DEC notes
Research findings

Big reductions in the protection of manufacturing

What lies behind these big gains? Tariffs on manufactures imports into industrial countries were reduced from a trade-weighted average of 6.3 percent to 3.8 percent, a cut to be phased in over five years.

Second of four notes on what the Uruguay Round means for developing countries

The reductions were not uniform, but were the outcome of a series of bilateral request-and-offer negotiations whose results were extended to all Round participants. For industrial countries, tariffs were reduced by an average of 45 percent on imports from other industrial countries and by only 30 percent for imports from developing countries. For developing countries, the reductions in tariff rates on manufactures averaged 28 percent on products from industrial countries and 29 percent on those from developing countries.

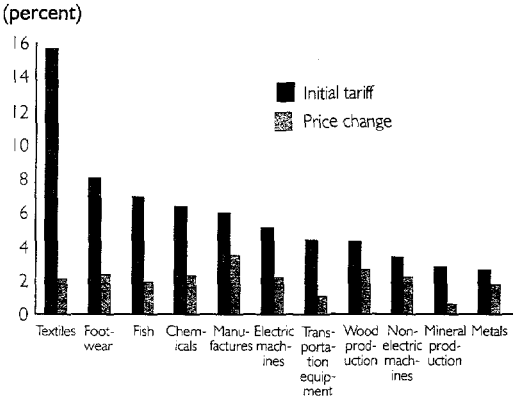
Commitments under the General Agreement on Tariffs and Trade (GATT) take the form of bindings—commitments not to levy a duty exceeding a particular (bound) rate. The proportion of industrial countries' tariffs on industrial products subject to bindings rose from 94 percent to 99 percent as a result of the Round. With 18 percent of their imports already bound duty-free, tariff reductions were feasible on only 82 percent of imports. Tariffs were, in fact, reduced on 64 percent of imports—with the remaining 18 percent divided between bindings without reduction and no offer.

The proportion of developing countries' imports of industrial products subject to bindings rose from 13 percent before the Round to 61 percent after it. This increase in the coverage of bindings was very widespread, with substantial increases in all regions. With only 1 percent of their manufactured imports initially bound duty-free, there was scope for tariff reductions on 99 percent of imports. Bindings involving tariff reductions were offered on 32 percent of imports, while bindings without reductions (ceiling bindings) were offered on a further 26 percent; no offers were made on the remaining 42 percent. So, developing countries made very substantial progress with their tariff bindings and reductions, but clearly much remains to be done.

If the average tariff cut in the Round had been uniform, it would have had the economically desirable feature of implying a larger reduction in the tariff-inclusive price of more highly protected goods. But there was only a very weak relationship between the initial rate of protection and the price reduction achieved (figure 1). For industrial countries' imports from developing countries, the two sectors with the highest tariffs (textiles and clothing, and footwear) experienced smaller price reductions than did many other sectors.

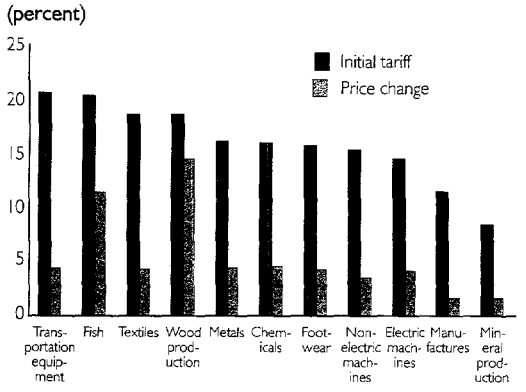
For developing countries' imports from industrial countries, there is no evidence of a consistent relationship between the initial tariff level and the reduction in the domestic prices of imported goods (figure 2). What is clear, however, is that the average depth of the

Figure 1. Initial tariffs and price reductions for industrial countries' imports from developing countries



Source: Abreu 1995.

Figure 2. Initial tariffs and price reductions for developing countries' imports from industrial countries



Source: Abreu 1995.

tariff-induced price cuts from the Round was greater in developing countries than in industrial countries. While the proportional tariff cuts were smaller in developing countries, the price cuts are larger because they apply to higher initial tariffs.

Tariff escalation in industrial country markets—tariff rates increase with the stage of processing—is a long-standing concern of developing countries because it discourages the export of processed raw materials. Tariff cuts under the Round reduced the absolute degree of tariff escalation on imports of manufactures, although some escalation clearly remains (figure 3).

The Round made substantial progress on measures that had sprung up to avert the disciplines imposed by GATT rules and tariff bindings

Excising some of the insidious nontariff barriers

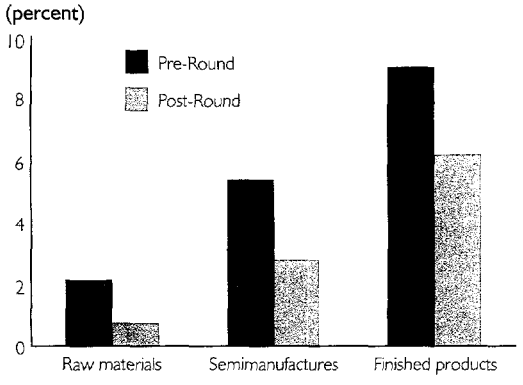
A key feature of the Round was the substantial progress made in dealing with the "gray area" measures that had sprung up to circumvent the disciplines imposed by GATT rules and tariff bindings. Voluntary export restraints must be abolished within four years, and the Multifiber Arrangement (MFA) is to be phased out over ten.

The abolition of the MFA can be expected to generate considerable benefits not just to exporting countries but also to the importing countries that imposed this peculiar and perverse form of protection.

For the United States and Canada, a typical mature industrial region, the abolition of the MFA means that textile output will cease to grow, while apparel output contracts (figure 4). The ten-year phase-out under the Round allows plenty of time to achieve an orderly restructuring of these industries into more specialized entities and for productive factors to find alternative uses. For South Asia, a typical dynamic developing region, abolition implies a very substantial expansion in the output of textiles and an increase in apparel output of more than 200 percent. Effecting such an expansion will require policy reform and infrastructure support to realize the full potential of these labor-intensive industries. The growth rates of the heavy machinery and transport equipment sectors in South Asia will slow as resources find more profitable outlets in textiles and clothing (these sectors will nevertheless contrive to grow quickly, at 6 percent and 5 percent a year, respectively). Similar patterns of output adjustment are observed in other developing country regions undertaking liberalization.

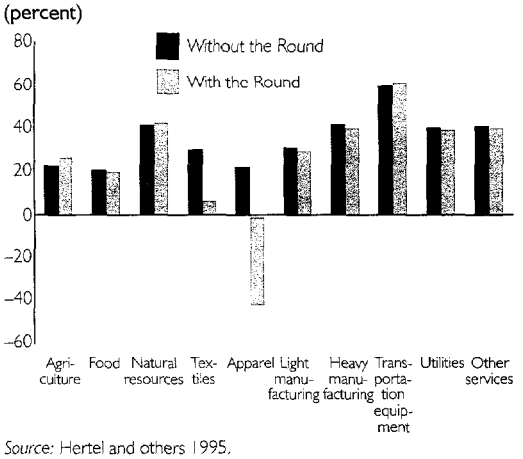
As with the MFA, voluntary export restraints violated the spirit of two of the most fundamental principles of the GATT—the prohibitions against imposing quantitative restrictions and against discriminating between suppliers (the most favored nation principle). These protection measures bought the compliance of exporters by giving them

Figure 3. Tariff escalation in industrial countries remains, but at lower levels



Source: GATT data.

Figure 4. United States and Canada: industrial restructuring



Source: Hertel and others 1995.

the opportunity to retain some of the artificial scarcity rents they created. They were of doubtful legality (or worse) under the GATT. The Uruguay Round agreement removes any ambiguity, prohibiting voluntary export restraints and measures with a similar effect. Since the protectionist pressures that gave rise to these measures will remain strong, however, outlawing them is likely to increase the pressures for other forms of contingent protection.

The agreements to abolish nontariff barriers on manufactured products will require careful monitoring and implementation, lest these barriers be replaced by equivalent (or worse) measures under the guise of safeguards or antidumping. Some commentators argue that the abolition of the MFA will require particular attention, since the quotas will be phased out progressively according to schedules determined by the importers, with almost half the quotas, and typically the quotas on the most sensitive items, remaining in place (though growing at accelerated rates) until the tenth year. Strong political pressures for delay are likely.

Gains and losses from abolishing the Multifiber Arrangement

Industrial country importers, at whose insistence the MFA was introduced, will benefit from its abolition for three reasons. First, they will be able to source imports efficiently, buying the best products at the best prices, instead of being forced to purchase imports from suppliers that happen to have sufficient MFA quotas or that have escaped the MFA quota net. Second, they will be able to rationalize their production and consumption decisions—substituting imports for domestic production where this is appropriate, and avoiding the distortion of consumer choices away from apparel. Third, they will avoid having to pay higher import prices to their export suppliers, who must currently include the price of MFA quotas in their asking prices.

Political pressures will likely delay the abolition of the Multifiber Arrangement

All the evidence shows that abolishing the arrangement will generate enormous benefits for the importing countries—$9 billion a year for the European Union, $10–12 billion for North America, and upwards of $25 billion a year for both markets by 2005, gains that will be magnified by scale economies.

Whether developing country exporters gain or lose from the abolition of the MFA is a more complex question. Since the quotas raise the prices received by exporters with access to quotas, it is possible for the quota system to make some of the restricted exporters better off. But there is no guarantee that this will be so.

Relatively new, and tightly restricted, exporters of textiles and clothing—such as China, the ASEAN exporters, and the more competitive South Asian exporters—seem most likely to gain from the abolition of the

MFA. Given the restrictions on their exports, they must now divert some of their exports to non-MFA import markets—such as Japan, Hong Kong, Australia, the Middle East, and Sub-Saharan Africa—where import prices are low. Once the MFA quotas are removed, these suppliers can be expected to increase their total exports and to shift their emphasis toward the currently MFA-restricted markets. By one estimate, China could gain more than $2 billion a year, while the major ASEAN exporters (Indonesia, Thailand, Malaysia, and the Philippines) could together gain around $2.8 billion a year in the long run. By another estimate, the gains to China could be $5.4 billion a year, and those to the big four ASEAN exporters $4 billion a year. South Asia is also projected to gain by $2–$3 billion a year.

Two groups of exporters are likely to suffer—those whose quotas are now large relative to their comparative advantage and those that may have been induced by the MFA to enter the production of textiles and clothing without possessing a comparative advantage in these goods. Some of the newly industrialized countries in Asia probably fall into the first group, but their losses in this part of the Round are heavily outweighed by their gains from tariff and other liberalization elsewhere. Exporters in the second group are found in Latin America.

A third group of countries that may be hurt includes Japan in apparel and Sub-Saharan Africa in textiles. Both now gain from low-cost exports diverted from the restricted markets, and they will pay higher import prices when the restrictions are eliminated. Of course, the domestic textile and apparel industries will become stronger and, in Sub-Saharan Africa, will be able to contemplate future export-led growth without the threat of restrictions on sales.

—by Will Martin and L. Alan Winters

Further reading

The following papers are available in Will Martin and L. Alan Winters, eds., 1995, *The Uruguay Round and the Developing Economies,* World Bank Discussion Paper 307. Revised versions are forthcoming in a volume to be published by Cambridge University Press.

Abreu, M. "Trade in Manufactures: the Outcome of The Uruguay Round and Developing Country Interests."

Hertel, T., W. Martin, K. Yanagishima, and B. Dimaranan. "Liberalizing Manufactures Trade in a Changing World Economy."

This *DECnote* has been prepared by Will Martin and L. Alan Winters in the International Economics Department of the World Bank. *DECnotes* transmit key research findings to Bank Group managers and staff. They are drawn from the work of individual Bank researchers and do not necessarily represent the views of the World Bank and its member countries—and should not therefore be attributed to the World Bank or its affiliates. *DECnotes* are produced by the Research Advisory Staff. We welcome your questions and comments; please e-mail them to the authors or to Evelyn Alfaro, RAD.