

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

COM.IND/W/111
28 June 1973

Limited Distribution

Committee on Trade in
Industrial Products

THE GENERALIZED SYSTEM OF PREFERENCES
AND MOST-FAVoured-NATION TARIFF REDUCTIONS

Note by the Secretariat

1. At the May meeting of the Committee on Trade in Industrial Products the secretariat undertook to examine the feasibility of carrying out a study on the relationship of the Generalized System of Preferences (GSP) to the multilateral trade negotiations and to report to the next session of the Committee.
2. The secretariat has since reflected on the subject and arrived at certain preliminary views regarding the material that it could make available to delegations in this connexion and the limitations of such a study.
3. It will be noted that the note below deals only with the relationship of the GSP to most-favoured-nation tariff reductions and does not expressly take into account aspects of the multilateral trade negotiations relating to non-tariff barrier measures in the field of agriculture and safeguards.
4. Any analysis of the relationship of the GSP to most-favoured-nation tariff reductions must address itself to two concerns. Will the value of the scheme to developing countries decline if the most-favoured-nation tariffs under which they enjoy preferential access are lowered and the margin of preference consequently narrowed? And, if so, what extent and pattern of most-favoured-nation tariff cuts, additional preferential arrangements, and other liberalization measures that might result from the negotiations would be necessary to (a) offset that, and (b) offer the developing countries additional trading advantage?
5. The bulk of the difficulty, which is of an analytical nature, resides in the first question. It addresses itself to the behaviour of incremental magnitudes of imports and exports following a given change in tariffs. The feasibility of carrying out a systematic, quantitative study of this problem - one of "the trade effects of tariff changes" - has been discussed at great depth in almost every meeting of the Tariff Study Working Party in 1972. The conclusion of that group of experts was that there does not exist an adequate supply of statistical data to engage in such a study with reasonable hopes of obtaining useful results.

6. To enable the developing countries to make for themselves at least rough estimates of these possible effects the secretariat could provide certain statistical data. The secretariat has already supplied to individual developing countries basic statistical tabulations which enabled it to see what are their exports, actual or potential, which already enjoy preferential benefit or encounter obstacles. On the basis of the data made available, these exports could be divided into four main headings:

- I. Those enjoying duty-free access on most-favoured-nation basis;
- II. Those which are dutiable and not covered by the GSP;
- III. Those enjoying unlimited preferential entry;
- IV. Those included in the GSP but with limitations (quotas, ceilings, surveillance).

In addition, a number of non-tariff barriers applying to each of these groups can be identified. On the basis of such data it is possible for each country to compare the volume of its recent exports under each of these four categories. Such a comparison could, when buttressed by other information governments themselves possess on market and supply conditions, provide some general impressions.

7. In addition, the secretariat could also furnish similar tabulations for developing countries as a group. Thus, on the basis of the data available in the Tariff Study files, the secretariat could identify imports from the developing countries into the thirteen import markets under the four classes mentioned above. While it would be unwieldy to break the data down into BTN headings as has been done for the tabulations for individual developing countries, it could be broken down into thirty product groups covering the whole field of trade (BTN Chapters 1-99) as presented in the attached annex. Within each of these thirty product groups the total imports into each of the thirteen main markets would appear classified into the four main classes noted above. Additional information for each class in each product group could include: the number of tariff lines in the class and their distribution according to the level of most-favoured-nation duty rates, the most-favoured-nation tariff averages (weighted and unweighted), the main developing countries suppliers and their status (i.e., whether preferred under the GSP or other preferential schemes); also, to the extent of secretariat's knowledge, the types of non-tariff barriers existing in individual markets and product groups under each category, as well as measures applied to limit preferential entry. (Additional technical notes can be found in the annex.)

8. The presentation of the global data supplemented by the information already available in certain individual developing countries on their actual exports could be helpful in identifying those product groups in which a reduction or elimination of tariffs and non-tariff barriers would be most desirable from the point of view of developing potential exports.

9. Once a general approach to the multilateral tariff negotiations has been agreed, the secretariat could, as a second stage exercise, show the arithmetic impact of the envisaged most-favoured-nation tariff reductions on preferential margins and, in the case of staged reductions, indicate the modification of the margins of preference corresponding to the various stages of the implementation envisaged.

10. In any analysis of such data as the secretariat is able to provide it would be helpful to keep in mind that the value of a tariff preference can be seen as having two aspects: (a) the lower rate at which preferred imports actually enter, i.e., improved access, or, in other words, an improvement in the competitive position of preferred exporters vis-à-vis domestic producers of like goods in the importing country; and (b) the extent of the preferential margin which measures the improvement in the competitive position of the preferred vis-à-vis the non-preferred (most-favoured-nation) exporters of like goods.¹ The response of preferred imports to the former - the threshold - advantage is governed by the price elasticity² of the demand for imports which is a measure indicating the increase in the quantity of imports demanded as their price is reduced by a given amount. This elasticity is, in turn, a result of two other elasticities, namely, the price-elasticity of demand (in the importing country) for the product in question, and the price elasticity of domestic supply of that product. A reduction in the product's price, made possible by the tariff reduction, would simultaneously (a) increase the total quantity demanded and (b) lead to some shrinkage of domestic supply; as a result, the margin to be filled by imports would widen. In a dynamic setting, some of these changes need not be absolute: the effect of the tariff cut on product price and domestic supply, for example, need not be an absolute decline but merely a temporary stability, or a less rapid rise than would have occurred otherwise.

¹To relate these two aspects to the familiar concepts of the theory of tariffs and customs unions, the first gives rise to trade creation, the second to trade diversion.

²The concept of 'elasticity' describes forces which actually operate in the economy but which are in practice difficult to distinguish from all other influences affecting the economy at the same time, and to measure in isolation. Nonetheless, a number of such estimates have been made by different scholars, for the aggregate of products traded by individual nations, for agricultural and manufactured products separately, and for individual product groups in each of these two large categories. A bibliography of this literature has been compiled by the secretariat and distributed under Spec(72)40/Add.1.

11. The effects of the second aspect of the advantage, the width of the preferential margin, are determined by the elasticity of substitution of preference-receiving and for non-preference-receiving imports per unit change in the price of the former. If the products exported by the preferred and non-preferred suppliers were identical, such substitution would be very high. However, perfect substitutability of exports is an exception rather than the rule in contemporary trade. In the case of manufactures, products exported by different countries, even within the narrowest categories of customs classification, are likely to differ in quality, design, possibly even end-use. These differences may be even more pronounced between exports from developed and developing countries than in general trade.¹

12. It is important to note that a possible analysis sketched in the preceding paragraphs assumes that preferential access is unlimited. Where imports from developing countries are preferred only within a tariff quota different considerations apply. If the tariff quota is effective, i.e., where it is filled and additional imports from developing countries are bought at the full tariff rate, the most-favoured-nation tariff reduction is, of course, beneficial to the developing country exporters. It does not reduce the amount of preferred exports, already limited, and makes the access of the additional exports easier. Similarly, in cases where most current or potential imports from developing countries are concentrated in products not enjoying preferential treatment, a linear most-favoured-nation cut might bring trading benefits to developing countries which would more than offset the erosion of the trading advantage, i.e., preferential margin, under the tariff items providing for preferential access.

13. It must again be emphasized that, for practical purposes, and for the time being, most of the conditions and relationships which determine the effects of tariff change are beyond the possibility of measurement. This does not mean, however, that an analytical exercise such as outlined in paragraphs 10, 11 and 12 above must be a barren one. When it is conducted from the viewpoint of an individual country, the responses of domestic exporters, foreign consumers, and competing producers in both the importing and other exporting countries can be estimated or assumed by knowledgeable persons on the basis of past experience acquired in the trade. It is a type of knowledge which does not appear to be available to an international secretariat, but the GATT secretariat can furnish a certain amount of basic data which would be of assistance in such an exercise.

¹A recent study by the United States Tariff Commission estimates that, in a broadly representative sample of manufactured products, imports from developing countries were sufficiently comparable to similar goods imported from elsewhere or produced in the United States that they might be substitutes in terms of the commodities themselves for one sixth of production for the home market and perhaps they were technically substitutable for one half of imports from third countries. Whether these potentialities could be realized would depend upon many factors other than technical substitutability including relative prices, delivery dates, changing consumer tastes, etc.