

# Sensitive Products

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# Sensitive product issues

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- May get more liberalization if there is some provision for sensitive products
  - Tops-down formula is highly desirable economically
  - Perhaps the price of deep cuts & a tiered formula is some flexibility?
  - Exceptions typically the major part of a formula-based negotiation
- Gain in flexibility is easy to evaluate
  - But loss in market access depends on all markets
  - Difficult to work out what trading partners will do

# Treatment of sensitive products

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- Countries are free to choose which products to classify as politically sensitive
  - No criteria like those for special products
- Doha negotiators aiming for a formula governing treatment of sensitive products
  - Smaller-than-formula cuts
  - Expansion of Tariff-Rate-Quotas

# Policy choices for sensitive products

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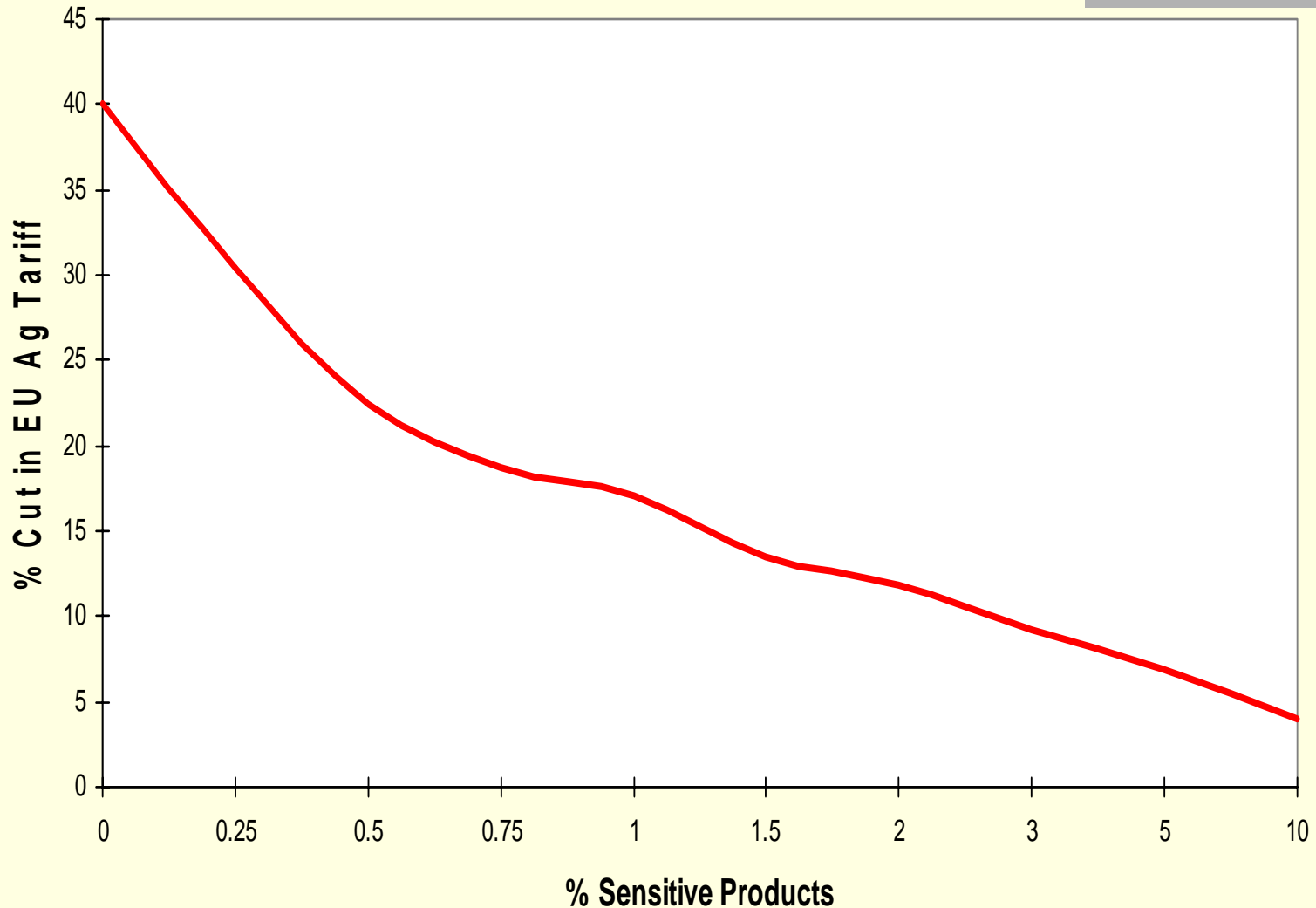
- How to balance desire for flexibility with goal of increasing market access?
- Restrictions on coverage
  - Percentage of tariff lines
  - Percentage of imports
  - % of tariff lines & % of imports
- Depth of cut in sensitive product tariffs
  - % of formula cuts or fixed % cut?
- Do tariff caps apply to sensitive products?
- TRQ expansion
  - Cut or TRQ expansion- or Cut & TRQ expansion

# Restrictions on coverage

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- Very hard to restrain by number of tariff lines
  - Some tariff lines are inherently important
    - Wheat, rice, maize?
    - Others not very important. Seaweed?
  - Some tariffs on important products are high
  - Some tariffs have little binding overhang
  - Many tariffs are zero
- Just a few % of sensitive products can dramatically reduce market access
- Percent of imports or limit on import share and # of tariff lines may be better
  - Takes into account the interests of the exporter <sup>5</sup>

# Changing % of sensitive tariffs -no cuts on sensitive prods, EU

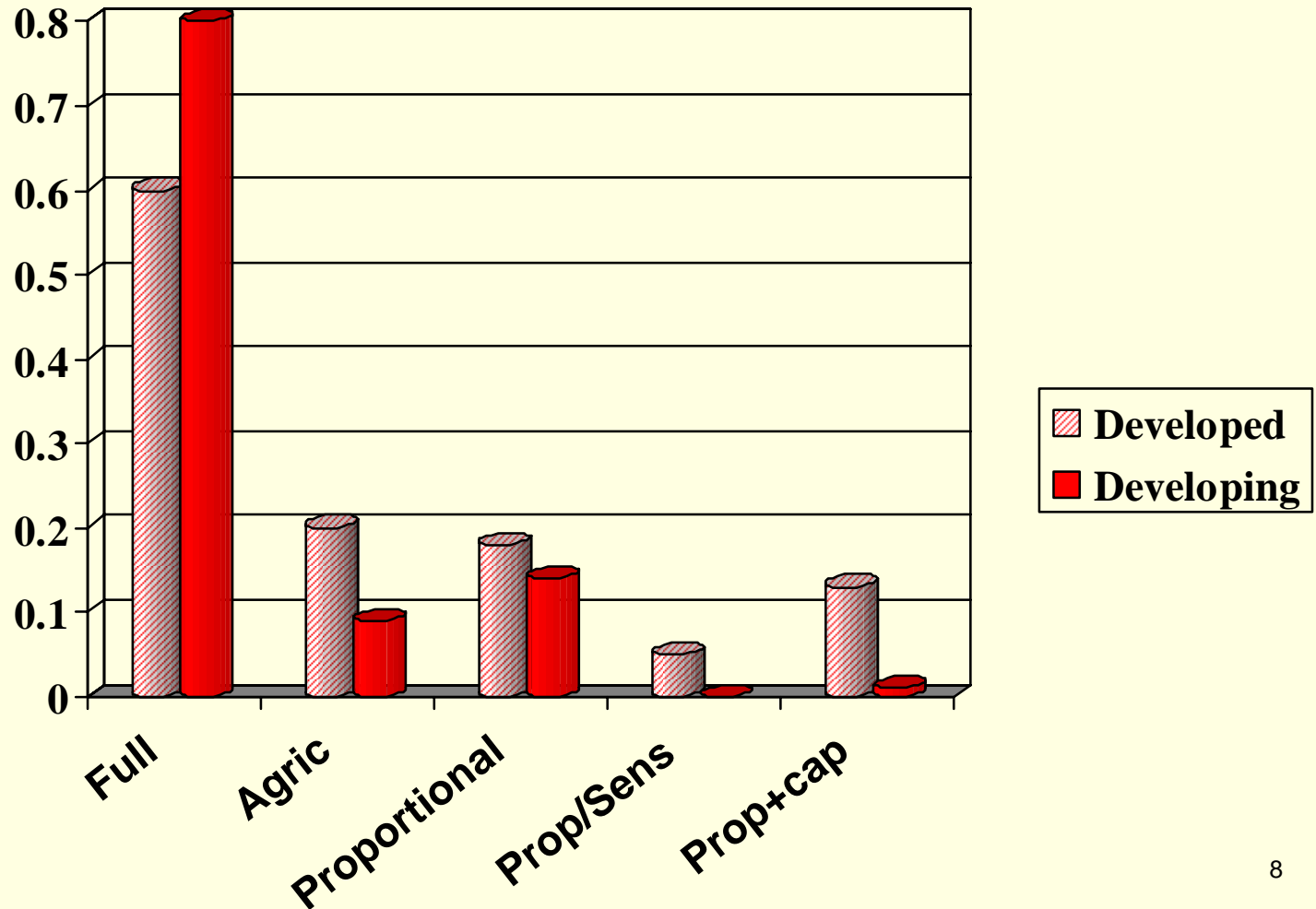


# Depth of the tariff cuts is important

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- With only a small cut in sensitive product tariffs, just a few percent of tariff lines excluded can eviscerate market access gains
  - Countries are likely to choose sensitive products which are important, have high applied rates & little binding overhang
- When Anderson, Martin and van der Mensbrugghe examined the welfare impacts of 15% cuts in sensitive products

# Possible Gains as a % of GDP

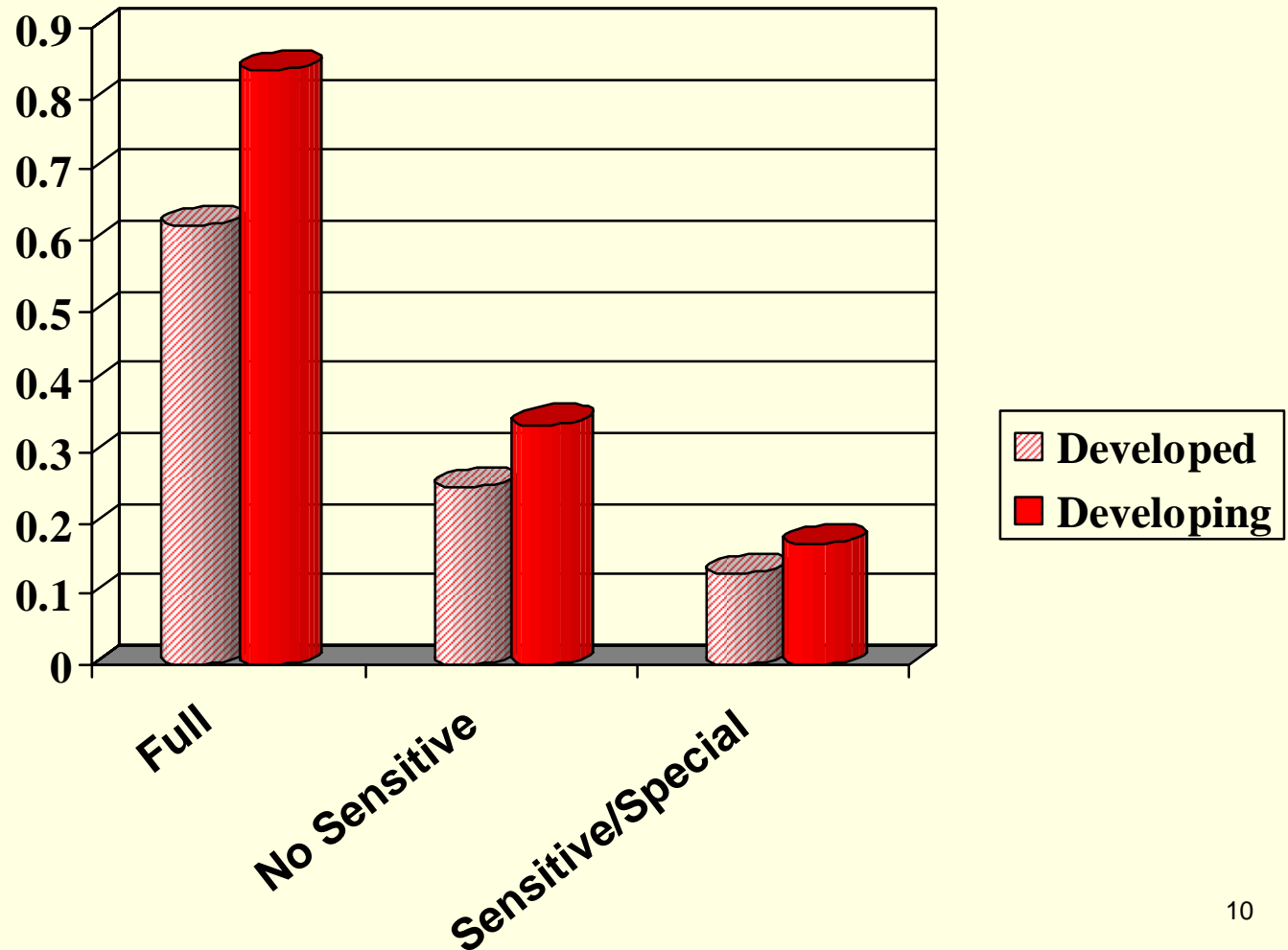


# Have been big advances in proposals

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- Early proposals involved small cuts in sensitive products
- And discretion--tariff cuts or TRQ expansion
  - Anderson, Martin & van der Mensbrugghe assumed a 15% cut in tariff bindings
- More recent proposals from the EC involve
  - Deeper cuts in sensitive product tariffs
  - Tariff cuts and Tariff-Rate-Quota expansion
- EC now proposes 50% of formula cuts, plus expansion of TRQs

# Possible Gains as a % of GDP: 20-20-20



# Applied agricultural tariffs, %

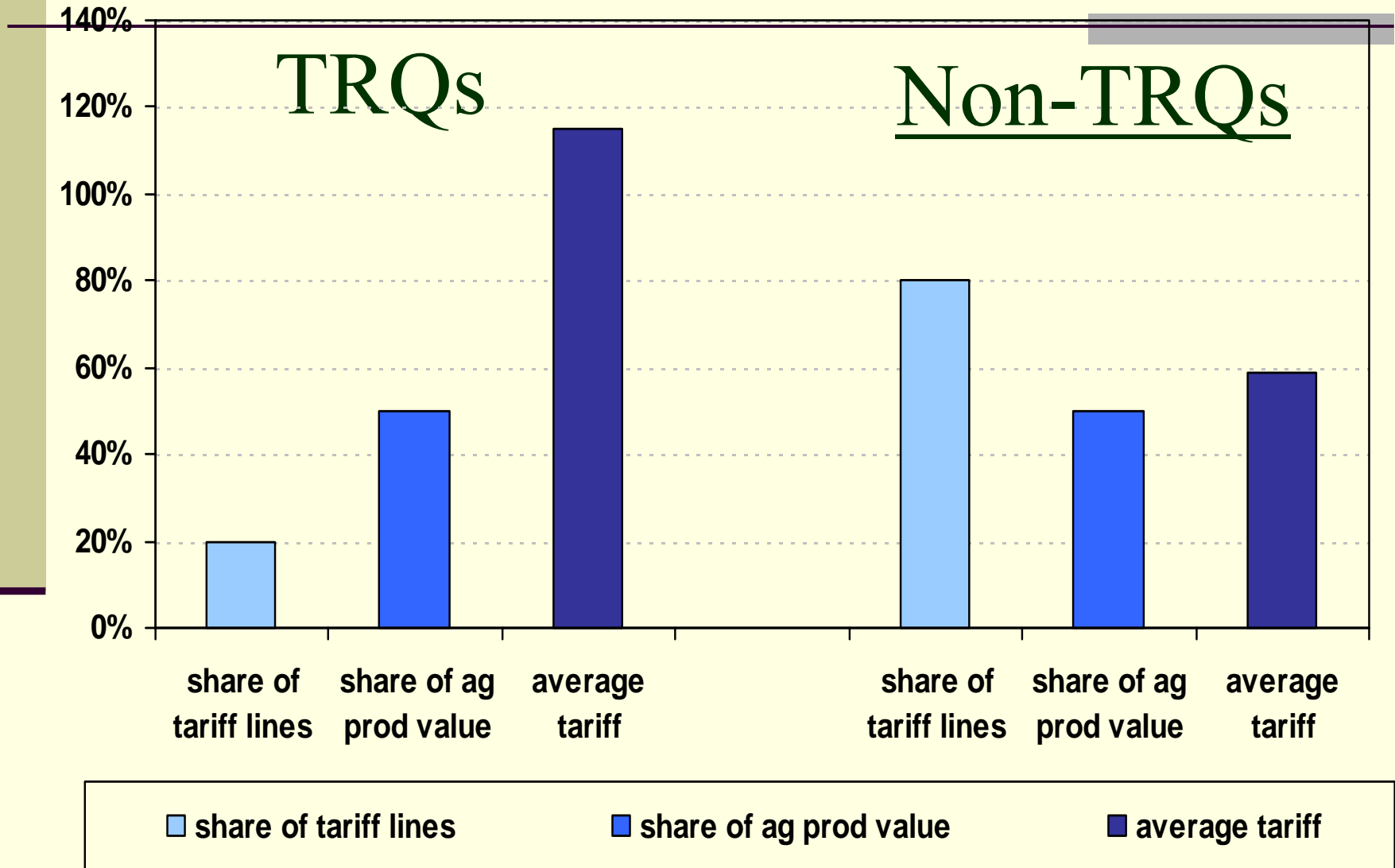
|                | 2001 | After<br>G-20<br>Formula | Formula<br>plus<br>sensitive &<br>special |
|----------------|------|--------------------------|---|
| High<br>income | 15.8 | 7.9                      | 12.3                                      |
| Developing     | 13.9 | 12.5                     | 13.7                                      |

# The outcome depends on the details

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- These estimated gains are based on simple rules of thumb for sensitive products
  - 50% of formula cuts in bound tariffs
  - Applied tariffs cut by the amount they initially exceeded the new bound rate
  - Assume in modeling work that the combination of tariff binding cuts & TRQ expansion corresponds to  $2/3$  of the formula cut in tariff bindings
    - The reality is much more complex, especially where TRQs are involved

# TRQ vs. Non-TRQ Tariff Lines



# Key issues on TRQs

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1. Expansion formula
  - Formula structure
  - Basis for expansion
  - Level (tariff line, TRQ or product?)
  - Size of deviation from formula tariff cuts
2. Impact of a tariff cap for sensitive products?
3. What to do with in-quota tariffs?
4. Modify TRQ administration methods?

# Proposals on TRQ expansion

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Formulas proposed have 3 key elements:

1. Autonomous expansion (% of cons.)
  2. Adjustment for current access (TRQ/cons.)
  3. Compensation for tariff cut not taken
- G-10, Cairns and U.S. proposals have all three
  - G-20 autonomous expansion only (6% of cons.)
  - EU proposal only adjusts for deviation

EU at tariff level; G-10 at TRQ level; others based on consumption and so at product level

Result is a huge variation among proposals in levels of TRQ expansion

If compensation for a tariff cut not taken,  
then economic theory tells us

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$$\text{TRQ expansion} = \text{Base} \cdot \eta^M \left( \frac{t_f - t_s}{1 + t_s} \right)$$

Base (imports, quota or % of cons.)

$\eta^M$  = import price elasticity, perhaps -4 on average

$$\eta^M = \eta^D \left( \frac{C}{M} \right) - \eta^S \left( \frac{Q}{M} \right)$$

$t_f$  = tariff after the full cut (from tariff formula)

$t_s$  = tariff after the partial cut (for sensitive products)

# EU proposal based on economic theory formula

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EU at first made only 2 modifications:

- 80% of the cut because it is a sensitive product
- Implicitly sets an import elasticity of -1

Then the EU added 2 more modifications:

- Uses the *initial tariff* in denominator
  - instead of the *tariff after the partial cut*
- Uses *% tariff cuts* rather than the *tariffs after the cut* in the numerator
  - this overestimates TRQ expansion if initial tariff is less than 100%; underestimates it otherwise

# TRQ expansion relative to economic formula

|         | Proposals |      |      |        |      |
|---------|-----------|------|------|--------|------|
|         | EU        | G-10 | G-20 | Cairns | USA  |
| Overall | 0.22      | 0.08 | 1.00 | 1.16   | 1.33 |
| EU      | 0.21      | 0.08 | 1.00 | 1.20   | 1.80 |
| USA     | 0.10      | 0.06 | 0.80 | 0.95   | 1.15 |
| Canada  | 0.47      | 0.16 | 1.90 | 2.20   | 1.20 |
| Japan   | 0.06      | 0.02 | 0.13 | 0.15   | 0.23 |

\* Imports as base

Tariff caps of 100% for formula tariffs; 150% for sensitive products

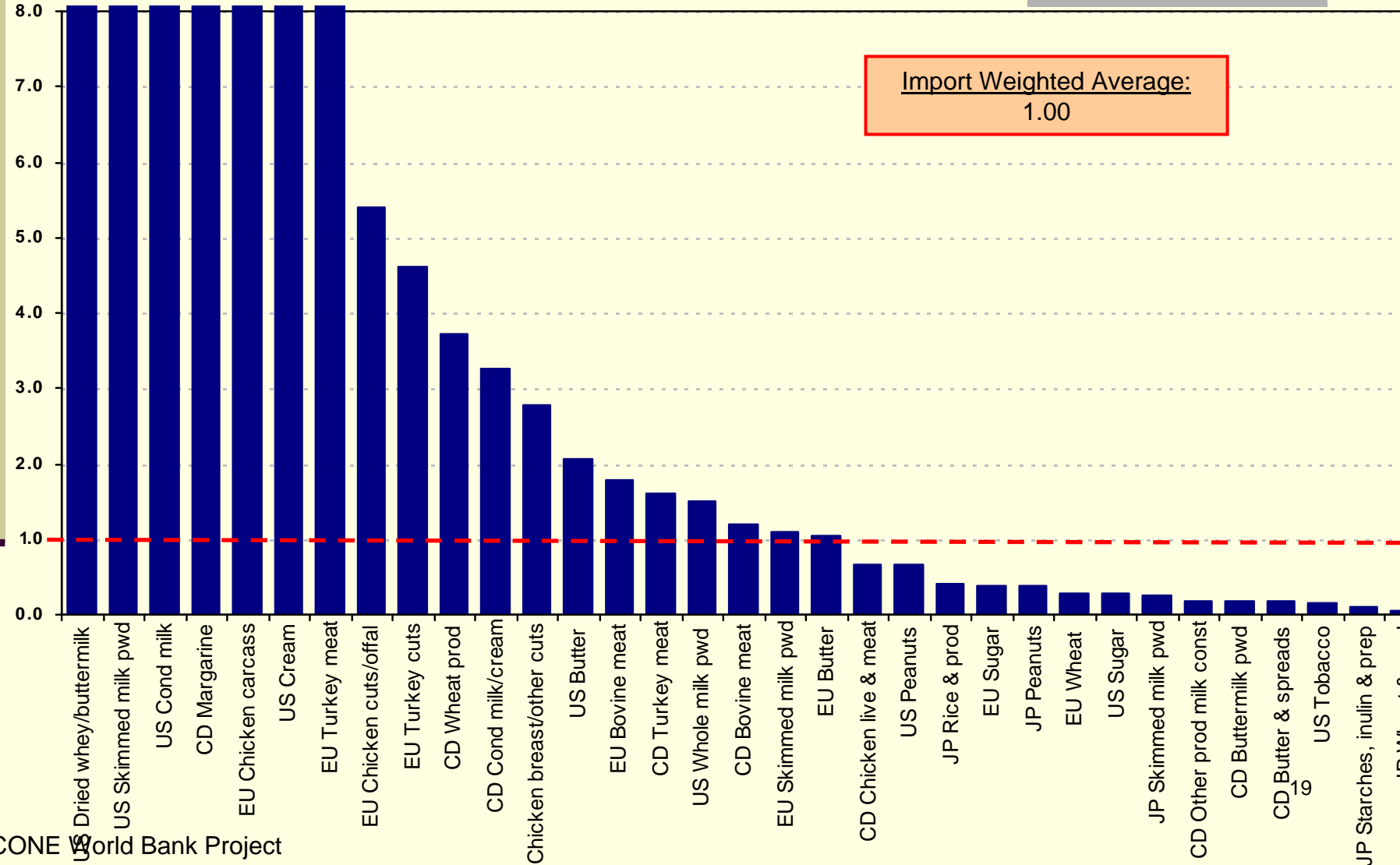
All numbers trade value weighted average

Source: ICONE World Bank Project

# G-20 Proposal vs. Economic Formula

52 21 13 12 9 9 9

G-20 Proposal to Economic Formula Ratio



# To summarize, TRQ expansion relative to economic formula...

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- Has systematic patterns across countries and across commodities within countries
- G-20 based on domestic consumption, so increases market access more where markets have small import penetration
- Cairns and USA very similar to G-20 but USA significantly more ambitious on average (Cairns somewhat)
- EU (with imports as base) usually well below, especially for tariffs  $> 100\%$  (G-10 even lower)

# Tariff caps reduce need for TRQ expansion

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- 100% tariff cap in tiered formula binds if tariff is greater than 400%
- 150% tariff cap for sensitive products binds if tariff is greater than 240%
- Results:
  - Cap has no impact on EU (for the TRQs we have chosen)
  - Only one for USA (tobacco)
  - Several for Canada
  - Important for Japan

# Quota expansion may not increase trade initially because of over-quota imports

**Table 1: TRQ Expansion for EU Beef and Chicken Sectors (1,000 metric tonnes)**

|         | Current over-quota imports | TRQ Expansion |                  |
|---------|----------------------------|---------------|------------------|
|         |                            | EU formula    | Economic formula |
| Beef    | 115.7                      | 43.4          | 292.4            |
| Chicken | 220.6                      | 40.7          | 183              |

Why is the EU reluctant to expand key TRQs with over-quota imports?

Actual imports will only increase with the economic formula for beef

# Implications: Over-quota imports reduce trade increase

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- Change in imports 53% of TRQ expansion because of over-quota imports (assuming a 100% quota fill rate)
- Declines to 34% if use historical fill rate with quota underfill due to:
  - Non-transparent, non-MFN quotas with inefficient administration methods and additional regulations
  - High in-quota tariffs

# Possible strategic behavior

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- Members may *include* a TRQ as sensitive if there are over-quota imports or quota underfill
  - Quota increase may have a limited effect on trade
- Countries may *exclude* a TRQ as sensitive if high levels of tariff binding overhang or water in the tariffs
  - decrease in over-quota tariffs will have no initial effect
- Countries may include only some tariff lines of a TRQ
  - to minimize TRQ expansion if current imports is the base

# Conclusions

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- Flexibilities for sensitive products are an essential part of a formula-based negotiation
  - But need to balance flexibilities & market access
- Important progress on sensitive prods in DDA
  - More realism likely on # of tariff lines &, more importantly, in the depth of tariff cuts
  - Exceptions costly, but worthwhile gains remain
- EU formula for TRQ expansion a useful start
  - Align more with economics to improve mkt access
  - Basing more on domestic consumption may help expand new markets