building measures to assist least-developed countries to participate effectively in the negotiations."

The NAMA negotiations began in early 2002 at the WTO. The first stage involved agreeing on the modalities of the negotiations. However, as the Cancun Ministerial Conference of September 2003 approached, there were significant differences among the WTO member states, and it was clear that an agreement on modalities would not be possible to achieve at the conference. It was thus decided to aim instead for a "framework on modalities", which could comprise prin-

ciples and major features, whilst the specific figures and further details could be filled in later in the final search for modalities.

Drafts of a Ministerial Declaration for Cancun were produced, with the final one being issued at Cancun on 12 September 2003 by the Chairperson of the conference, Mexican Foreign Minister Luis Ernesto Derbez. There continued to be strong differences of views on this text, as there were on previous drafts. As is well known, the WTO members were ultimately unable to come to a conclusion on many issues at Cancun, and the conference ended without any declaration.

Following Cancun, negotiations continued on NAMA at the WTO headquarters in Geneva. The discussions continued to be divisive, with the Chairman of the NAMA negotiating group making use of the Derbez text on NAMA as the basis for negotiations, while many members (especially the African and Caribbean countries) were very critical of the Derbez text and requested that a different approach be used instead.

The controversy increased when the Chairman insisted on placing the Derbez text unchanged as the NAMA framework document in the draft of the "July Package", i.e., the decision of the WTO General Council's special session on 26-31 July 2004 which was tasked with finishing the work of the failed Cancun Ministerial Conference.

Despite the strong objections of the Group of African, Caribbean and Pacific (ACP) countries, the Derbez text ended up as Annex B of the July Package. However, a new paragraph 1 which had been heavily negotiated was added to the front of the Derbez text on NAMA, which provided the objecting developing countries some space with which to continue to negotiate important elements contained in the Derbez text.

Several meetings of the NAMA negotiating group have been held since the July Package was adopted. These meetings showed that many developing countries still have strong misgivings about the approach taken in the Derbez text.

Since there is much at stake in the decisions to be taken on the NAMA modalities and especially since the adoption of Annex B of the July Package was so controversially carried out, it would be useful to consider the many aspects in the Doha mandate for NAMA, and in the negotiations.

This paper examines the link between liberalisation and industrial development in developing countries. It analyses the Doha mandate for NAMA. It provides a summary of various positions in the negotiations. It analyses the major elements in the NAMA part of the July Package and their implications for developing countries. It also suggests the way ahead in modalities from a development perspective.

2 Conceptual Framework

THE issues at stake in the negotiations on market access for non-agricultural products are very crucial to the prospects and future of the industrial sector and the industrialisation process in developing countries. There are at least three major aspects that need to be considered in industrial development.

The first aspect is production and employment. Developing countries need to produce more industrial products and to employ more people in this sector in order to contribute to overall economic growth and development. The industrial output in developing countries can be geared towards the local market and the export market. There has to be a medium- and long-term programme to build the capacity of developing countries' industrial sector to produce, and to produce more efficiently. Without this supply capacity, developing countries will be unable to take advantage of industrialisation. At present, many developing countries have relatively weak supply capacities. They have to recognise this weakness, the limitations it places on them, and the need to correct it.

The second aspect is exports. It would be very good if developing countries can increase their industrial exports. For this to happen, there must be better market access, especially to the developed countries. The NAMA negotiations should result in expanded export opportunities for developing countries. However, market access is not a panacea for many developing countries. Any improvement in market access by itself may not have the desired positive effect since the supply capacity in many countries is too weak, at least in the short run, to enable a significant increase in exports and production.

The third aspect is imports. Further liberalisation will enable imports to enter faster and at lower prices. This would reduce consumer prices. However, cheaper imports can also cause serious disruptions in the industrial sector of developing countries. Many local firms and industries are still too weak to withstand competition from a large inflow of cheaper imports resulting from the lowering of import barriers. In many developing countries that have a weak and vulnerable industrial base, rapid import liberalisation has led to reduced production or even outright closure of local firms and labour retrenchment, whilst there has been no evidence of shifting of the displaced capital or labour to more efficient industries. In many developing countries, there has been a weakening of the industrial sector, and even a process of "deindustrialisation". Moreover, the reduction in industrial tariffs due to liberalisation has caused significant loss of government revenue, which has created more difficulties to the government budget situation.

What is of relatively greater importance to developing countries is the maintenance and development of their industrial sector, which means more industrial output, better technology and more manufacturing jobs. They should achieve this through production for the local and the export markets. The progress of the industrialisation process is critical to overall economic and social development. The development of the industrial sector in developing countries, especially the countries with weak and vulnerable industrial sectors, must be the major objective of this round of NAMA negotiations. Utmost care must be taken to avoid a situation in which the negotiations lead to further inappropriate import liberalisation in developing countries, to the detriment of local industries and the industrialisation process. This objective as well as this danger should be uppermost in the consideration of the deliberations and negotiations, starting with the discussion on modalities.

In this context, another very relevant point which must be taken into account in the modalities is that developing countries need the policy space and flexibility to be able to modify their tariff levels. The modalities and subsequent negotiations must fully take into account and enable the developing countries to have this flexibility.

The following are two examples of cases in which this policy flexibility is required.

Firstly, a developing country needs to be able to modulate the tariffs on various types of products on a dynamic basis to support its upgradation of industrial production. It may need to have lower tariffs on certain products, for example machines, for some time to encourage their use in the production of downstream products. But after some time, these tariffs may need to be raised when the country embarks on producing the former product, i.e., the machines in this example, in order to protect its newly emerging machine-building industry. If a commitment to bind the tariffs on machines has already been made, such raising of tariffs will not be possible without compensation. The developing country will lose the flexibility to develop its industrial sector from manufacturing lower-technology products to higher-technology products, if it is not able to raise the tariffs on particular products from time to time. Hence an insistence that developing countries undertake binding commitments at lower levels of tariffs will harm their industrialisation process.

Secondly, the developing countries may need to ration out their limited foreign exchange earnings for the import of essential products. Tariffs can be a useful tool to discourage the import of non-essential products and encourage the import of products that are essential and also critical for industrial development. For this reason too, it is important for a developing country to retain its flexibility to raise or lower its tariffs so that imports can be made to play a useful role in industrial development. If a commitment has already been made for binding the particular tariffs at lower levels, this tool for development will not be available.

The above are only two examples, and there may be other reasons why it is vital to enable developing countries to vary their tariff levels for developmental purposes, which the modalities should fully recognise.

3 Recent Experiences of Liberalisation and Industrial Performance

ACCORDING to the orthodox approach used by the International Monetary Fund (IMF) and the World Bank and often assumed within the WTO, import liberalisation necessarily has positive effects on developing countries. Consumers benefit from cheaper imports, and local producers become more efficient under import competition or else shift to another sector in which they have comparative advantage. Any adjustment costs are taken as temporary. From this perspective, the faster and deeper the liberalisation, the greater the benefits.

In the real world, there are countries that benefit from (or at least do not suffer from) import liberalisation, where the local industries could withstand import competition and increase efficiency, whilst the consumers enjoy real income gains from cheaper products. However, other countries have experienced negative effects from liberalisation. The effects of liberalisation depend partly on the conditions present in the liberalising country, the rate of liberalisation, the sectors chosen, the sequencing, and so on. Countries that liberalise too fast or in the wrong sectors may end up incurring damage to local firms and industries and labour retrenchment. The adjustment that is assumed to take place automatically in many cases does not take place or is of an inadequate extent. The result could be deindustrialisation, net job loss and a worsening of the trade deficit. There is no automatic link between liberalisation and industrial growth or income growth. When conditions are not present for success, or when the liberalisation process is done incorrectly, there can be significant adverse effects.

The *Trade and Development Report 1999* of the United Nations Conference on Trade and Development (UNCTAD) showed that "big bang liberalisation" con-

tributed to developing countries (excluding China) increasing their average trade deficit by 3 percentage points of GDP between the 1970s and 1990s (while the average growth rate was lower by 2 percentage points). “It (trade liberalisation) led to a sharp increase in their import propensity, but exports failed to keep pace, particularly where liberalisation was a response to the failure to establish competitive industries behind high barriers. With the notable exception of China, liberalisation has resulted in a general widening of the gap between the annual growth of imports and exports in the 1990s.”

An earlier study by UNCTAD economist Mehdi Shafaeddin (1994), who surveyed 41 least-developed countries (LDCs), found “no clear and systematic association since the early 1980s between trade liberalisation and devaluation, on the one hand, and the growth and diversification of output and growth of output and exports of LDCs on the other. In fact, trade liberalisation has been accompanied by deindustrialisation in many LDCs, and where export expanded it was not always accompanied by the expansion of supply capacity….The design of trade policy reforms has also been an important factor in performance failure.”

Recent studies by academics have also provided increasing empirical evidence of many developing countries experiencing these negative consequences. For example, a book authored by Professor Edward Buffie and published by Cambridge University Press in 2001, entitled *Trade Policy in Developing Countries,* has collated what he calls “the most disturbing evidence” of post-1980 liberalisation episodes in the African region. According to information collected in the book (pp. 190-191):

- Senegal experienced large job losses following a two-stage liberalisation programme that reduced the average effective rate of protection from 165% in 1985 to 90% in 1988. By the early nineties, employment cuts had eliminated one-third of all manufacturing jobs.

- The chemical, textile, shoe and automobile assembly industries virtually collapsed in Cote d’Ivoire after tariffs were abruptly lowered by 40% in 1986. Similar problems have plagued liberalisation attempts in Nigeria. The capac-

ity utilisation rate fell to 20-30%, and harsh adverse effects on employment and real wages provoked partial policy reversals in 1990, 1992 and 1994.

- In Sierra Leone, Zambia, Zaire, Uganda, Tanzania and the Sudan, liberalisation in the eighties brought a tremendous surge in consumer imports and sharp cutbacks in foreign exchange available for purchases of intermediate inputs and capital goods. The effects on industrial output and employment were devastating. In Uganda, for example, the capacity utilisation rate in the industrial sector languished at 22% while consumer imports claimed 40-60% of total foreign exchange.

- The beverages, tobacco, textiles, sugar, leather, cement and glass products sectors have all struggled to survive competition from imports since Kenya initiated a major trade liberalisation programme in 1993. Contraction in these sectors has not been offset by expansion elsewhere in manufacturing. The period 1993-1997 saw the growth rates of output and employment in manufacturing fall to 2.6% and 2.2%, respectively.

- Manufacturing output and employment grew rapidly in Ghana after liberalisation in 1983 and generous aid from the World Bank greatly increased access to imported inputs. But when liberalisation spread to consumer imports, employment plunged from 78,700 in 1987 to 28,000 in 1993. The employment losses owed mainly to the fact that "large swathes of the manufacturing sector had been devastated by import competition".

- Following trade liberalisation in 1990, formal sector job growth slowed to a trickle in Zimbabwe and the unemployment rate jumped from 10 to 20%. Adjustment in the nineties has also been difficult for much of the manufacturing sector in Mozambique, Cameroon, Tanzania, Malawi and Zambia. Import competition precipitated sharp contractions in output and employment in the short run, with many firms closing down operations entirely.

The book also provides some information on other developing countries outside Africa. According to the author: "Liberalisation in the early nineties seems to have

resulted in large job losses in the formal sector and a substantial worsening in underemployment in Peru, Nicaragua, Ecuador and Brazil. Nor is the evidence from other parts of Latin America particularly encouraging: 'the regional record as it now stands suggests that the normal outcome is a sharp deterioration in income distribution, with no clear evidence that this shift is temporary in character.' (Berry 1999, p. 4)."

Information of this type indicates that for many developing countries the effects of import liberalisation can be negative and sometimes devastating, reducing their prospects for industrialisation and indeed, in some cases, destroying the domestic industrial base. It contradicts the orthodox approach that import liberalisation necessarily leads to growth.

Domestic industries in many developing countries are already facing problems including closure and loss of jobs due to tariff reductions. There is an additional problem of loss of government revenue. It is thus of the highest priority that the outcome of the NAMA negotiations does not further worsen the basis for industrial development in developing countries.

4 Desired Objectives of Negotiations

IN the context of the conceptual framework above, and cautioned by the experiences of deindustrialisation resulting from inappropriate liberalisation, it is important to state that the aim of the negotiations on NAMA is not to achieve liberalisation in itself. It should be recognised that trade (and in this regard, import liberalisation in particular) is only a means, to be used when appropriate and to be used carefully, while industrial development is the goal. It is thus proposed that the following be among the main objectives of the NAMA negotiations and thus of the modalities:

- To contribute positively to the industrial development of the developing countries.

- To ensure the continued and increased viability of local industrial enterprises in developing countries.

- To significantly increase industrial jobs and employment in developing countries.

- To ensure that developing countries' governments can maintain (and if needed, increase) their revenues derived from trade (in particular imports) in industrial products.

- To facilitate an increase in export opportunities and export revenues obtained by developing countries in non-agricultural products.

- To ensure that the flow of imports and price of imports of non-agricultural products in developing countries are commensurate with their goals of achieving industrial development and the viability and growth of their local industries.

- To ensure that developing countries be enabled to maintain or expand the national policy space, policy options and policy instruments so as to be able to undertake measures that lead to successful industrial development.

- To therefore ensure that developing countries will not be expected to make commitments that are inconsistent with their development, financial and industrialisation needs.

- To recognise that developing countries need to have the flexibility and ability to vary their tariff levels in line with developments and needs (such as a change in priorities or circumstances, or the need for the appropriate sequencing of their industrialisation process, or the need to rationalise imports due to scarcity of foreign exchange), and that this should be incorporated and be fully taken account of in the modalities and the results of the negotiations.

5 The History of and Case for a Flexible Approach

IT is important to remember the techniques and approaches used in previous rounds of trade negotiations on industrial products, as this has implications for the current negotiations.

In the history of the General Agreement on Tariffs and Trade (GATT, the predecessor of the WTO) and the WTO up to the Uruguay Round of negotiations, WTO members have not been subjected to a single formula approach in tariff reduction on industrial products. There was flexibility, particularly for developing countries, to choose: (i) the scope of their tariff bindings (the number of products to be bound); (ii) the level at which the bindings are to take place; and (iii) the rate of tariff reduction in each tariff line.

In the Uruguay Round, developing countries were given an overall target of 27% average reduction. The negotiations were conducted using the request-offer technique. Within this parameter, countries could choose the rate of reduction in each tariff line. There was thus a significant extent of flexibility for the developing countries as to what rate of reduction to assign to each tariff line, as long as the overall average reached the target.

In the earlier rounds, the developed countries also had significant flexibility. Negotiations took place mainly through the request-offer approach (in which each member requested other members to reduce their tariffs in various sectors, and each member responded to the requests it received by making offers) and there were no general targets or formulae. In the Tokyo and Kennedy Rounds there was a linear formula used for the first time by developed countries and even then

there were exceptions to the application of this formula such that the actual reductions were less than the targets. In the Uruguay Round, there were proposals for a Swiss harmonisation formula but countries, in particular the US, objected to its application as these countries still had high industrial tariffs. In the end, the countries agreed to an average 33% reduction through a formula of their choice, whilst the US "stuck to its approach of following the request-offer, item by item, technique" (Hoda 2001, p. 36).

In other words, the developed countries, through most of the GATT's history, had considerable flexibility to choose their rate of liberalisation. Developing countries had even more flexibility for most of the period, in line with their special needs. With regard to the Uruguay Round, according to the WTO report, "Market Access: Unfinished Business" (2001): "The average tariff on developed countries' imports of industrial products was cut by 40% on imports from all sources and by 35% on imports from developing countries. For developing countries the reductions averaged 25% for industrial products imported from developed countries and 21% for industrial products imported from developing countries. These tariff reductions, it should be noted, were negotiated line by line rather than through the use of a formula approach."

Therefore the proposed adoption of a Swiss or Swiss-type formula for tariff reduction that is binding on all members in the current NAMA negotiations would be an unusual and major departure for developing countries, which does not correspond to their level of economic development. Developed-country members have taken a significant period of time over successive rounds of negotiations to have their levels of tariffs reduced gradually in line with their own economic growth, and up to now have not been subjected to a Swiss formula approach themselves. For this reason, developing countries cannot therefore be denied the flexibility required for their development.

Given the above, WTO members should not assume that a formula approach must be adopted during the current negotiations. Developed countries enjoyed flexibility and did not adopt a harmonisation approach even in the Uruguay Round. It would not be appropriate to impose a general formula applicable to all countries

in the current negotiations. Developing countries should be allowed to choose the rate and type of liberalisation appropriate to their needs.

6 Basis and Principles of the Negotiations

IT is clear from Paragraphs 2 and 16 of the Doha Ministerial Declaration that the main foundations and principles underlying the negotiations on market access for non-agricultural products are the promotion of the special needs and interests of developing and least-developed countries.

Paragraph 2 states: "...The majority of WTO Members are developing countries. We seek to place their needs and interests at the heart of the Work Programme adopted in this Declaration..."

This extremely important general statement applies as much to the negotiations on non-agricultural products as it does to everything else in the Declaration. Thus, each aspect of the NAMA negotiations must incorporate the spirit and substance of this statement. The needs and interests of developing countries must be at the heart of the principles, modalities, substance and outcome of the NAMA negotiations.

Paragraph 16, which is specifically on NAMA, includes the following:

- "We agree to negotiations which shall aim … 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."

- "The negotiations shall take fully into account 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 and the provisions cited in Paragraph 50 [of the Doha Declaration] below."

- "[T]he modalities... will include appropriate studies and capacity-building measures to assist least-developed countries to participate effectively in the negotiations."

On the first point, the meaning is clear: the negotiations should focus on assisting developing countries to obtain greater market access for products of interest to them. The negotiations should help developing countries improve their exports of industrial products; and each developing country should be helped in this respect in the context of promoting their needs and interests. The objective is thus centred on the interests of developing countries and not on the needs of developed countries and the latter's interest in obtaining greater access to developing countries' markets.

The second point is a general statement again reaffirming that the special needs and interests of developing countries and LDCs should be fully taken into account, since these are at the heart of the overall Doha work programme (as stated in Paragraph 2).

The third point provides an example (only one example, and thus other methods can and should be deployed as well) of how the developing countries' needs can be taken account of, i.e., through "less than full reciprocity." The two provisions cited in support of this principle of "less than full reciprocity" are the following:

- Article XXVIII *bis* of GATT 1994. Paragraph 3 of this Article states that "Negotiations shall be conducted on a basis which affords adequate opportunities to take into account: (a) needs of individual contracting parties and individual industries; (b) the needs of less-developed countries for a more flexible use of tariff protection to assist their economic development and the special needs of these countries to maintain tariffs for revenue purposes; and

(c) all other relevant circumstances, including the fiscal, developmental, strategic and other needs of the contracting parties concerned."

- Paragraph 50 of the Doha Declaration states that the negotiations shall take fully into account the principle of special and differential (S&D) treatment for developing and least-developed countries embodied in Part IV of GATT 1994; the Decision of 28 November 1979 on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries; the Uruguay Round Decision on Measures in Favour of LDCs and other relevant WTO provisions.

In relation to the provisions mentioned in Paragraph 50, the following are among the more relevant:

(a) The non-reciprocity principle was established in Paragraph 8 of Article XXXVI, which is in Part IV of the GATT. Paragraph 8 states that: "The developed contracting parties do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less developed contracting parties". An interpretative note to this paragraph adds that the developing countries "should not be expected, in the course of trade negotiations, to make contributions which are inconsistent with their individual development, financial and trade needs, taking into consideration past trade developments". The interpretative note also extends the applicability of the concept of non-reciprocity to renegotiations under Article XVIII or XXVIII.

(b) The concept was further elaborated in the Tokyo Round Decision on "Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries", also known as the "Enabling Clause", which was adopted on 28 November 1979. It states: "The developed countries *do not expect reciprocity* for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of developing countries, i.e., the developed countries do not expect the developing countries, in the course of trade negotiations, to make contributions which are inconsistent with their individual development, financial and trade needs.

> Developed contracting parties shall therefore not seek, neither shall less-developed contracting parties be required to make, concessions that are inconsistent with the latter's development, financial and trade needs…Having regard to the special economic difficulties and the particular development, financial and trade needs of the least-developed countries, the developed countries shall exercise the *utmost restraint* in seeking any concessions or contributions for commitments made by them to reduce or remove tariffs and other barriers to the trade of such countries, and the least-developed countries shall not be expected to make concessions or contributions that are inconsistent with the recognition of their particular situation and problems." (emphasis added)

In light of the above provisions, it is very clear that within the context of the principle of "less than full reciprocity", developing-country members should be fully enabled to exercise their rights to make decisions on their commitments which they consider to be consistent with their development, financial and trade needs, and that they cannot be expected to make commitments inconsistent with their needs, their particular situation and problems. The modalities and negotiations should ensure that developing countries retain or enlarge the "policy space" or the range of policy options that they require in order to improve and expand their domestic industrial development. This central principle must be fully reflected in the many aspects of the modalities.

The fourth point of the Paragraph 16 mandate states that the modalities will include appropriate studies and capacity-building measures to assist least-developed countries to participate effectively in the negotiations. It should be recognised that this point was included in the Doha Declaration in response to requests made by many developing-country members. For example, a communication by Kenya, Mozambique, Nigeria, Tanzania, Uganda and Zimbabwe (document WT/GC/W/453 dated 2 November 2001) proposed that relevant studies be conducted prior to the commencement of any negotiations. Although the Declaration refers to "least-developed countries", it should be accepted in both spirit and substance that the studies and capacity-building measures refer as well to other developing countries that request for the studies and measures. The studies and capacity-building measures must also be an integral part of the modalities.

7 The Use of Tariffs in Industrial Policy

TARIFFS are an important component of development and industrial policies. The use of tariffs in such policies is well documented and was deployed by the advanced developed countries in their own industrialisation process. Also, the successful East Asian economies of Taiwan, South Korea and Japan resorted to tariff measures to pursue their industrial development. As part of their industrial development policies, these countries "picked their winners" and used tariffs to protect the products of these selected industries until they became sufficiently efficient to compete internationally.

The importance of using tariffs as a policy tool for industrial development for developing countries is underscored by the fact that recourse to other policies for industrial development may be limited by lack of resources and by WTO and other international rules and obligations.

For instance, the WTO Agreement on Trade-Related Investment Measures (TRIMs) prohibits the usage of the local-content requirement as it is regarded to be inconsistent with the principle of "national treatment". In this context, tariff measures have acquired greater importance as a means of maximising the benefits of foreign direct investment (FDI). An effective tariff rate on an imported good which is in competition with the same, locally produced good could be imposed by the government in order to ensure that the investor purchases the local good. This will allow backward linkages between the FDI and the local economy and enhance the benefits of such investment. If the flexibility in setting tariff levels is removed, and in the context of TRIMs, another positive synergy with FDI will be diminished.

Policy options for industrial development are also curtailed by the WTO Agreement on Subsidies and Countervailing Measures. Large direct and indirect subsidies were essential to the rapid growth of many of today's most successful developing economies at the early stages of their development. In East Asia's "tiger economies" of Malaysia, Singapore, Taiwan and Korea, subsidies played an important role in the export promotion policies used to develop new local industries. Such policies enabled these economies to become world-class exporters of modern industrial products such as electronics, semiconductors and ships. This range of policies is now circumscribed, if not prohibited, under the Agreement on Subsidies and Countervailing Measures.

The subsidies permitted under this agreement (defined as non-actionable subsidies in Article 8 of this agreement, which are subsidies of a more generalised character such as subsidies for R&D or infrastructural development, as opposed to directly selected industries), apart from their appropriateness, are beyond the financial means of many developing countries.

Hence, the role of tariffs as a policy tool for industrial development acquires an even greater significance.

Flexibility in setting tariff rates is also important to deal with an ever-changing business environment. While an existing tariff rate may be appropriate for a country at this point in its development, it may not be so in the future. Changes in technology, for instance, could drive down significantly the price of the imported good, so that the existing tariff rate will be insufficient in ensuring that the imported product does not effectively eliminate local businesses producing that good. The tariff rate for that product may then have to be augmented so that local businesses appreciate the external challenge, and are given the room and opportunity to make themselves more competitive, without being overwhelmed by it. The historian Arnold Toynbee, in ascertaining how civilisations take root and flourish, came to the conclusion that when societies are challenged they rise to the occasion, innovate and progress. In the absence of challenge, societies then tend to be complacent and advancement is not forthcoming. However, when challenges are overwhelming and cannot be overcome, societies are displaced and destroyed.

The flexibility in the use of tariffs is critical to ensure the appropriate level of challenge so that the private sector in the developing countries can adapt, innovate and improve without being engulfed and eliminated by overwhelming circumstances.

Finally, for many developing countries, customs revenues constitute 20 to 30% or more of government revenue, while for developed countries this is less than 1%, according to the IMF annual statistics yearbook. This is significant, especially given the paucity of financial resources in developing countries. As pointed out by the United Nations Development Programme (UNDP), cutbacks in government revenue could result in decreased social spending, such as on health and education, in countries and situations where consumption of these essential services is already highly limited and low.

The current negotiations have also to be seen in the context of the wider liberalisation efforts ongoing at the regional and bilateral levels. If the WTO negotiations leave tariffs significantly lower, countries involved in bilateral or regional negotiations will have to offer even further concessions to make these negotiations attractive. This may drive down tariffs to inappropriately low levels, resulting in the loss of the positive roles they can play in promoting not only industrial but also human development.

Danger of Erosion or Removal of This Policy Tool under the Current WTO Negotiations

Developing countries' tariffs could be lowered significantly and bound under the current negotiations. The flexibility in tariffs could thus be made marginal or ineffectual or, worse, completely taken away through the following approaches:

- Bind all – Developing countries are being pushed to have virtually all their tariffs bound by the end of this round of trade talks. Many developing countries, especially those in Africa, have not bound many of their tariffs, hence providing some needed measure of flexibility to pursue and protect their respective national economic interests. In Annex B of the July Package de-

veloping-country members would have most of their tariff lines bound. (LDCs are also asked to increase their tariff bindings.)

- Dramatic reduction of tariffs – The developed-country members such as the US, EU and Japan have been pushing for a very dramatic reduction in the level of tariffs generally through the use of a non-linear formula. In particular, the US and New Zealand have stated that they would like to see tariffs brought down to zero before 2020. In line with this ambition, the US has submitted its drastic proposal of cutting tariffs to no more than 8% by 2010 and then subsequently to zero by 2015. A dramatic reduction of tariffs through a non-linear formula would leave tariffs impotent as a policy tool.

- Proposed mandatory tariff elimination in selected product sectors through the sectoral approach. The use of tariffs as a policy tool would be lost completely in these sectors.

Double Standards and Empty Promises

The proposals by developed countries along the above lines reflect double standards, as they themselves during their stages of development (and in fact up to now) have been able to determine their pace and pattern of tariff reduction.

- Developed countries took many rounds in the GATT to reduce their tariffs.

- Even in the last round, the US could not accept a non-linear formula approach. In the end, developed countries reduced their tariffs according to what they felt was most appropriate.

- One of the objectives of the current round of negotiations as contained in Paragraph 2 of the Doha Declaration is to increase the share of developing countries in world trade. However, if the negotiations go the way envisaged by the developed countries, it is they that will acquire greater market access than developing countries. Given the different tariff structures between developed and developing countries, the latter, which generally have higher

tariffs, will end up making more significant cuts in their tariffs than developed countries. Hence, it is the developing countries making the concessions here. This is the case even for a linear formula. For instance, cutting a 100% tariff by 50% will reduce the tariff to 50%, and cutting a 10% tariff by 50% will bring it down to 5%. A $1 product will now enter in the first case at $1.50 as opposed to $2.00 before the cut. In the second case, a $1 product will now enter at $1.05 instead of $1.10. The market access gained in the first instance, which sees a 50-cent difference, is more significant than in the second instance, which entails only a 5-cent difference. This disparity will be aggravated with a non-linear formula. There will be no reciprocity and mutual benefit in the outcome, let alone fulfilling the principle of "less than full reciprocity" for developing countries.

- An even more punishing and stringent regime for tariff cuts for developing countries is envisaged in the current negotiations. Developed-country members have been insisting on a compulsory approach to eliminate tariffs in some sectors, i.e., the so-called sectoral tariff elimination approach. It is also the intention of the developed-country members to increase the number of these sectors to more than the seven mentioned in a WTO document. This marks a sharp break from past practice, where the sectoral approach was undertaken on a voluntary basis. These sectors include fish and fish products, leather goods, motor vehicle parts, electronics and textiles and clothing. While eliminating tariffs in developed countries in these sectors may benefit some developing countries, to subject developing countries to tariff elimination in these sectors is totally inappropriate. Generally, these sectors are protected by relatively high tariffs in many developing countries, because they have domestic industries producing these products. However, if the developing countries were also made to reduce dramatically their tariffs in these areas, this would put tremendous pressure on their already weak, vulnerable and limited industrial base.

- The principles of less than full reciprocity, S&D and having to take into account the special needs and interests of developing countries contained in the Doha Declaration have in reality been ignored in the developed countries' proposals and in the July Package.

8 How the July Package Was Adopted

THE main push for a new round of industrial tariff cuts (through the Doha work programme) came from the major developed countries, which advocated a new mandate at the Seattle Ministerial Conference and again at the Doha Ministerial Conference. Several developing countries were against the launching of new negotiations on industrial goods. A paper by several African countries just prior to the Doha conference argued that African and other countries were suffering from deindustrialisation induced by rapid liberalisation, and requested that there not be a start to negotiations on further liberalising the import of industrial products. However, the appeal by the African countries went unheeded and the Doha meeting did launch the negotiations on NAMA.

The African and Caribbean countries, individually and also through their regional groupings, have been vocal in their demand that developing countries should be allowed to retain the flexibilities that enable them to choose when they would like to liberalise, the scope of tariff bindings, and at what rate.

However, the developed countries have come up with aggressive positions to open up developing countries' markets. Despite the clauses in the Doha Declaration that appear to safeguard developing countries' interests, since the Doha Ministerial Conference, there has been intense pressure from the developed countries to subject the developing countries to very steep tariff reductions. The developed countries propose a general non-linear formula that would apply to all tariff lines. The scope of binding is also proposed to rise to almost 100%, and then the newly bound tariffs would also be subject to reduction by the formula. And for several selected sectors, there would be an accelerated schedule for tariff elimination.

These demands of the developed countries were basically captured in the Chairman's text before the Cancun Ministerial Conference, and in the revised draft (the Derbez text) at Cancun. During the post-Cancun consultations on NAMA up to December 2003, the Chair of the WTO General Council proceeded on the basis of the Derbez text. The Derbez text also eventually became the framework for modalities on NAMA (Annex B) in the July Package.

Although Annex B of the July Package now enjoys a tremendous advantage as the main basis of the NAMA negotiations, the extent to which some of its major points may be subject to challenge or alternatives remains to be determined. Fundamental differences between developing and developed countries over various aspects of the negotiations remain unresolved. This state of affairs is captured by Paragraph 1 of Annex B.

Most developing countries (especially from Africa and the Caribbean) had opposed the Annex for many months, as it had been recycled from the Derbez text presented at Cancun. It had been criticised at Cancun and in the post-Cancun period. Many developing countries had submitted their own proposals for a NAMA framework, which were radically different from the Derbez text.

In contrast, developed-country members, especially the US and EU, were very supportive of the Derbez text, since it reflects in the main their joint proposal submitted with Canada in August 2003.

Many developing countries insisted that at best it could be one of the main documents used as a reference point in the negotiations, whilst other proposals (especially those from the developing countries) should also be referred to in the negotiations.

The African, Caribbean and Pacific (ACP) countries and the LDC Group (in their G90 Ministerial meeting on 12 July 2004) had criticised the Derbez text on NAMA for its potential for causing deindustrialisation, unemployment and poverty in their countries.

They also protested specifically against the decision by Ambassador Stefan Johannesson, Chair of the NAMA negotiating group, to submit this text, unchanged, to constitute part of the July Package. Delegates were promised, however, that their concerns over the Derbez text would be articulated in a cover letter that would accompany the submission of the Derbez text to the WTO Director-General and the Chair of the General Council, who were responsible for drafting the July Package.

Many developing countries were thus outraged that the Derbez text popped up again unmodified in the first July Package draft of 16 July 2004. The African Group immediately proposed amendments to Annex B of the package pertaining to NAMA. But any amendment to the text was said to be unacceptable to the developed countries. At one stage, it looked as if the Geneva meeting would collapse on the NAMA issue.

The only concession the developed countries were willing to make was to create a "vehicle" to indicate that further negotiations were required on some aspects of the Annex.

Negotiations then focused on a "vehicle" or explanatory paragraph that would state that more negotiations would be needed on some elements of Annex B.

The location and thus legal status of this "vehicle" became a subject of controversy, and after another big battle it was agreed to place the "vehicle" in the body of the Annex.

In the end, the developing countries agreed to accept the disputed Annex with no modification, except that it is prefaced with a first paragraph explaining that the Annex contains "the initial elements" for future work, and that "additional negotiations are required to reach agreement on the specifics of some of these elements." These relate to the formula, treatment of unbound tariffs, flexibilities for developing countries, participation in the sectoral component, and preferences.

It is incredible how such an important text as a framework for modalities on such an important subject as NAMA could be adopted without any changes whatsoever, when its most important elements had been opposed by so many members; and that many members who objected to it found themselves in a situation where they had to agree to adopt it, with only an inadequate "chapeaux" or Paragraph 1 to indicate that they can reopen some aspects of it, with no guarantee that the reopening can be to an adequate extent.

Nonetheless, this paragraph has given the developing countries a space from which to continue to battle for a better framework. But since the Derbez text forms the rest of Annex B, and will be the basis for the negotiations, it will be an uphill task for the developing countries to put forward their own versions of modalities that are suited to their industrial development. The unjust process of placing a non-consensual and contentious text as the framework, and then asking countries to work with it as the basis, has placed the developing countries at a grave and unfair disadvantage. It will be an uphill battle for them to limit the damage, and a more than Herculean task to succeed in putting in place an alternative set of modalities.

It is improbable that the NAMA Annex would have been adopted if there had been a fairer decision-making process.

The manner in which the Chairman of the NAMA negotiations put the Annex in the text (thus placing the developing countries in an extremely vulnerable position during the negotiations) shows in a stark way how unfairly the WTO negotiating process functions at present. Also, the fact that the developing countries did not reject the NAMA text outright shows their weakness in the WTO system.

9 Problems with the July Package Text on NAMA

THERE are many problems in the July Package text for developing countries, many of which have expressed their strong reservations or objections. The text does not honour the clauses of the Doha Declaration to fully take into account the special needs and interests of developing countries, including through less than full reciprocity.

The following are the most serious or contentious issues contained in the July Package's Annex B on NAMA:

- **Paragraph 4** contains the directive that the negotiating group continue work on a non-linear formula applied on a line-by-line basis. According to this kind of formula, there are to be steeper percentage cuts the higher the tariff levels. Many developing countries have relatively high bound tariffs in order to protect their small industries. The non-linear formula will drastically reduce the developing countries' tariffs, which could threaten the viability of many of their domestic industries. The high tariff reductions would also reduce customs duties collected and thus affect the level of government revenue, as many developing countries rely heavily on import duties for a significant part of their revenues.

- **Paragraph 5 tiret 2** implies that unbound tariff lines shall also be subjected to the non-linear approach, after they are bound at (twice) the applied rate. This would have very serious implications for many countries. It would mean that after the exercise: (a) the presently unbound tariff lines will be bound, and (b) in many cases the new tariff rates would be below (and in some

cases significantly below) the present applied rates. The flexibility for raising applied rates would be eroded or in some cases eliminated.

- **Paragraph 7** on the "sectoral tariff component" (i.e., accelerated tariff reduction eventually to zero) contains the controversial line that "participation by all participants will be important", implying it will be mandatory. This is against the demand by most developing countries that such a scheme should only be voluntary. This could commit developing countries to eliminating tariffs on seven sectors or more, many of which house local industries whose survival would be seriously threatened. (Annex B does not state which sectors are involved, or how many, and thus these are to be selected during the further negotiations. An earlier draft before Cancun had mentioned seven sectors.)

The above elements in Annex B are likely to create or worsen problems for the industrial development plans of developing countries. Existing bound tariffs would be subjected to reduction, many of them at steep rates. The text would oblige developing countries to bind almost all their presently unbound tariffs, and subject the newly bound tariffs to immediate cuts through the non-linear formula. Finally, if participation is mandatory, the sectoral approach would have tariffs eliminated in the selected sectors, which could disrupt developing countries' domestic industries in these sectors since they would be unlikely to adjust in the short time available to compete successfully in the new zero-tariff environment. For many developing countries, Annex B could well lead to deindustrialisation, or further deindustrialisation. They would find it more and more difficult to build an industrial base for development.

The developed countries have generally much lower industrial tariffs than developing countries (with the significant exception of tariff peaks and high tariffs, especially on products of export interest to developing countries). The developing countries generally have higher bound tariffs, which they require because their local industries are less technologically equipped, and thus many of them would be unable to be viable in the face of cheap imports. Due to these differences in tariff profiles, the application of a non-linear formula would affect the developing coun-

tries much more than the developed countries, as the former would be subjected to much steeper cuts in terms of percentage points, as compared to the latter. The result is that the developing countries would have to increase the access to their markets much more than the developed countries. This would be counter to the principle of less than full reciprocity and to the more general principle of special and differential treatment.

10 Inappropriateness of a Standard Formula Approach for Developing Countries

A MAJOR part of the Doha mandate on NAMA is that "the negotiations shall take fully into account the special needs and interests of developing and least-developed country participants, including through less than full reciprocity in reduction commitments", and this is to be in accordance with Article XXVIII *bis* of GATT 1994 and Paragraph 50 of the Doha Declaration (on special and differential treatment).

Paragraph 3 of Article XXVIII *bis* states that "Negotiations shall be conducted on a basis which affords adequate opportunities to take into account: (a) needs of individual contracting parties and individual industries; (b) the needs of less-developed countries for a more flexible use of tariff protection to assist their economic development and the special needs of these countries to maintain tariffs for revenue purposes; and (c) all other relevant circumstances, including the fiscal, developmental, strategic and other needs of the contracting parties concerned."

Thus, developing countries should be enabled by the NAMA modalities to have the option of an approach that meets their needs for "a more flexible use of tariff protection" to assist development and maintain tariffs for revenue purposes.

In order to meet these goals, developing countries should not be subjected to a standard formula approach. Generally, the developing countries have higher tariffs on industrial products than developed countries. A formula approach, which requires all members to reduce their tariffs by a certain percentage, would affect the tariffs of developing countries more than the tariffs of developed countries. This would be so even if developing countries are allowed a lower percentage of tariff

reduction. In the proposals using the formula approach that have been put forward, the Swiss-type proposals or "compression" proposals (put forward, for example, by the US and EU) would seriously affect developing countries as their tariffs have to be very significantly reduced overall, and the higher tariffs would especially be subjected to drastic cuts. This would have very serious consequences for many industrial products and sectors and accelerate the process of deindustrialisation, closure of local firms and job losses, as well as drastically reduce the customs revenues that form a large part of the government's total revenue in developing countries.

However, even the linear-cut formula approach would adversely affect developing countries, even if they are allowed to have a lower reduction rate than that of the developed countries. For example, the Indian linear-cut formula asks for 50% tariff reduction for developed countries and 33.3% reduction for developing countries; and that after these reductions are made, all members should also ensure that they do not have in any tariff lines a tariff rate more than three times above the overall average rate. Although this linear-cut approach with differential rates for developed and developing countries will not have as drastic an effect on developing countries as the Swiss-type formula approach, it will still have adverse effects on developing countries, and moreover it remains an inequitable system.

Paragraph 16 of the Doha Declaration mandates that the negotiations shall take fully into account the special needs and interests of developing and least-developed country participants, including through less than full reciprocity in reduction commitments. It also states that the negotiations should take fully into account the principle of special and differential treatment for developing and least-developed countries. The formula approaches do not reflect the Doha mandate in that they do not fully take into account the needs of developing countries, nor do they constitute special and differential treatment.

The central drawback of the formula approaches put forward is that they ask members to make reduction commitments by a certain percentage. Basing a formula on the basis of percentage reduction may seem equitable, but in fact it is not so. This is because those countries that in general have higher tariffs would

have to reduce their tariffs by more, in terms of *percentage points*, even if all countries reduce their tariffs by the same *percentage*. In effect, the countries with higher tariffs would be undertaking a higher commitment. This may be so even if they are allowed a lower percentage reduction. Since developing countries have in general much higher tariffs than developed countries, the developing countries would be making far higher commitments than the developed countries.

Let us take an example to illustrate this point. Developed country A has an average industrial tariff of 4% while developing country B has an average tariff of 40%. If both are asked to reduce their tariffs by the same percentage of 50%, then the tariff of A would be reduced from 4 to 2%, while the tariff of B would drop from 40 to 20%. A's tariff falls by only 2 percentage points whilst B's tariff falls very significantly by 20 percentage points. The differences in the effects of this are vast.

In the example, let us say that B is exporting a product to A at the price of $100, and A is selling a product to B also at $100. The situation is thus as follows:

- Country A imports the product at $100 and used to sell it at $104; after the tariff reduction the price falls to $102. Although the tariff is reduced by 50%, it is reduced by only 2 percentage points, and the sale price falls only slightly by 1.9%, from $104 to $102. Country A loses only a small amount of customs revenue. Also, the increase in market access in A for the product of B will be very small, as the price has fallen by only 1.9%.

- Country B imports the product at $100 and used to sell it at $140; after the tariff reduction the price falls to $120. Due to the tariff reduction of 50%, the tariff is reduced by 20 percentage points, and the sale price falls significantly by 14.3% from $140 to $120. This would mean that market access to B for the product of A would increase significantly as a 14% fall in price can be expected to increase the demand for the imported product. The local producer would also face stiff competition from the import.

Even if the developing country is allowed a lower rate of reduction (33% instead of 50%, as in the India model), its reduction commitment would still be steeper

than the developed country's. In the example above, B would reduce its tariff from 40% to 26.8%, or by 13.2 percentage points. The sale price of its imported product would fall from $140 to $126.80, or by 9.4%.

The effects of the different tariff-cut scenarios illustrated above are shown in the following table.

	Average Tariff	**After Percentage Reduction of 50% (for Countries A and B) and 33% (for Country C)**	**Import Price of $100 Good After Initial Tariff**	**Import Price of $100 Good After New Tariff**	**Change in Price**	**Percentage Change in Price**
Developed Country A	4%	2%	$104	$102	$2	1.9%
Developing Country B	40%	20%	$140	$120	$20	14.3%
Developing Country C	40%	26.8%	$140	$126.80	$13.20	9.4%

Thus, even the linear-cut approach would leave developing countries at a disadvantage.

If the Swiss-type formula approach is used, in which tariffs at the higher end are cut by a larger percentage than tariffs at the lower end, the disadvantage to and serious effects on developing countries will be even more serious, as can be expected.

Taking our example again, developed country A with a current average tariff of 4% would have the tariff reduced under the different proposed formulae to about 1.7% (China formula), 2.2% (EU formula), 1.9% (India formula), 2.9% (Korea formula) or 1.4% (US formula). Meanwhile, developing country B with a current average tariff of 40% would have the tariff reduced to about 21.2% (China for-

mula), 12.9% (EU formula), 26.8% (India formula), 21.5% (Korea formula) or 6.7% (US formula). It should be noted that the effects on country B (in terms of tariff reduction in percentage points, customs revenue loss, and drop in import price) would be especially drastic under the US and EU formula approaches, compared to the India formula.

[The estimates in the above paragraph are based on Table 1 of document JOB(03)/67 dated 4 April 2003, i.e., the Secretariat's Note on Formula Approaches to Tariff Negotiations. The lines for the EU, with an actual average tariff of 3.9%, and for Fiji, with a tariff of 40.0%, were chosen to illustrate the situation of country A and country B respectively.]

The conclusion that can be drawn from this example is that the present proposed formula approaches would result in much larger tariff cuts by developing countries in terms of percentage points. This would be so even under a proposal that allows for lower percentage reductions for developing countries.

Under the formula approaches, developing countries would be at a disadvantage and would suffer losses in the following ways:

(a) Generally, most developing countries have higher tariffs than developed countries, and would thus have to make greater commitments in terms of tariff reductions in percentage points.

(b) In general, market access to developed countries would be increased only marginally for the products of developing countries, due to the generally existing low tariffs in developed countries. In contrast, market access to developing countries would be increased very significantly. There would thus be an imbalance in the increase in market access between developed and developing countries.

(c) Developing countries will suffer a significant decline in customs revenue. This will have serious adverse consequences for the fiscal situation in many developing countries which are heavily dependent on import duties for govern-

ment revenue. According to the IMF Yearbook of Statistics on government finance, for more than 50 developing countries, tariff revenue comprises over 20% of total government revenue. In comparison, tariff revenue makes up only 1% of government revenue in OECD countries.

(d) In developing countries, the very significant decline in tariffs in percentage points would lead to very significant price declines for imported products. These cheaper imports can be expected to compete effectively with local products, leading to loss of market share or closure of local industries and significant loss of jobs.

(e) Since there would be a much higher rate of opening up their markets to imports in developing countries, whilst the access to developed countries' markets would only increase slightly in comparison, it can be expected that developing countries' imports would increase more than their exports of industrial products. This would have an adverse effect on their trade balance.

Defining Reciprocity and "Less than Full Reciprocity"

In view of this, we need to carefully consider the appropriate meaning of "tak[ing] fully into account the special needs and interests of developing and least-developed country participants, including through less than full reciprocity in reduction commitments", as stated in Paragraph 16 of the Doha Declaration. It is important that this is operationalised. In particular, the meaning of "less than full reciprocity" should be properly defined and operationalised.

Some of the formula approaches do not seem to make accommodation for developing countries. In some cases, "less than full reciprocity" may only mean a longer time frame for developing countries to implement their commitments. Some proposals do provide lower percentage reduction rates for developing countries *vis-à-vis* developed countries (e.g., 33% instead of 50%). However, as explained earlier, these are all inadequate. The basic flaw in the formula approaches is that they use percentage reductions as the basis of their calculations. Even if developing countries are allowed a lower percentage reduction, the result is that most of

them have to make more drastic reductions in terms of percentage points than developed countries. These higher percentage-point reductions translate into higher loss of customs revenue as well as steeper rates of reductions in the prices of the imported products, which in turn means a higher increase in the demand for the products, a higher volume of imports, and a higher import bill – higher not only in absolute terms but also relative to the developed countries.

In fact, if we take the meaning of "less than full reciprocity" to be only a lower percentage reduction in tariff commitments, the result will be that developing countries will make relatively heavier commitments than developed countries, i.e., they will make "more than fully reciprocal" commitments. Therefore percentage reductions in tariffs should not be the basis for calculating the relative commitments of developing and developed countries.

A definition of "reciprocity" which is closer to our meaning can be found in the traditional product-by-product "request-offer" negotiating method that was a common practice in previous GATT rounds of industrial tariff negotiations. As described by the international trade expert Bhagirath Lal Das in his book, *An Introduction to the WTO Agreements* (1998, pp. 22-23): "In this type of negotiation (request-offer approach), generally two countries get together to negotiate. Country A has an interest in the export of product P to country B; and country B has an interest in the export of product Q to country A. A will then ask B to reduce its tariff on product P; similarly, B will ask A to reduce its tariff on product Q. In the final agreement between the two countries, an attempt will be made to achieve reciprocity as far as possible. Reciprocity is generally achieved by equalising the reduction of total customs duty on each side. The average value of the export of product P from A to B is multiplied by the percentage point of the reduction of tariff on this product by B. This is a measure of the concession which A gets from B."

Using the same example, with numerical figures, in another book, *The World Trade Organisation: A Guide to the Framework for International Trade* (1999, pp. 61-62), Das continues: "The loss of customs revenue to B is calculated by multiplying: (i) the average value of the export of product P from A to B

by (ii) the reduction of tariff. If the average value of the export is US$200,000 and the tariff is proposed to be reduced by 3%, the loss of revenue is US$200,000 x 0.03, i.e., US$6,000. This is a measure of the concession which A gets from B. The quantum of concession which B gets from A on the export of product Q will be calculated in a similar manner. An effort will be made to match the two. In this manner, A and B will agree to their mutual new tariffs on products P and Q. Then, these two new tariff levels will get included in their respective schedules [of commitments]….they will be applied to all Members of the WTO according to the MFN principle."

In this method of achieving reciprocity, the tariff reduction in percentage points rather than in percentages is used in the calculation. Reciprocity means an equalising of loss of customs revenue. It is proposed that this definition of reciprocity be explored as part of a more useful and appropriate method in the NAMA modalities. In this sense, "less than full reciprocity" means that developing countries should be expected to have less reduction in customs revenue as compared to developed countries.

As a central part of the modalities, developing countries should be allowed to apply the product-by-product request-offer method if they choose to do so, rather than abide by a standard formula approach.

Finally, in the context of "taking fully into account the special needs and interests of developing and least-developed country participants", the meaning of "less than full reciprocity in reduction commitments" should be taken to mean the following:

(a) Developing countries should not be obliged to make equal commitments as developed countries, and in fact should be entitled to make less reduction commitments.

(b) These lower commitments should also translate into higher benefits for developing countries, in comparison to the developed countries.

(c) As Paragraph 2 of the Doha Declaration states that "we shall continue to make positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development", the higher benefits to developing countries should also translate into an increased share in global exports of non-agricultural products.

(d) At the least, higher benefits to developing countries should mean that the modalities should result in a positive effect on the trade balance (exports minus imports) of these countries. The modalities would be inappropriate if they lead to a worsening of the trade balances of developing countries.

In other words, "taking fully into account the developing countries' special needs and interests" and their being enabled to enjoy "less than full reciprocity in commitments" must be operationalised in having the appropriate modalities. The test of the appropriateness of otherwise of the modalities is whether they lead to tangible benefits for developing countries. Therefore "less than full reciprocity in commitments" must be operationalised to become "more than reciprocal or more than average trade benefits for developing countries" in results and in practice.

One of the best estimates of benefits and costs is the effect that a proposed modality will have on a country's exports and imports. The modalities should lead to developing countries having a more positive trade balance.

The WTO Secretariat and other organisations, including UNCTAD, should carry out studies to determine the implications of each of the formula approaches and other approaches in terms of the effect on each member's exports and imports (volume and value). Until these studies are carried out and their implications explored fully, it would be difficult or impossible to assess whether a proposed formula or modality would meet the Doha mandate of less than fully reciprocal commitments, and of fully taking account of the needs of developing countries.

11 Potential Effects of Formula Approaches on Developing Countries

(a) Projected effects on tariffs

THE use of formulae will erode the flexibility which until now has been available to WTO members, especially developing countries.

There are two major types of formulae considered in the NAMA discussions: the linear formula, in which tariffs are cut by the same percentage, whatever the tariff level; and the non-linear formula, in which the higher the tariff level, the higher the percentage cut. There can be and are many variations of the non-linear formula.

In the NAMA discussions, there have been explanations of and proposals for:

- A simple linear formula, for example, all tariffs are cut by a certain percentage (for example, by 10 or 25 or 50%).

- The Indian linear formula, in which (a) developed countries cut their tariffs by 50% and (b) developing countries cut their tariffs by 33%. Also, members shall not impose a tariff on any product in excess of three times their average tariff (the average is calculated after the tariff reduction).

- The US non-linear formula. (1) In phase 1 of 2005-2010: (a) tariffs of 5% or below are reduced to zero; (b) tariffs above 5% are subject to a Swiss formula with a target of tariffs falling to a maximum of 8%; (c) for some sectors, tariffs are reduced to zero. (2) In phase 2 of 2010-2015, tariffs are brought to zero by a linear cut in five years.

- The EU proposal of a “compression mechanism”, to reduce all tariffs and their dispersion by compressing them into a range. For initial tariffs above a certain level (50%), the new reduced rates will have a cap at 15% (i.e., no tariffs can exceed 15%).

- The China version of the non-linear formula.

- The Japan and Korea formulae.

Calculations have been made using these formulae to show the effect of each on various tariff rates or profiles. For example, a developing country having a tariff of 60% for a product would have to reduce it to 45% under a linear formula (with a cut of 25%); 40.2% under the India linear formula; 20.4% under the China formula (using a certain coefficient); 23.5% under the Korea formula (using a certain coefficient); 15% under the EU formula and 7.1% under the US formula (“Formula approaches to tariff negotiations”, Note by the WTO Secretariat, WTO document TN/MA/S/3/Rev.2 dated 11 April 2003). (See Annexes A-C for the impact on different tariff rates of the various tariff-cut formulae.)

Using WTO secretariat data, India (in a paper to the WTO) has estimated the simple averages of final bound duties before and after the application of various formulae for certain countries. An extract of this is reproduced in the table on the next page (for a fuller list of countries, see Annex D).

It can be seen that the developed countries have lower initial average tariffs and the tariff reductions are negligible for them in terms of the impact on market opening or competition to their local industry. Developing countries have higher average tariffs, and the cuts are significant under all the formulae, but especially under the non-linear formulae of the US and EU. The choice of formula will affect the depth of the cuts.

Country	Initial simple average (%)	New averages by proposal (%)
Bangladesh	35.7	23 (India), 11.1 (EU), 5.8 (US)
Indonesia	35.6	23.8 (India), 11.8 (EU), 6.3 (US)
Malaysia	14.9	10 (India), 6.2 (EU), 3.2 (US)
Sri Lanka	19.3	12.9 (India), 7.4 (EU), 4 (US)
Thailand	24.2	16.2 (India), 9.1 (EU), 5.5 (US)
EU	3.9	1.9 (India), 2.2 (EU), 1.4 (US)
US	3.2	1.4 (India), 1.7 (EU), 1 (US)
Japan	2.3	1.1 (India), 1.3 (EU), 0.7 (US)
Kenya	54.8	36.7 (India), 13.9 (EU), 6.9 (US)

(b) Projected effects on tariff revenue

A major effect of proposed tariff cuts will be reductions in government revenue derived from import duties. Obviously, the deeper the tariff cuts, the greater the fall in revenue. Many developing countries depend to a significant extent on tariff revenue, so the non-linear formulae in particular will impact seriously on overall government revenue.

De Cordoba, Laird and Vanzetti (2004) of UNCTAD estimated the loss of import duty under four scenarios: (1) free trade (tariffs are cut to zero), (2) "WTO hard" (Swiss non-linear formula with higher cuts for developing countries), (3) "WTO soft" (Swiss non-linear formula with milder cuts), (4) "simple mix" (linear formula with a cap for tariff peaks).

The results for some developing countries and regions are as follows (see Annex E for the full list of projections):

(a) In South-East Asia (excluding Indonesia), tariff revenue of $13.3 billion is 28% of total government revenue of $47.9 billion. The estimates are that import duty revenue in the region will be cut by 85% under scenario 1; by 45% under scenario 2; and by 10% under scenarios 3 and 4. (Under scenario 1 of "free trade", revenues are not cut by 100% because tariffs outside the industrial sector will still remain.)

(b) In China, tariff revenue of $24.9 billion is 21% of government revenue of $118.8 billion. The tariff revenue will be cut by 82, 72, 54 and 51% for the respective scenarios.

(c) For India, with $11.9 billion tariff revenue, or 24% of government revenue of $50.3 billion, the loss of revenue will be 87, 58, 13 and 12%.

(d) For the rest of South Asia, tariff revenue of $3.9 billion is 37% of government revenue of $10.5 billion and the loss of revenue will be 84, 26, 5 and 7% respectively.

In contrast, tariff revenue is only 2% of government revenue in the EU and 5% in Japan, and thus a cut in tariff revenue will have an insignificant effect on overall government revenue.

The overall figures for the world as a whole are also important. The tariff revenue worldwide is $248 billion, and tariff reduction would reduce the total by as much as 76, 55, 35 and 27% under the four scenarios respectively.

(c) Projected effects on imports and exports

Simulations by UNCTAD staff [De Cordoba, Laird and Vanzetti (2004)] show that generally there will be significant increases in the value of imports due to liberalisation under the four scenarios mentioned in the previous section. For

developing countries, these increases in imports are generally larger than the increases in export earnings. The projections for some Asian countries are given below:

Under the four scenarios (scenarios 1, 2, 3, 4) mentioned above, China's imports are projected to increase by 12.1, 11.7, 9.1 and 6.8% respectively, whilst its exports would increase by 9.8, 10, 7.7 and 5.5%.

For India, imports would increase by 29.2, 20.9, 6.4 and 4.6% whilst exports would increase by 20.5, 14.9, 5.3 and 3.9%.

For other South Asian countries, imports would increase by 15.6, 7.4, 4.6 and 2.4%, whilst exports would increase by 12, 6.3, 4.5 and 2.7%.

For Indonesia, imports would increase by 5.6, 4.4, 2.8 and 1.1% whilst exports would rise by 5.2, 4.3, 2.8 and 1.3%.

For other South-East Asian countries, imports would increase 4.4, 2.7, 1.0 and 0.5%, whilst exports would rise by 3.3, 2.1, 0.9 and 0.5%.

(See Annexes F and G for the full list of projected changes in imports and exports respectively.)

As the projected imports grow faster than exports, there would be a negative effect on the balance of trade.

(d) Projected effects on output

The same UNCTAD paper also projected changes in output resulting from the four scenarios (see Annex H). The results are mixed according to sector. For most Asian countries or sub-regions, there would be output increases in textiles and wearing apparel. However, there would be serious losses of output in the motor vehicles sector, and some losses in the leather sector.

For example, under scenario 1 (“free trade”), India would increase its output in textiles (3%) and wearing apparel (15%) but suffer declines in motor vehicles (-6%), chemicals, rubber and plastics (-2%) and other transport (-1%).

For other South Asian countries, there would be gains in textiles (1%) and wearing apparel (23%) but losses in motor vehicles (-47%), other transport (-19%) and chemicals, rubber and plastics (-5%).

For China, there would be gains in textiles (2%), wearing apparel (7%) and leather (11%) but losses in motor vehicles (-18%) and chemicals, rubber and plastics (-3%).

For Indonesia and other South-East Asian countries, there would be gains in textiles, wearing apparel and leather, but losses in motor vehicles (-11% for Indonesia and -12% for other South-East Asian countries).

About the same sectoral pattern of gains and losses would apply under the “WTO hard” scenario 2 and the “WTO soft” scenario 3.

12 Suggested Approach to Modalities for NAMA

THE following are preliminary views on the modalities of the NAMA negotiations.

It should be recognised that: (1) the modalities form an extremely vital part of the negotiations as they are the set of guidelines that in fact influence the course of the rest of the negotiations; (2) extreme care must be taken to ensure that the modalities, being so important, must be derived from and fully reflect the objectives and the principles of the negotiations.

It has been argued above that the central **objective** of the negotiations is the promotion of the needs and interests of the developing countries (specifically, promotion of their industrial development), and that the **main principles** are that the modalities and outcome of the negotiations should be such as to:

- assist developing countries to gain a greater share of industrial output and exports through providing greater market opportunities (especially to developed countries' markets); and

- ensure that they have sufficient "policy space" or the range of policy options required for their industrial development.

In view of this, the following suggestions are made on various aspects of the modalities.

(a) Different capacities of and differential treatment of developed- and developing-country members

(i) *Recognition of differences in capacities and thus differential treatment.*

It should be recognised that developed and developing countries have different levels of economic development in general and industrial capacity in particular. This difference in development and industrial capacity should be fully taken account of in the modalities and negotiations. One way of taking this into account is to establish differential treatment for developed and developing countries. This is especially important as the objective of and principles in the negotiations are to promote and take account of the needs and interests of developing countries.

(ii) *Developed countries should increase their market access in ways that significantly benefit developing countries.*

The developed countries should clearly commit to increasing access to their markets for the industrial products of developing countries, and this commitment should be reflected as a major positive aspect in the modalities. The modalities should contain commitments by developed countries to greatly reduce or eliminate tariff peaks and tariff escalation in relation to products of export interest to developing countries. Given the high level of development, the high productivity and the very well-diversified range of industries and economic sectors that the developed countries possess, there should be little or no difficulty for them to increase their market access for developing countries' industrial products.

(iii) *Developing countries must be given the right and space to determine their own policies.*

In comparison, developing countries generally have a weaker and more vulnerable industrial sector, as their domestic firms do not have the technology, high productivity, management systems and marketing outreach of the larger enterprises of the developed countries. Almost all developing countries have to rely on

their domestic firms for industrial development. Foreign firms can play a valuable contributory role; however, much of the investment and production in most developing countries is made by local firms. Since these local firms are still at the development and learning stage, they require significant assistance and a long time frame in order to be more efficient and competitive *vis-à-vis* imported products. Governments also require customs duties as a major source of revenue. For these reasons, the modalities must recognise that developing countries are allowed the freedom and space to choose the overall rate of liberalisation, and the sectors or products for liberalisation at rates that are suitable for these sectors and products. In short, developing countries should not be expected (or be subjected to pressure) to reduce their tariffs beyond the rates they choose.

(iv) *Developing countries that have suffered adverse effects from previous liberalisation should be allowed to increase their tariffs beyond the bound levels without paying compensation.*

In many developing countries, previous reductions in tariffs have led to the widespread closure of firms and industries and the retrenchment of workers. The capital, management or labour resources that were dislocated could not be relocated to alternative or more efficient sectors, at least not in full. The modalities should take into account these difficulties faced by developing-country members from previous tariff reductions, and allow these affected countries to increase their tariffs beyond the bound levels in respect of specific products/product areas for a specified period, in line with the provisions of Article XVIIIA and XVIIIC of GATT 1994. These affected developing countries should not be called upon to give any compensation for these measures.

(b) Special problems potentially faced by developing countries from reduced preferential trading margins

The modalities should recognise that reduction of high tariffs and tariff peaks by developed countries can adversely affect the preferential margins of developing countries that have preferences under the Generalised System of Preferences (GSP) or that are parties to regional trading arrangements with a developed country or

developed trading entity. The modalities should include a procedure for establishing measures and mechanisms to deal with this issue, with the aim of avoiding or offsetting this problem or compensating the relevant parties.

(c) Choice of techniques for tariff negotiation

(i) *Introduction*

There are various methods of negotiation, the main ones (previously and also being suggested for the current negotiations) being: (a) request-offer on a product-by-product basis; (b) the tariff-independent formula approach, often called the linear-cut approach (where all tariffs are covered for reduction by a standard or similar rate); (c) the tariff-dependent formula approach, often called harmonisation approach (where there are higher rates of reduction for tariffs at higher levels); and (d) the "zero-for-zero" approach (in which participating parties agree to eliminate tariffs for a particular product).

(ii) *Developing countries*

In all the previous rounds of tariff reduction, developing countries have participated in negotiations on a request-offer basis. This method has allowed developing countries to be more flexible in being able to choose the sectors or products in which they are more comfortable liberalising, and also the rate of tariff reduction, and thus also to decide on the sectors and products in which the bound tariffs are to be maintained. If they are subjected to the other approaches, developing countries would be under pressure to reduce their tariffs across the board (or generally, with perhaps a few exceptions) and at a standard rate. Since developing countries presently have higher industrial tariffs than developed countries, the other approaches would result in the developing countries having to make larger tariff reductions. The harmonisation approach would cause pressure to be put especially on those products or sectors in which the developing countries have high tariffs and which they have chosen to protect, perhaps as part of industrial policy to develop specific industries. The zero-for-zero approach would be even more disadvantageous to developing countries as they generally have higher tariffs than

the developed countries and thus the latter can be expected to make much smaller tariff reductions. Finally, the formula approaches would also lead to greater loss of tax revenues as tariffs could be cut across the board, and with even more rounds of reduction in future on the same basis, import duties would no longer be relied on to raise revenue for the government, and this would have serious fiscal consequences for many developing countries. Loss of revenue would of course be even more serious in the zero-for-zero approach.

Therefore, the modalities should allow developing countries to make use of the request-offer approach on a product-by-product basis, as they have done in all previous rounds. They should not be subjected to pressure to make use of the other methods if they do not choose to.

Developing countries should be given the flexibility to determine their own rate of tariff reduction. This could be similar to the Uruguay Round approach, in which developing countries were given an average overall reduction target of 27%, with the flexibility to choose the rates of each tariff line. Moreover, products and industries that are sensitive or important need not be subjected to any tariff reduction.

Developing countries that consider themselves to have a relatively weak or vulnerable industrial sector should not be subjected to pressures to commit to a general reduction rate in the modalities, nor to pressures during the negotiations.

This proposal would establish a modality on tariff negotiation techniques that reflects the principle of "less than full reciprocity". As explained earlier, this principle means that developing-country members should be fully enabled to exercise their rights to make decisions on their commitments which they consider to be consistent with their development, financial and trade needs, and that they cannot be expected to make commitments inconsistent with their needs, their particular situation and problems. The modalities and negotiations should ensure that developing countries retain or enlarge the "policy space" or the range of policy options that they require in order to improve and expand their domestic industrial development.

(iii) *Developed countries*

The developed countries should be committed to assisting the developing countries. Since many of their products that are covered by high tariffs and tariff peaks are products of export interest to developing countries, the developed countries could make use of the harmonisation formula approach which is aimed primarily at reducing the tariff peaks and high tariffs. However, in the past when the linear formula or the harmonisation approaches were used, the developed countries made exceptions, and many of the exceptions were for products of export interest to developing countries. In the present exercise, the developed countries should not exclude developing countries' products from the formula approaches that may be used; this should be included in the modalities. Even if the product-by-product approach is used by a developed country, the modalities should spell out that tariffs on products of export interest to developing countries should especially be reduced at a higher rate.

(d) Credit to developing countries for autonomous liberalisation

Many developing countries have significantly reduced their tariffs unilaterally outside the WTO framework, either as part of their own strategy or as part of structural adjustment policies under loan conditionalities. These lower tariff rates have benefited the trade of other countries. Credit should be given to those developing countries that have liberalised unilaterally. The modalities should recognise this principle of credit for autonomous liberalisation and establish methods for giving the credit.

(e) The scope of tariff bindings and the choice of rates to use and the relation between bound and applied rates

The negotiations should take place on the basis of the bound rates of tariffs.

Generally the developing countries have a higher difference between their bound and applied tariff rates. This "buffer" between bound and applied rates has a useful function for developing countries, as they can first reduce the applied rates

and note the effects and consequences. If problems occur, they will still have the flexibility to enhance the applied tariff up to the bound rate. If, after an adequate period, there are no problems, then the country may decide to reduce the bound rate.

In the GATT/WTO trading system previously and up to now, developing countries have had the flexibility to choose which tariffs and how many to bind. Moreover, when binding is undertaken, the rate at which to bind the tariff was chosen by the country concerned. This flexibility has been an important instrument for the planning of industrial development, and it should be retained.

However, the July Package has proposed to remove or severely erode these flexibilities by making it mandatory for developing countries (except LDCs) to bind all their tariffs (except 5% of tariff lines provided they do not exceed 5% of total import value). Moreover the presently unbound tariffs would be bound at (twice) the applied rates, and then subjected to the formula tariff cut. The removal of such flexibilities would be a major loss and blow to the developing countries.

The modalities should recognise the importance in serving developing countries' needs and interests of maintaining differences between bound and applied rates, and of not binding some product lines. Developing countries should continue to have the flexibility to choose to increase the number of bound tariff lines according to their own circumstances, needs and timing. In doing so, they should choose the rates at which to bind their products.

Furthermore, in the calculation of tariff-reduction commitments, the presently bound rates should be used and not the applied rates.

(f) Staging of tariff reductions

Developing countries should be given a significantly longer time frame to implement the commitments made, as compared to developed countries. However, this longer implementation period should not be taken to be the main or even a major S&D concession.

(g) Studies and capacity-building

Several developing countries (Kenya, Mozambique, Nigeria, Tanzania, Uganda and Zimbabwe) in document WT/GC/W/453 dated 2 November 2001 had stated their concerns that previous and present import liberalisation of industrial products has had serious and adverse effects on domestic industries, jobs and government revenue in many countries in Africa and other regions. They had therefore expressed serious reservations about starting negotiations in this area and called for a study process to be completed first before negotiations.

Paragraph 16 of the Doha Declaration does make a reference to including appropriate studies and capacity-building measures to assist LDCs to participate effectively in the negotiations. It is proposed that the studies should take into account other developing countries besides LDCs, as many non-LDC developing countries share the same industrial-sector characteristics and the same problems as LDCs, as can be seen in the examples provided above.

It is also proposed that the preparation and consideration of studies be the first order of business.

Regarding the studies that are mandated by Paragraph 16, the following proposal contained in the communication of Kenya *et al* (in WT/GC/W/453, p. 3) should be adopted as part of the modalities:

"The study process shall take into account the special needs and interests of developing and least-developed country Members, including: (1) the effects that previous import liberalisation and tariff reductions have had, including on domestic firms, employment and government revenue; (2) the effects that tariff peaks and tariff escalation in developed countries have had on the trade prospects of developing countries; and (3) the implications of these for future policies. The study process shall focus on the reduction or elimination of tariff peaks and escalation in developed countries in sectors and products of export interest to developing countries. It should also clarify that exemptions from further liberalisation commitments shall be given to least developed countries and to developing countries that have

been and would be adversely affected by such liberalisation. It should also clarify the appropriate framework, guidelines and rules that can cater to the different conditions and needs of Members, including non-reciprocity for developing countries, and the ability of developing countries to increase their tariff beyond bound rates in certain cases. The study process, based on an examination of these elements, may make recommendations for guidelines and modalities for any future negotiations."

The studies should be conducted and discussed along the above lines as the first item of discussion in the NAMA negotiating group, and the appropriate conclusions should be drawn from the discussions on the studies. This sequencing of the agenda should be part of the modalities.

13 Conclusion

THE NAMA negotiations are at an important phase as the discussion is on the modalities, which will influence the course of the whole negotiations.

The July Package annex on NAMA has many elements that are not conducive to attaining the objectives or to operationalising the principles of special and differential treatment and "less than full reciprocity." It should be re-examined and a fresh start made, based on development principles as has been mandated in the Doha Declaration.

The modalities must take into account the needs and interests of developing countries: to have greater access to developed countries' markets, and to be able to set their own appropriate levels of import tariffs.

Appropriateness must first and foremost take into account the level of strength or weakness of local industries that can be affected by too rapid or too steep a rate of import liberalisation. Thus the modalities must not be in the nature of a one-size-fits-all approach or formula. The modalities must recognise that there are different categories of members with different levels of industrial capacity.

There must therefore be a differential approach to fully take into account these differences. The level and rate of liberalisation or protection that is appropriate for one group of countries may be inappropriate or even totally inappropriate for another group of countries.

Developing countries, especially those with a weak industrial base, should be allowed to choose levels of liberalisation and protection that enable their weak industrial sectors to remain viable and to develop in future with greater efficiency, with the assistance of complementary measures mentioned above.

It is absolutely essential that the modalities and the negotiations that follow recognise the need and right of the developing-country members to have the flexibility and option to choose the rates of import duties that are required for the survival and development of their domestic industries.

In summary, it is proposed that the modalities should be based on two principles:

(1) Developed countries should provide improved market access to developing countries by eliminating or at least significantly reducing their tariff peaks, high tariffs and tariff escalation. They should adopt a harmonisation formula which should be designed to eliminate tariff peaks, high tariffs and tariff escalation on products of export interest to developing countries. No tariff line should be at a level more than three times the average industrial tariff of the country. They should also remove or significantly reduce their non-tariff barriers.

(2) Taking into account the adverse effects that many developing countries have suffered due to liberalisation measures taken earlier, developing countries should be left to determine for themselves any further liberalisation measures, including tariff-reduction commitments. Developing countries should be provided the flexibility to negotiate on a line-by-line basis through a request-offer technique. The reduction rates are to be chosen or negotiated in line with each developing country's level of development and national policy. Those developing countries that wish to, can make use of a formula of their choice. This flexibility in choosing techniques and formula was made use of by developed countries during the Uruguay Round and some previous rounds.

To further elaborate on point (2):

(a) Developing countries should be given the flexibility to determine their own rate of tariff reduction. This could be similar to the Uruguay Round approach, in which developing countries were given an average overall reduction target of 27%, with the flexibility to choose the rates of each tariff line. Moreover, products and industries that are sensitive or important need not be subjected to any tariff reduction.

(b) Developing countries also had the option in the Uruguay Round of choosing the scope of tariff binding. This flexibility should also be retained, as was the case in all previous rounds.

(c) In any tariff-reduction approach, the bound rates should form the basis. Applied rates should not be used in any calculation or formula.

(d) The sectoral approach should not be applied to developing countries.

(e) LDCs should be exempted from further tariff-reduction obligations.

(f) There are, however, many developing countries that are not LDCs but have characteristics similar to LDCs in relation to the weak and vulnerable state of their domestic industries. Thus flexibility should be given to developing countries in general, and not only to LDCs. Those developing countries that believe they are able to liberalise more can do so.

(g) Newly acceded members of the WTO shall have recourse to lower levels of commitment in tariff reduction, to take account of the commitments undertaken in their accession process.

(h) A mechanism should be established to deal with the erosion of preferences, aimed at either avoiding or offsetting the problem or compensating the affected members.

This two-pronged approach to modalities is justified because of the differences in industrial capacity between developed and developing countries. This is recognised by the Doha Declaration when it calls for reduction and elimination of tariff peaks etc. in products of export interest to developing countries. There can thus be a significant reduction in the tariffs across the board for developed countries (using a linear or Swiss-type formula), with the additional commitment that after tariff reduction, no presently bound tariff line shall exceed three times the average of the reduced bound tariffs of the developed-country member.

In relation to the developing countries, a different approach should be taken. They should be allowed to choose for themselves the rate and timing of liberalisation, so that they can tailor their commitments to the situation and needs in their industrial sector and sub-sectors. Developing countries should not be subjected to a formula approach, either of the Swiss type or the linear-cut model. Their commitments can be made through the request-offer approach. This was the approach and process that developing countries used in the previous rounds of negotiations. They have not been mandatorily subjected to a formula approach before, and this should not be applied to them in the present negotiations, especially since the Doha Declaration has stated that the interests and needs of developing countries should be at the heart of the Doha work programme. Of course developing countries that themselves choose to make use of a formula approach can do so, but those that prefer the request-offer approach should be allowed to opt for it.

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Annex A: Impact of a linear formula cut on a hypothetical tariff profile for various coefficients

Tariff line	Initial tariff rate	Final tariff rate after reduction			Reduction in percent		
		c=.90	c=.75	c=.5	c=.90	c=.75	c=.5
Line 1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Line 2	2.5	2.3	1.9	1.3	10.0	25.0	50.0
Line 3	5.0	4.5	3.8	2.5	10.0	25.0	50.0
Line 4	7.5	6.8	5.6	3.8	10.0	25.0	50.0
Line 5	10.0	9.0	7.5	5.0	10.0	25.0	50.0
Line 6	12.5	11.3	9.4	6.3	10.0	25.0	50.0
Line 7	15.0	13.5	11.3	7.5	10.0	25.0	50.0
Line 8	17.5	15.8	13.1	8.8	10.0	25.0	50.0
Line 9	20.0	18.0	15.0	10.0	10.0	25.0	50.0
Line 10	22.5	20.3	16.9	11.3	10.0	25.0	50.0
Line 11	25.0	22.5	18.8	12.5	10.0	25.0	50.0
Line 12	27.5	24.8	20.6	13.8	10.0	25.0	50.0
Line 13	30.0	27.0	22.5	15.0	10.0	25.0	50.0
Line 14	32.5	29.3	24.4	16.3	10.0	25.0	50.0
Line 15	35.0	31.5	26.3	17.5	10.0	25.0	50.0
Line 16	37.5	33.8	28.1	18.8	10.0	25.0	50.0
Line 17	40.0	36.0	30.0	20.0	10.0	25.0	50.0
Line 18	42.5	38.3	31.9	21.3	10.0	25.0	50.0
Line 19	45.0	40.5	33.8	22.5	10.0	25.0	50.0
Line 20	47.5	42.8	35.6	23.8	10.0	25.0	50.0
Line 21	50.0	45.0	37.5	25.0	10.0	25.0	50.0
Line 22	52.5	47.3	39.4	26.3	10.0	25.0	50.0
Line 23	55.0	49.5	41.3	27.5	10.0	25.0	50.0
Line 24	57.5	51.8	43.1	28.8	10.0	25.0	50.0
Line 25	60.0	54.0	45.0	30.0	10.0	25.0	50.0
Average	30.0	27,0	22,5	15,0	9,6	24,0	48,0
Maximum	60.0	4,6	12,0				
Std. Dev[1]	18.4	16,6	13,8				
Coeff. Var.[2]	61.3	61,3	61,3				
Escalation[3] (line13/line5)	3.0	3,00	3,00				

Note: Linear tariff-cut formula: $t_1 = c \times t_o$, where t_1 = final tariff rate
c = constant coefficient
t_o = initial tariff rate

[1] Standard deviation, a measure of absolute dispersion of the tariff profile.
[2] Coefficient of variation, a measure of relative dispersion. Defined as the standard deviation divided by the tariff average, and presented in percent.
[3] Tariff escalation, measured here as an arbitrary ratio of two tariff lines in the lower and upper spectrum of the tariff profile, in this case lines 5 and 13.

Source: WTO (2003).

Annex B: Impact of Swiss formula on a hypothetical tariff profile for various coefficients

Tariff line	Initial tariff rate	Final tariff rate after reduction			Reduction in percent		
		a=5	a=15	a=50	a=5	a=15	a=50
Line 1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Line 2	2.5	1.7	2.1	2.4	33.3	14.3	4.8
Line 3	5.0	2.5	3.8	4.6	50.0	25.0	9.1
Line 4	7.5	3.0	5.0	6.5	60.0	33.3	13.0
Line 5	10.0	3.3	6.0	8.3	66.7	40.0	16.7
Line 6	12.5	3.6	6.8	10.0	71.4	45.5	20.0
Line 7	15.0	3.8	7.5	11.5	75.0	50.0	23.1
Line 8	17.5	3.9	8.1	13.0	77.8	53.9	25.9
Line 9	20.0	4.0	8.6	14.3	80.0	57.1	28.6
Line 10	22.5	4.1	9.0	15.5	81.8	60.0	31.0
Line 11	25.0	4.2	9.4	16.7	83.3	62.5	33.3
Line 12	27.5	4.2	9.7	17.7	84.6	64.7	35.5
Line 13	30.0	4.3	10.0	18.8	85.7	66.7	37.5
Line 14	32.5	4.3	10.3	19.7	86.7	68.4	39.4
Line 15	35.0	4.4	10.5	20.6	87.5	70.0	41.2
Line 16	37.5	4.4	10.7	21.4	88.2	71.4	42.9
Line 17	40.0	4.4	10.9	22.2	88.9	72.7	44.4
Line 18	42.5	4.5	11.1	23.0	89.5	73.9	46.0
Line 19	45.0	4.5	11.3	23.7	90.0	75.0	47.4
Line 20	47.5	4.5	11.4	24.4	90.5	76.0	48.7
Line 21	50.0	4.6	11.5	25.0	90.9	76.9	50.0
Line 22	52.5	4.6	11.7	25.6	91.3	77.8	51.2
Line 23	55.0	4.6	11.8	26.2	91.7	78.6	52.4
Line 24	57.5	4.6	11.9	26.7	92.0	79.3	53.5
Line 25	60.0	4.6	12.0	27.3	92.3	80.0	54.6
Average	30.0	3,9	8,8	17,00	77,2	58,9	34,0
Maximum	60.0	4,6	12,0	27,3			
Std. Dev[1]	18.4	1,1	3,3	8,1			
Coeff. Var.[2]	61.3	28,1	36,8	47,7			
Escalation[3] (line13/line5)	3.0	1,3	1,7	2,3			

Note: Swiss tariff-cut formula: $t_1 = (a \times t_o)/(a + t_o)$, where t_1 = final tariff rate
a = coefficient
t_o = initial tariff rate

[1] Standard deviation, a measure of absolute dispersion of the tariff profile.
[2] Coefficient of variation, a measure of relative dispersion. Defined as the standard deviation divided by the tariff average, and presented in percent.
[3] Tariff escalation, measured here as an arbitrary ratio of two tariff lines in the lower and upper spectrum of the tariff profile, in this case lines 5 and 13.

Source: WTO (2003).

Annex C: Impact of various line by line formula proposals on a hypothetical tariff profile

Tariff line	Initial tariff rate	China[1] t_a=30, B=1	China[1] t_a=30, B=3	European Communities	India[2] 50%	India[3] 33%	Korea t_a=30	USA
Line 1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Line 2	2.5	2.3	2.3	1.8	1.3	1.7	2.0	0.0
Line 3	5.0	4.3	4.4	3.0	2.5	3.4	4.0	0.0
Line 4	7.5	6.0	6.1	4.1	3.8	5.0	6.0	3.9
Line 5	10.0	7.6	7.7	5.2	5.0	6.7	8.0	4.4
Line 6	12.5	8.9	9.2	6.4	6.3	8.4	10.0	4.9
Line 7	15.0	10.1	10.4	7.5	7.5	10.1	12.0	5.2
Line 8	17.5	11.2	11.6	8.0	8.8	11.7	14.0	5.5
Line 9	20.0	12.2	12.7	8.6	10.0	13.4	16.0	5.7
Line 10	22.5	13.0	13.7	9.1	11.3	15.1	18.0	5.9
Line 11	25.0	13.8	14.6	9.6	12.5	16.8	20.0	6.1
Line 12	27.5	14.6	15.4	10.2	13.8	18.4	20.3	6.2
Line 13	30.0	15.2	16.2	10.7	15.0	20.1	20.5	6.3
Line 14	32.5	15.9	17.0	11.2	16.3	21.8	20.8	6.4
Line 15	35.0	16.4	17.7	11.8	17.5	23.5	21.0	6.5
Line 16	37.5	17.0	18.3	12.3	18.8	25.1	21.3	6.6
Line 17	40.0	17.5	18.9	12.9	20.0	26.8	21.5	6.7
Line 18	42.5	17.9	19.5	13.4	21.3	28.5	21.8	6.7
Line 19	45.0	18.3	20.1	13.9	22.5	30.2	22.0	6.8
Line 20	47.5	18.8	20.6	14.5	23.8	31.8	22.3	6.8
Line 21	50.0	19.1	21.1	15.0	25.0	33.5	22.5	6.9
Line 22	52.5	19.5	21.6	15.0	26.3	35.2	22.8	6.9
Line 23	55.0	19.8	22.1	15.0	27.5	36.9	23.0	7.0
Line 24	57.5	20.1	22.5	15.0	28.8	38.5	23.3	7.0
Line 25	60.0	20.4	23.0	15.0	30.0	40.2	23.5	7.1
Average	30.0	13.6	14.7	10.0	15.0	20.1	16.7	5.4
Maximum	60.0	20.4	23.0	15	30	40.2	23.5	7.1
Std. Dev[4]	18.4	5.9	6.7	4.5	9.2	12.3	7.4	2.2
Coeff. Var.[5]	61.3	43.5	45.5	45.4	61.2	61.3	44.6	40.7
Escalation[6] (line13/line5)	3.0	2.0	2.1	2.1	3.0	3.0	2.6	1.4

[1] t_a and B are parameters in the Chinese formula. t_a = initial tariff average = 30 in this tariff profile; B = an adjusting coefficient for the year of implementation (B=1 for 2015 or B=3 for 2010).

[2] Applicable to developed countries.

[3] Applicable to developing countries.

[4] Standard deviation, a measure of absolute dispersion of the tariff profile.

[5] Coefficient of variation, a measure of relative dispersion. Defined as the standard deviation divided by the tariff average, and presented in percent.

[6] Tariff escalation, measured here as an arbitrary ratio of two tariff lines in the lower and upper spectrum of the tariff profile, in this case lines 5 and 13.

Source: WTO (2003).

Annex D: Simple averages of final bound duties before and after application of various proposed tariff-reduction formulae

Name	Binding coverage (percent)	Non ad valorem duties (percent)	Simple average	New averages by proposal					
				China B = 1	China B = 3	European Communities	India	Korea	USA
Argentina	100.0	0.0	31.8	15.6	16.7	11.1	21.3	19.9	6.3
Australia	96.5	0.1	11.0	4.5	5.5	4.8	5.1	7.6	3.1
Bangladesh	3.0	0.0	35.7	16.1	17.2	11.1	23.0	18.6	5.8
Barbados	97.6	0.0	73.0	36.8	37.8	15.0	48.8	24.8	7.2
Botswana	96.0	0.0	16.1	7.5	8.5	6.7	10.8	11.5	4.3
Brazil	100.0	0.0	30.8	15.1	16.2	10.8	20.6	19.6	6.2
Canada	99.7	0.4	5.3	2.1	3.1	2.8	2.6	3.7	2.3
European Communities	100.0	0.7	3.9	1.7	2.6	2.2	1.9	2.9	1.4
Guinea	29.6	0.0	10.0	4.7	5.7	4.9	6.7	7.7	2.7
Indonesia	96.1	0.0	35.6	17.6	18.6	11.8	23.8	20.2	6.3
Jamaica	100.0	0.0	42.5	20.6	21.6	13.1	28.5	19.7	6.2
Japan	99.6	3.6	2.3	0.9	1.5	1.3	1.1	1.5	0.7
Kenya	1.6	0.0	54.8	26.8	27.8	13.9	36.7	22.6	6.9
Malaysia	81.2	0.2	14.9	7.0	7.9	6.2	10.0	11.1	3.2
Nigeria	6.9	0.0	48.8	24.3	25.3	13.9	32.7	22.4	6.8
Norway	100.0	2.6	3.1	1.1	2.0	1.8	1.4	2.0	1.0
Sri Lanka	28.3	1.1	19.3	8.4	9.5	7.4	12.9	11.6	4.0
Thailand	70.9	21.1	24.2	11.5	12.6	9.1	16.2	17.0	5.5
United States	100.0	5.0	3.2	1.1	2.0	1.7	1.4	2.0	1.0
Venezuela	100.0	0.0	33.1	16.7	17.7	11.4	22.2	20.5	6.4
Zambia	4.1	0.0	42.7	21.3	22.3	13.1	28.6	21.8	6.7

Source: Secretariat calculations based on CTS data

Extract from paper by India on NAMA to the WTO in 2003 (Paper TN/MA/W/10/Add.3)

Annex E: Projected effects of tariff cuts on tariff revenues

	Initial government revenues	Initial tariff revenues	Ratio of tariff to total revenue	Change in tariff revenue under different tariff-cut scenarios			
				Free trade[1]	Hard[2]	Soft[3]	Simple[4]
	$m	$m		%	%	%	%
Andean Pact	32738	5024	0.15	-86	-41	-7	-6
Central America & Caribbean	48424	15367	0.32	-86	-42	-5	-4
Canada	125694	4332	0.03	-57	-50	-47	-30
Central and Eastern Europe	63922	15004	0.23	-76	-64	-51	-49
China	118821	24872	0.21	-82	-72	-54	-51
European Union 15	1479046	27858	0.02	-57	-50	-47	-29
Indonesia	14619	2666	0.18	-80	-31	-7	-8
India	50341	11936	0.24	-87	-58	-13	-12
Japan	407959	21679	0.05	-61	-59	-59	-50
Middle East	142323	12341	0.09	-80	-54	-30	-29
Mercosur	174578	16576	0.09	-83	-51	-16	-15
North Africa	27693	10020	0.36	-84	-55	-15	-11
Oceania	79515	3031	0.04	-92	-56	-43	-8
Other West Europe	67423	5550	0.08	-41	-40	-40	-38
Rest of Asia	87896	12978	0.15	-78	-60	-30	-26
Rest of World	110574	11923	0.11	-66	-34	-17	-16
South Asia	10532	3887	0.37	-84	-26	-5	-7
South East Asia	47877	13271	0.28	-85	-45	-10	-10
Sub-Saharan Africa	24943	6733	0.27	-85	-33	-7	-7
United States	1201779	20866	0.02	-83	-74	-70	-40
South Africa	28979	2128	0.07	-84	-59	-18	-10
Total	**4345675**	**248043**	**0.06**	**-76**	**-55**	**-35**	**-27**

Source: GTAP database and simulations

[1] Tariffs are cut to zero (revenues are maintained from tariffs outside the non-agricultural sector).
[2] Swiss non-linear formula with higher cuts for developing countries.
[3] Swiss non-linear formula with milder cuts.
[4] Linear formula with a cap for tariff peaks.

Source: De Cordoba, Laird and Vanzetti (2004)

Annex F: Change in imports under different tariff-cut scenarios

	Free trade[1] %	Hard[2] %	Soft[3] %	Simple[4] %
Andean Pact	5.0	2.8	0.8	0.5
Central America & Caribbean	11.1	6.0	0.7	0.8
Canada	0.1	0.5	0.8	0.4
Central and Eastern Europe	8.5	6.9	5.2	5.4
China	12.1	11.7	9.1	6.8
European Union 15	0.6	0.5	0.4	0.4
Indonesia	5.6	4.4	2.8	1.1
India	29.2	20.9	6.4	4.6
Japan	6.5	6.6	5.6	4.1
Middle East	5.5	3.5	1.6	1.8
Mercosur	14.4	9.1	3.4	2.8
North Africa	18.2	13.2	2.7	2.4
Oceania	4.7	3.4	2.9	1.2
Other West Europe	2.1	2.3	2.2	2.0
Rest of Asia	10.6	9.0	5.7	4.4
Rest of World	8.1	5.5	4.0	3.4
South Asia	15.6	7.4	4.6	2.4
South East Asia	4.4	2.7	1.0	0.5
Sub-Saharan Africa	7.6	3.1	0.1	0.3
United States	2.5	2.4	2.0	1.2
South Africa	9.9	6.8	2.6	1.0
Total	4.4	3.5	2.2	1.7

Source: GTAP simulations

1 Tariffs are cut to zero.
2 Swiss non-linear formula with higher cuts for developing countries.
3 Swiss non-linear formula with milder cuts.
4 Linear formula with a cap for tariff peaks.

Source: De Cordoba, Laird and Vanzetti (2004)

Annex G: Change in export revenue under different tariff-cut scenarios

	Free trade[1] %	Hard[2] %	Soft[3] %	Simple[4] %
Andean Pact	4.1	2.7	1.3	1.1
Central America & Caribbean	8.3	5.0	1.0	1.0
Canada	0.8	0.9	0.9	0.6
Central & Eastern Europe	5.6	4.5	3.2	3.4
China	9.8	10.0	7.7	5.5
European Union 15	1.6	1.1	0.7	0.7
Indonesia	5.2	4.3	2.8	1.3
India	20.5	14.9	5.3	3.9
Japan	6.5	5.4	3.6	2.4
Middle East	2.9	2.2	0.9	1.0
Mercosur	15.0	9.6	4.4	3.7
North America	10.0	8.3	2.1	2.0
Oceania	4.7	3.6	2.9	1.5
Other West Europe	1.8	1.8	1.5	1.4
Rest of Asia	8.9	7.5	4.9	3.7
Rest of World	6.4	5.3	3.7	3.1
South Asia	12.0	6.3	4.5	2.7
South East Asia	3.3	2.1	0.9	0.5
Sub-Saharan Africa	4.8	2.5	0.8	0.9
United States	5.6	4.5	3.5	2.4
South Africa	5.7	4.3	2.1	1.2
Total	4.4	3.5	2.2	1.7

Source: GTAP simulations

1 Tariffs are cut to zero.
2 Swiss non-linear formula with higher cuts for developing countries.
3 Swiss non-linear formula with milder cuts.
4 Linear formula with a cap for tariff peaks.

Source: De Cordoba, Laird and Vanzetti (2004)

Annex H: Change in output unde

	USA	Canada	Central America	Andean Pact	Mercosur	European Union	Other West Europe	Central and Eastern Europe	Mi Ea
Free trade[1]									
Textiles	-1	-4	3	-1	-1	-1	-2	-4	
Wearing apparel	-2	-6	0	4	-1	-3	-2	-3	
Leather	-1	-5	-3	-4	1	1	0	0	
Chemicals, rubber and plastics	0	0	-2	-2	-1	0	0	-2	
Motor vehicles	0	0	7	-23	1	0	0	2	
Transport other than motor vehicles	-1	0	6	0	0	-2	-4	-1	
Hard[2]									
Textiles	-3	-10	3	-3	-2	-2	-5	-7	
Wearing apparel	-6	-19	1	2	-2	-8	-10	-8	
Leather	-7	-22	-6	-7	0	-1	-6	-1	
Chemicals, rubber and plastics	0	-1	0	0	0	0	0	-2	
Motor vehicles	0	0	2	-21	-1	0	0	5	
Transport other than motor vehicles	-1	1	4	0	0	-2	-6	1	
Soft[3]									
Textiles	-4	-10	9	2	0	-3	-3	-6	
Wearing apparel	-8	-18	9	4	0	-7	-6	-6	
Leather	-9	-22	1	-1	0	-2	-3	2	
Chemicals, rubber and plastics	0	-1	0	0	0	0	0	-2	
Motor vehicles	1	1	-4	-9	0	0	0	2	
Transport other than motor vehicles	1	2	-1	-1	-2	0	-3	1	
Simple[4]									
Textiles	-2	-5	8	0	0	-1	-1	-4	
Wearing apparel	-4	-8	11	1	0	-3	-3	0	
Leather	-5	-10	3	-1	-1	1	0	3	
Chemicals, rubber and plastics	0	-1	0	0	0	0	1	-2	
Motor vehicles	0	0	-4	-5	0	1	0	2	
Transport other than motor vehicles	0	2	-2	-1	-1	0	-2	0	

[1] Tariffs are cut to zero. [2] Swiss non-linear formula with higher cuts for developing countries. [3] Swiss no

Source: De Cordoba, Laird and Vanzetti (2004)

r different tariff-cut scenarios (%)

iddle ast	North Africa	Sub Saharan Africa	South Africa	China	Japan	India	Other South Asia	Indonesia	Other South East Asia	Rest of Asia	Oceania	All other regions	World
-4	-6	-7	-1	2	3	3	1	5	3	6	-3	1	0.36
-3	2	-6	11	7	-2	15	23	12	15	2	-7	3	0.58
-13	-5	-14	-7	11	-13	10	2	21	14	5	2	-3	1.86
0	-4	-5	-1	-3	4	-2	-5	0	0	0	-1	-1	0.13
-4	-25	21	-10	-18	5	-6	-47	-11	-12	3	-5	-11	0.05
0	1	20	1	2	6	-1	-19	4	1	2	0	-1	0.30
-5	-6	-8	-2	4	4	4	3	6	7	13	-8	3	0.61
-5	7	-9	30	18	-5	23	15	19	25	6	-15	10	-0.12
-19	-11	-22	-24	17	-32	10	-8	49	18	16	3	-8	1.50
0	-1	-1	-1	-4	5	-1	-2	-1	-1	0	0	0	0.12
-4	-32	12	-16	-24	7	-7	-55	-8	-9	2	-5	-14	0.07
2	11	33	4	1	7	0	-10	-1	-2	1	-2	0	0.09
-4	-4	-2	0	4	2	3	3	6	9	9	-8	5	0.62
-7	-4	-1	17	16	-6	16	14	16	18	10	-16	14	-0.34
-9	-2	-8	-14	14	-31	4	-11	45	11	12	-3	0	1.66
0	0	0	-1	-3	4	-1	-1	-1	0	0	-1	0	0.09
0	-15	1	-4	-20	5	0	-15	-1	-1	1	-3	-12	0.05
0	7	3	2	0	0	-1	-5	-4	-2	-2	-2	-1	0.08
-2	-1	-1	-1	0	3	1	1	0	1	4	-3	2	0.09
-4	-1	-1	3	7	-2	6	6	1	2	2	-1	1	-0.15
-7	-1	-3	-10	8	-24	6	-5	29	-4	6	-3	-2	0.89
0	0	0	-1	-2	4	0	-1	0	0	0	-1	0	0.10
0	-7	-1	0	-16	3	0	-13	0	-1	0	-2	-12	-0.01
1	3	3	2	1	1	0	-3	-2	0	-2	-3	0	0.07

on-linear formula with milder cuts. [4] Linear formula with a cap for tariff peaks.

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