

Border battles *The Economist* 3 October 1998

Conventional trade barriers are coming down, but not quickly enough.

Throughout eight rounds of GATT talks, tariffs were trade negotiators' staple fare. Only in the sixth, the Kennedy round, did the diplomats even begin to add other trade barriers to their diet. After half a century at the table, you would think, they must have made plenty of progress. And so they have; but it is surprisingly hard to say how much, and disappointingly easy to conclude that they still have a lot on their plates.

A commonly quoted statistic is that when the GATT was founded, developed countries' tariffs on manufactured goods averaged around 40%. According to the WTO, by 2000 that average will have tumbled to less than 4%. Most developing countries have further to go, but these figures convey the right message: trade has become freer over the past 50 years. At the same time the figures' precision is misleading.

In particular, it is hard to pin down a meaningful average tariff rate for the late 1940s. Outside the United States, tariffs at that time were not even the main barriers to international commerce. After the first GATT talks in 1947, *The Economist* sniffed that: 'For many of the countries involved ... customs tariffs are at present without any influence on the volume of trade.' Currencies were not freely convertible, and imports were subject to licences and quotas. The trouble with quotas is that, once filled, they completely insulate domestic producers against foreign competition, and bestow monopolies on the importers that hold them. One of GATT's achievements was to establish tariffs as the least bad method of protection, and to negotiate maximum tariff rates (so-called 'bound' levels). By now nearly all OECD countries have bound all, or almost all, of their tariffs.

Another reason for treating historical data with caution is that in GATT's early days most tariffs were 'specific', i.e., based on the volume of imports rather than their value. This, according to a paper by Douglas Irwin of Dartmouth College, explains why America's average tariff rate looked far lower in the early 1950s (12%) than in the 1930s (50%). Four-fifths of that fall was due to inflation.

However, even today, measuring protection remains difficult. Quotas, licences and specific tariffs are still around. Although WTO members are committed to imposing tariffs on a 'most-favored-nation' (MFN) basis, which is meant to be non-discriminatory, in practice most of them do discriminate. Imports from partners in regional trade agreements are tariff-free. Developed countries levy special low tariffs on some goods from poor countries.

Even the MFN tariffs actually imposed may be far below the 'bound' levels. Applied tariffs are therefore a better guide to protection than formal WTO commitments, but there is a risk that they may be increased abruptly. For example, Nigeria's bound tariff on most agricultural goods is 150%, and few industrial tariffs are bound at all; its applied tariffs now average 23%, but they have changed frequently in the past few

years.

In addition, 'average' tariffs can hide as much as they reveal. The measure used by the WTO is to weight tariffs by the share of goods in a country's imports. But if a tariff is pitched so high that it chokes trade altogether, its weight becomes zero, which is clearly nonsense.

The OECD's annual survey of trade barriers uses several different weighting systems, none of them perfect. Under one, tariffs are weighted by the shares of goods in the domestic production of the importing country, but this gives too much weight to highly protected products. In another, the simple average of all tariffs is used unweighted, which means it takes no account of the relative importance of different goods. In a third, the import weights used are OECD averages rather than the country's own. Yet OECD countries often protect the same industries, depressing their weights across the board. Even among developed countries, which tend to have lower tariffs than developing ones, the use of different weights can yield markedly different results. In 1996, estimates the OECD, Canada's import-weighted average tariff was 5.7%, its simple average was 9.2% and its production-weighted average was 12.1 %.

No matter which weighting system is used, averages tell you nothing about extremes. In manufacturing trade high tariff rates, or spikes, are less common than they used to be, but even in developed countries they still persist. For example, trucks attract a tariff of 25% in America and 22% in the European Union. High tariffs in the food industry often reflect heavy protection for agriculture. America's tariff on peanut butter is 132%; the Eu slaps anything between 46% and 215% on fruit juices.

Developing countries can be spikier still. Malaysia's average import-weighted applied tariff fell from 15.2% in 1993 to 8.1 % last year; well done. But tariffs in agricultural goods and car manufacture can go up to 145%, on top of licensing restrictions. Many developing countries make heavy use of high tariffs to protect their car makers (see 5).

And so to work

All of this suggests that the WTO still has plenty of tariff-cutting to do. The best place to start would be manufactured goods. In developed countries, the tariffs on some of them are so low that they are barely worth collecting. They should be scrapped. In developing countries, average levels still have a long way to go-Mercosur's common external tariffs, for example, range up to around 20%. And there are plenty of spikes that need blunting.

The WTO also has to sort out textiles and agriculture, two of the world's most protected industries. The Uruguay round brought both of these under the same trade rules as other goods. That this counts as an achievement is a measure of how bad things were, and are. Although the agreements created the basis for further negotiation, they did little to reduce protection.

Until the Uruguay round, much of the world's trade in textiles and clothing was governed

by the Multifibre Arrangement (MFA), a cat's cradle of bilateral import quotas. Under the new textiles agreement, these quotas are being increased and items covered by the MFA are gradually being brought under GATT rules. 'Gradually' is the operative word. At the start of 1995, WTO members shifted items accounting for 16% of their 1990 imports into the new system. Another 17% followed at the beginning of this year. A further 18% is due to move over in 2002, and the rest follows in 2005.

To slow things down further, importing countries (mostly developed ones) chose to start the transition from the MFA to the GATT with items on which quotas were not fully used. In the early years, therefore, it makes very little difference. And even when all the quotas have gone, trade will be no more liberal than at the outset, because high tariffs will remain. The United States, for instance, levies tariffs of between 14% and 32% on most synthetic, woollen and cotton clothing. A \$25 pair of leather shoes imported into Japan attracts a tariff of 160%. No wonder that developing countries, which tend to be textile exporters, feel short-changed-even though their own markets are rarely monuments to open trade.

In much the same way as the textiles agreement, the Uruguay round's agreement on agriculture brought farm trade under GATT disciplines for the first time. In a useful recent study*, Timothy Josling, an economist at Stanford University, lucidly explains the fiendishly complicated results. The agreement did three things. First, with a few temporary exceptions, it converted all non-tariff barriers and unbound tariffs into bound tariffs. These tariffs have to be cut by an unweighted average of 36% between 1995 and 2000. Second, it prohibited new export subsidies and cut existing ones. And third, it began to tackle the domestic subsidies which, in effect, protect farmers against foreign competition in much the same way as tariffs.

This provides the starting point for new negotiations, due to begin next year. There is plenty to talk about. Some of the tariffs that have taken over from quotas are clearly set at a level designed to stop trade altogether: 300% on butter in Canada, 550% on rice in Japan, 215% on frozen beef in the EU, 179% on sweet powdered milk in America.

Further liberalization, argues Mr Josling, is urgently needed, not only because tariffs and subsidies remain high but because the countries trying to join the WTO include big agricultural producers with large state-owned enterprises, such as China and Russia. There are some promising signs. In its recent Farm Act, America took another step towards uncoupling support for farmers from production subsidies. American farmers, keen to export, have been lobbying for a renewal of fast-track negotiating authority. In the EU, meanwhile, the prospect of enlargement to the east is increasing the pressure for reform of the common agricultural policy.

Then again, the difficulties should not be underestimated. If farm prices were to tumble, both America and Europe might be loth to relinquish export subsidies, which in recent years have been kept down by firm markets. America's sugar, dairy and peanut farmers have so far held on tenaciously to protection, and will try to go on doing so. Europe, too, can still muster plenty of opposition to free farm trade. Agriculture nearly scuppered the

Uruguay round altogether. It seems more than capable of disrupting the next one.

Changes in U.S. Tariffs: The Role of Import Prices and Commercial Policies. *American Economic Review*, September 1998

Indicators of Tariff and Non-Tariff Trade Barriers. 1997 edition

Agricultural Trade Policy: Completing the Reform. Institute for International Economics, Washington, DC, April 1998

Seconds out *The Economist* 3 October 1998

For the next round

When Peter Sutherland, the GATT 's last director-general, brought down the gavel on the Uruguay round in December 1993, some people wondered whether there would ever be another such all-encompassing round of trade talks. The thought may have been prompted by jaw-ache after more than seven years of often exasperating negotiations. More importantly, however, the Uruguay round came with a built-in program of future work. Talks on four areas of services trade remained unfinished; new talks on agriculture were already set for 1999; and more negotiations on services were scheduled for 2000.

Since then, the WTO has proved itself reasonably adept at doing business outside trade rounds. Two lots of left-over services talks – on telecoms and financial services- eventually succeeded. The information-technology agreement was all but sealed in Singapore in December 1996, within a year of starting. And there is a fair chance that Mr Clinton's plea for allowing electronic commerce to develop without barriers will be heeded.

Yet next autumn, when trade ministers meet in America for the WTO 's next conference, the most important decision they will face will probably be whether to launch a new round. Their answer should be an unreserved yes. There are at least four reasons why.

The first is that trade negotiations seem to work best when a range of issues can be bundled together. Single-issue negotiations on services have not been an unqualified success. Negotiations on maritime services were sunk by the Americans before they left port. Rich-country indifference also dashed any hopes of an agreement on the "movement of natural persons", trade-speak for the temporary employment of foreign workers. A round that ties together a complex package of issues offers a better chance of striking deals: concessions in one area can be traded for advances in another.

Second, a long agenda is building up. In addition to services and agriculture, there are manufacturing tariffs, the treatment of foreign investors and competition policy. Sooner or later, too, WTO members will have to find some way of resolving the conflict between the organization's rules and those of multilateral environmental agreements.

A round covering all this would go some way to completing the huge shift in trade rules begun in the Uruguay round. These rules now recognize that free trade amounts to far more than the removal of barriers to trade in goods. But in services and investment, foreign suppliers are often still a long way from getting "national treatment". Some agreement on antitrust law would help to stop private trade barriers replacing official ones.

The third reason is that if the WTO does not come to grips with the new issues, regional

trade organizations will continue to go their own way. In some cases that may be fine, but in others it may get in the way. If global liberalization were continuing apace, there would be less need to worry about the way regional agreements distort trade.

Why now is a good time

The fourth and most important reason for a new trade round is the parlous state of the world economy. This argument may not be immediately obvious. The deep recession in many Asian economies and the turmoil in world financial markets may well spread to the trading system. Already, Americans and Europeans are struggling to sell their wares in depressed Asia, and are losing markets to Asian goods made far more competitive by huge devaluations. Some westerners may, therefore, be tempted to call for curbs on trade. And if financial markets crash, or the world economy moves into recession, free markets may seem less of a good idea than they did a couple of years ago.

Yet these are arguments not for closing the shutters, but for opening them more widely. In the 1930s, protection turned recession into rout. If the same remedy were adopted, history could repeat itself in the 1990s. Freer trade, on the other hand, offers the prospect of earlier recovery.

Helpfully, WTO commitments bind governments, up to a point, to keeping markets open, come rain or come shine. Moreover, this would not be the first time that a trade round started in turbulent times. Fred Bergsten, of the Institute for International Economics, points out that the Tokyo round was launched in 1973, in the middle of the first oil crisis; and the preliminaries for the Uruguay round came in the wake of the Latin American debt crisis. Launching a new round in 1999 would be a signal that governments are still committed to open markets-and understand that the prosperity of their peoples depends on them.