

Policy of Tariff Protection in the Light of WTO Accession

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Abstract

Tariff rates are crucial instrument of trade policy. This paper covers several important issues related to the reforms of this area. First part of the paper explains the key features of tariffs as protection instrument: different policy takers and opposite economic interests; benefits and adverse effects; alternative measures of protection; dependence of tariff policy on the development priorities and the welfare effects, etc.

This document explains main World Trade Organization requirements concerning protection policy such as primary role of tariffs, restricted set of non-tariff instruments, limited scope of safeguard measures, comparison on the legal development in the field until now, and an indication of further legislation changes necessary in the period of adjustment. It also gives main elements of the customs-reform strategy: choice and concentration of goals and priorities; criteria for preparation of the alternative scenarios; solving convergence problems; defining conditionality for alternative solutions and interdependence of relevant externalities. The goal of the paper is to give recommendation for trade policy reform in our country necessarily to become member of World Trade Organization

Keywords: Trade liberalization, Tariff rate, Policy-taker, World Trade Organization, customs, multilateral negotiations

1. Introduction

World with which today again begin to cooperate, undoubtedly changed over the years our isolation. Major changes are not related only to new technology, market expansion and the introduction of modern ways of doing business. During recent years, the concepts of liberal and market-oriented economy have lost any serious alternative and become accepted by almost all countries in the world."One of the key steps of integration of Montenegro into modern international economic relations is the membership in the World Trade Organization."¹ It is also an important element of support for the process of internal economic reforms, as well as necessary steps in the process of joining the European Union.

"Pursuant to the provisions of Article XII of GATT-a², Montenegro December 2004, launched proceedings membership in the World Trade Organization model "Twin-track", approved by the European Union, also provided space for independent access to Montenegro this organization."³

The World Trade Organization is one of the most important international institutions regulating trade on an international level, and its efforts to international trade liberalization as much as possible. In the South Eastern European region only Serbia, Montenegro and Bosnia and Herzegovina are not WTO members and, together with Russia, Ukraine and Belarus, are the only one in Europe.⁴ Slovenia became a member in 1995, with the establishment of the WTO; Croatia in 2000 after three-year negotiations, Macedonia entered WTO in 2003⁵.

"Experience has shown that liberalizing the economy to grow faster, and the economic growth are the best means of eliminating poverty in a society according to the analysis of OECD, the protective policies of developed

¹ Bagwell K, Staiger RW. 2001a. Strategic trade, competitive industries and agricultural trade disputes. Economics and Politics

² Any State or separate customs territory, which has full autonomy in the implementation of trade politics can access what under conditions that have been agreed between the country and the Members.

³ Michalopoulos C. 1999. Trade Policy and Market Access Issues for Developing Countries: Implications for the Millennium Round. World Bank Washington DC

⁴ World Trade Organization: Becoming a member of the WTO - The Accession Process.

⁵ World Trade Organization: Trading into the future -an introduction to the WTO, Geneva, 1999

countries limit the growth of countries developing several times more than it increases development assistance."⁶

"World Trade Organization took over the role of the GATT (General Agreement on Tariffs and Trade), that promotes and regulates the process of liberalization of modern

International trade, through multilateral negotiations."⁷ The concept of multilateral negotiations on market access refers to the eight consecutive rounds of negotiations in the WTO, which led to a significant reduction of customs duties applied to the developed countries as well as the obligations that developing countries take to respect their customs.⁸ However, there is still a high level of protection in certain Industrial sectors of developed countries (textiles and clothing) - Customs peaks and tariff escalation, as well as protectionist agricultural policies that implement some of the developed countries.

2. Protective tariffs as an instrument of economic policy

"Customs, as the main instrument protection of economic policy, a duty on imports, are part of the tax system and method of income redistribution".⁹ At the same time, the customs means of restricting trade, so it has far-reaching effects to the consumer, producers, state, region, national wealth and economic development. Introduction duty (or increase tariffs) on imports of a product in the corresponding amount, above all, increases the price of the product on the domestic market. Therefore, direct positive effects of tariffs are: protection of producers and collect tax revenue, but have negative effect of the loss on the consumer side. In the longer term, of course, there are indirect effects, which mainly consist in loss of efficiency.

⁶ Potipiti, T. 2006. Import Tariffs and Export Subsidies in the WTO: A Small Country Approach. Unpublished mimeo. April, Chulalongkorn University

⁷ Bagwell K, Mavroidis PC, Staiger RW, Sykes AO. Forthcoming. *Principles of World Trade Law Part II: Border Instruments*. American Law Institute and Cambridge University Press
Bagwell K, Staiger RW. 1999. An economic theory of GATT. *American Economic Review* 89.

⁸ Popovic Tomislav, Svjetska trgovinska organizacija: Rezultati Urugvajske runde multilateralnih trgovinskih pregovora, Institut ekonomskih nauka, Beograd, 1996

⁹ Gulati S, Roy D. National Treatment and Optimal Regulation of Environmental Externalities. *Canadian Journal of Economics* 41: 2008.

Because customs mainly aim to protect domestic industry from foreign competition, it is good to ask under what conditions the duty to be successful in improvement of domestic production. First and foremost, the elasticity of domestic supply should be high, so that a small increase in price, which implies low tariff rate, lead to a large increase in domestic production. Simply put, if domestic supply is inelastic, there is no practical effect because no protective duty thrives in the improvement of domestic production. Second, although of minor practical importance, demand for the product should be cost- inelastic. Because it is highly elastic, so that a small increase in price leads to a dramatic reduction demand for the product, demand would, after the introduction of tariffs, be so small that protected domestic industries face the narrow, market, which is the opposite effect desired.

If the customs brought in a large country, its effects would be similar to the described effects, with one notable remark: whenever a big country, with significant share in the world trade, offering more or less requires a specific product, the world price of the product changes. Reduction in world prices means that elasticity and the domestic supply and demand must be taken into account when microeconomic analysis of the potential effects of tariffs is made.¹⁰

3. Trends in international trade and WTO rules on safeguard policy

"After the Uruguay Round negotiations the reduction of tariff rates in the world, what was particularly noticeable in the case of developed countries. However, the tariff policy developed countries (Canada, the European Union, USA and Japan) and further characterized by high tariffs in certain sectors (particularly the so-called point Customs peaks)¹¹ and customs escalation."¹²

¹⁰ Jackson JH, Davey WJ, Sykes AO. 1995. *Legal Problems of International Economic Relations, Cases, Materials, and Text*. Third Edition

¹¹ Tariff escalation implies the appearance of growth of tariffs along with the higher stages of processing product. Thus, the raw materials and less processed products to charge tariffs at a lower rate than which is charged to more processed. Countries exporting primary products point out that customs escalation provides a greater degree of effective protection of manufacturing importing countries than to provide users with a nominal tariff rates.

¹² Staiger RW, Sykes AO. 2011. International trade, National Treatment and Domestic Regulation. *Journal of Legal Studies* 40

"About 10% of the customs in the scale of the developed countries is still above the 12% ad valorem, after full implementation of the Uruguay Round and the General Scheme of Preferences".¹³ Customs peaks in this country are moving in the range of 350% to 900% for important export products of developing countries¹⁴, especially for food and shoes.¹⁵ This situation is consequence of the so-called the tariffs - and the transformation of tariff and non-tariff protection measures at the border of the customs equivalent, resulting in extremely high rates, and reaching 900 %.¹⁶

"Tariffs of earlier quantitative restrictions, duties, and similar non-tariff measures protection are raised tariff rates to levels that in most cases exceeding 30%".¹⁷ EU applies an additional burden for poultry, meat, eggs and sugar. The food industry in the EU covers about 30 % of all tariff peaks, in the range of 12% to 100%¹⁸. "In a few cases there is an additional burden, in order to protect the manufacturing industry branches of the high prices of imported agricultural inputs".¹⁹

Recent history of international trade is characterized by the process of globalization, the expansion of multinational companies and the general trend towards the liberalization of various shapes of international exchange. The creation of the General Agreement on Tariffs and Trade (GATT) accompanied by the establishment of the WTO, resulting in a uniform system of rules for the largest part of the international economic exchange. The method of expressing the interests of the Member States, especially in the sphere of trade policy uses various forms of protection,

¹³ Sykes AO, 2005. The economics of WTO rules on subsidies and countervailing measures.

In *The World Trade Organization: Legal, Economic and Political Analysis*. Vol. II, eds. Appleton A, Macrory P, Plummer M. Springer-Verlag

¹⁴ Kee HL, Nicita A, Olarreaga M. 2009. Estimating Trade Restrictiveness Indices. *The Economic Journal* 119

¹⁵ Top Customs (Tariff Peak) is a customs duty or a small group of duties that are especially high, often even several times higher than the average nominal tariffs.

¹⁶ Zubic Petrovic, Snežana, Milivojevic Radmila, Todorovic Bojana, *Rezultati Urugvajske runde multilateralnih trgovinskih pregovora*, Institut ekonomskih nauka, Beograd, 1996.

¹⁷ Hudec RE. 1990. *The GATT Legal System and World Trade Diplomacy*. Second Edition, Salem: Butterworth Legal Publishers

¹⁸ Brou D, Ruta M. 2011. *A Commitment Theory of Subsidy Agreements*. unpublished mimeo, March, WTO

¹⁹ Bagwell K, Staiger RW. 2002. *The Economics of the World Trading System*. Cambridge, MA: The MIT Press

where the domestic product is protected from, especially unfair competition, hedges of customs and non-tariff measures²⁰.

However, protection is significantly different from protectionism despite the fact that the "Assets", i.e. identical instruments (tariff and non-tariff measures), respectively: protection? Protectionism implies the formulation of economic policy that the basic approach to prevent exposure to domestic producer's fierce competition in international market, and in this case, these instruments are not applied in a transparent manner.

Protectionism implies almost constant use and, as a rule, is characterized by the absence of cost-benefit analysis (which allows estimation of the effects trade measures on the domestic economy). In addition, in most cases the use of these instruments is related to the alleged cultural, health and environmental reasons. Also, "especially in the recent history trade policy, protectionism has significantly promoted the so-called abuse".²¹ Extraordinary measures to protect trade, which include anti-dumping measures compensator customs, and emergency protective measures.

On the customs territory can therefore be used as a measure of protection duties as favored measures and various non-tariff barriers to trade. The concept of non-tariff measures including the ability to import, export, production and export subsidies, as well as measures with similar effects. These measures are widely defined as non-tariff barriers and existing agreements as set detailed rules and obligations that must be fulfilled during their introduction.

The use of tariffs under the WTO is governed by the rules of GATT, which distinguishes between internal and measures at the border, where tariffs and non-tariff measures are in category of measures at the border. In accordance with the GATT, tariffs are highly desirable instruments to restrict imports and the Members shall have the right to impose tariffs on the condition that they apply to non-discriminatory basis. Primate who had a duty as an instrument for the protection of market access has been further strengthened by the requirements of GATT that import duties are only means of the financial burden of imports. In addition to this there is an additional requirement that if you apply the internal charges, they must be

²⁰ Brou D, Ruta M.2011.A Commitment Theory of Subsidy Agreements. unpublished mimeo, March, WTO

²¹ Organization for Economic Co-operation and Development, Open Markets Matter - The Benefits of Trade and Investment Liberalization, OECD, Paris, 1998.

applied to non-discriminatory basis, as well as tariffs and duties that are related to imports (not may pose a hidden form of tariff protection).

The basis for favoring the use of tariffs is that they represent transparent and measurable trade barriers. On the other hand, although GATT does not prohibit the use of tariffs, nor limits their scope, their reduction is, induced during multiple rounds of trade negotiations. The result of these negotiations is Cut Sheet predetermined tariff reductions for each country WTO member or so called of concessions²². When a product is hope in this list, the rate of duty specified for the product is "consolidated" in accordance with the WTO, which means that it cannot grow if you meet certain conditions, that is not to renegotiate already established concessions. Renegotiation also implies provision of compensator concessions for other products. If in any event no agreement is reached, the injured parties have the right to withdraw "Basically the same concessions" that were established with members that initiated the renegotiation.

GATT does not require a separate custom structure either in nominal or in effective terms. Therefore, any party for having given the opportunity to realize the tariff structure that is considered most suitable for carrying out its economic goals. Along with that, each member can have effective tariff escalation and to increase tariffs that have not previously been consolidated, whereas in the case of consolidated tariffs there is a legal obligation that the duty does not increase above consolidated level.

Many countries, especially those in the developing world, succeeded during the last multilateral trade negotiations to reach an agreement on the so-called Ceilings customs consolidations, "which practically means the consolidation of duties at a level that is above the applied rates".²³ In this way, made a difference has permitted to conducted fairly flexible tariff policy, which is particularly useful in the case of sudden influx of imports. In fact, in such cases the State may wish to increase tariffs to the level of consolidated ceiling, avoiding in this way the resort complicated procedures to launch other trade defense measures.

²² The term was used more concessions in negotiations for GATT, and later in the negotiations with the WTO, that the candidate country to accept a ceiling tariff rates, or to reduce the otherwise imported restrictions, in turn,concessions Member States, odosno. benefits obtained through acquisition membership.

²³ Staiger RW, Wolak F. 1994. Measuring Industry Specific Protection: Antidumping in the United States. Brookings Papers on Economic Activity: Microeconomics. Volume 1

The fact that the GATT has given full priority tariffs as an instrument for the protection of trade and advanced this policy through regular rounds of trade negotiations, it has equally and simultaneously recognized the need to narrow the ability of members to use non-tariff barriers. Existing agreements and the measures governing the use of the following non-tariff barriers: quantitative restrictions, national trade, government acquisition, control of goods before delivery, exchange controls, national standards and technical regulations, customs procedures, rules of origin, publication trade regulations.

3.1. Requirements of the new candidates for membership in the WTO

In terms of customs for each State acceding WTO crucial is that from the very beginning to accept the fact that every accession process takes place in accordance with the terms of that state agree that access to and the Members. This means that this process predominantly takes place in the context of negotiations, rather than in the context of the set rules (most of the countries that have recently joined had to accept higher levels of obligations than was the case with the founders STO). Consequently, when we talk about tariff negotiations, each accessing is a case of itself.

Tariff negotiations are taking place on a bilateral basis and the confidentiality of the character and process continues until a complete agreement. "This phase of the accession generally occurs when the trial of the economic system and trade regime country approach ensured sufficient information (on the basis of the submitted Memorandum on Foreign Trade Regime, national legislation in the field shops, as well as through the exchange of relevant questions and answers)"²⁴. States that access then submitted the first offer tariff concessions, and further development is the result of talk about the offers or requests.

In recent negotiations on the accession of a new candidate, it is required participation in the initiative "zero for zero" or initiative for the elimination of tariffs for the following products:²⁵

- Beer;
- Drinks of alcohol distilled;
- Wood pulp;

²⁴ Milivojevic Radmila, Kovacevic Radovan, *Ekonomski aspekti carinske reforme u svijetlu pristupanja Svjetskoj trgovinskoj organizaciji*, SCEPP, Beograd, 2004

²⁵ Roberts, Mark J, Tybout James R, *Direction in Development – What Makes Exports Boom*, The World Bank, Washington, D.C. 1997.

- Paper;
- Furniture;
- Pharmaceutical products;
- Steel;
- Construction equipment;
- Medical and agricultural equipment;
- Initiative for customs harmonization for products of the chemical industry and
- Initiatives regarding the abolition of customs duties for a wide range of products for information technology.

An important modality of negotiations is the use of "phase" approach - phased enforcement reduction, as most countries that have recently joined were not allowed to use Panama had to commit them to implement the agreed reduction tariffs on industrial products, starting from the date of accession. Mongolia has the same conditions accepted for all products, and Kyrgyzstan for all agricultural products.

In some negotiations, arguments emerged to avoid the usage of specific duties, because they are not transparent²⁶. Although it is the use of tariff quotas connection with the so-called tariffs of any accepted during the negotiations of the Uruguay Round agriculture as an instrument; provides minimum / current approach, when as a result of conversion of non-tariff measures into tariffs report extremely high tariffs for many agricultural products, the same right was not allowed into any of countries that have recently joined. As for other duties and taxes, the list of all countries that have joined their sum is zero. "In terms of tariff peaks, many States that will require to be substantially reduced despite the fact that they exist in Customs lists many major WTO member at levels that are often above 100 %"²⁷. One of the main requirements in the process of accession to state that access to offer tariff concessions are "commercially viable"²⁸ shall have the meaning in commercial sense "or" appropriate level of economic

²⁶ Maggi G, Rodriguez-Clare A. 2007. A political-economy theory of trade agreements. *American Economic Review* 97

²⁷ Bjelic Predrag, Svjetska trgovinska organizacija, Prometej, Beograd, 2002.

²⁸ Bagwell K, Mavroidis PC, Staiger RW, Sykes AO. Forthcoming. *Principles of World Trade Law Part II: Border Instruments*. American Law Institute and Cambridge University Press
Bagwell K, Staiger RW. 1999. An economic theory of GATT. *American Economic Review* 89.

development, "but there is neither any rule or reference example in determining what level of adequate".²⁹

3.2. Harmonization of Montenegro customs policy with WTO rules

Bearing in mind that the WTO recognizes the duty as the only fully legitimate instrument for the protection of domestic production, for the acceding countries in this organization it is recommended that prior to entering into negotiations, carry out a detailed analysis of its economic performance, and to identify national interests in terms of development in the fields of industry and agriculture.

The modern customs policy should take into account the requirements of the WTO as the only global trade organization, and at the same time provide adequate protection of the local economy and to prevent distortion of the rules of free competition and the emergence of unequal conditions of business. The domestic tariff policies should incorporate all the instruments of tariff protection that are legitimate in the WTO. Customs policies should be designed to be harmonized with the application of modern non-tariff hedging instruments, such as technical regulations and standards (thereby protecting the market from the entry of substandard goods quality), the application of the safeguard clause in the event of a sudden and unexpected increase in imports, protection in case of a disturbance of balance of payments, etc.

As regards to customs deals, a new candidate has the opportunity to submit an offer where are (all or specific) customs positions consolidated at the level of applied tariffs, then at the lower level of applied tariffs, or the so-called ceiling level (which is higher than the level of applied tariffs). In most cases, members of WTO request from new candidates to follow the first option, and to agree to substantial consolidation of the number of tariff rates (which means the consolidation of all positions of the Customs Tariff, which is not the case with most members of the WTO, the founders of this organization). Tariff concessions in negotiations to become a member representing concessions. In the form of reduced / consolidated tariff rates, which is a candidate approved Members of the WTO. The programming process begins with the formation of the list of initial offers that further

²⁹ Limao N, Tovar P. 2011. Policy choice: Theory and evidence from commitment via international trade agreements. *Journal of International Economics*

subject to additional requirements and corresponding member of the negotiations with the candidate.

Montenegro will have to propose an initial list of offer concessions bearing in mind network of free trade agreements with the countries of South Eastern Europe. It is realistically expected that these countries will not occur as the applicants in customs negotiation of our country with the WTO. A similar assumption stands for the EU, with which the trade relations are regulated in the framework of the Stabilization and Association Agreement. Bearing this in mind, the negotiations will be conducted with the so-called MFN partners, or with countries with which trade exchange takes place on the basis of clause most-favored- nation (MFN).

Since the accession of each candidate making the process that takes place under conditions are negotiated between the candidate and a member of the WTO, designing changes our new tariff policy must be set by the recognizing two facts:

- To get in front of new candidates almost a rule set requirements that are not force for the country's founding fathers (the " WTO plus" obligations) and
- That often prevented new candidates to call for rights contained in the WTO and which have been made available to the founders STO.

Also, "it is necessary to bear in mind the fact that we still did not set up adequate defense mechanism measures for trade in accordance with the rules of the WTO, which automatically means that duty becomes the only instrument of protection at the border."³⁰

"The proposal of the new customs tariff was done by harmonizing Customs Tariff Montenegro with the Convention of the World Customs Organization HS in 2002."³¹ It basically works on the harmonization of tariff codes and their nomenclature in the 6 digits. "EU this harmonization conducted at 8 digits, a draft domestic legislation included 10 digits, in order to acknowledge the specificity of separation CN codes."³² Montenegrin tariff nomenclature at this time based on Harmonized System

³⁰ Potipiti, T. 2006. Import Tariffs and Export Subsidies in the WTO: A Small Country Approach. Unpublished mimeo. April, Chulalongkorn University

³¹ WTO. 2011. World Trade Report 2012. Geneva

³² World Trade Organization: Trading into the future -an introduction to the WTO, Geneva, 1999

HS 96 "There are an 8554 tariff rates and all the 10 - digit level."³³ "All rates are ad valorem in the range of 0 % to 30%. There are 13 ad valorem custom groups"³⁴.

If we take into account the experience of other countries in terms of concessions, it can be observed, the greatest reduction of tariffs for the new member of the WTO was to the industrial sector, while high tariffs were kept in agriculture. "Accession into the WTO, in Croatia, the average tariff rate on industrial products reduced from 9.7% to 6.5% and after the transition period of 2-5 years 5.34%."³⁵ For agricultural products, tariffs were reduced from 33.7% to 25%, while after a transitional period of 7 years will be reduced to 16.4%, including tariffs on imports of fish and fishery products, which will be reduced from 32.1% to 15.5%³⁶. "Macedonia, which entered the WTO in 2003, has committed that in the anticipated period of adjustment to lower average tariff rates on agricultural products to the level of 11.3 % and the industrial products to the level of 6.2 %."³⁷

Bearing in mind the obligations that Montenegro will have to take entry in this organization of special importance to the process of accession of pride in an organized and disciplined way, since you assume liabilities for many years, thus automatically defines the nature, content and directions of national trade policies. Each deviations or exemptions from commitments are subject to new negotiation Members of the WTO (with accompanying compensation for lost benefits³⁸). Administrative Board of the Reasons join process is a complex and demanding process, requiring being elaborated negotiating strategy, strong analytical instruments, developing adequate institutional structure and thus creating strong professional capacity within the administration.

³³ World Trade Organization: *Becoming a member of the WTO- the Accession Process*.

³⁴ Sykes AO, 2005. The economics of WTO rules on subsidies and countervailing measures. In *The World Trade Organization: Legal, Economic and Political Analysis*. Vol. II, eds. Appleton A, Macrory P, Plummer M. Springer-Verla

³⁵ Matsuyama K.1990. Perfect equilibrium in a trade liberalization game. *American Economic Review* 80.

³⁶ Maggi G, Rodriguez-Clare A. 1998. The value of trade agreements in the presence of political pressures. *Journal of Political Economy* 106

³⁷ Organization for Economic Co-operation and Development, *Open Markets Matter - The Benefits of Trade and Investment Liberalization*, OECD, Paris, 1998.

³⁸ Jovanovic Gavrilovic, Predrag, Kovac Oskar, Kovacevic Mladen, Kozomora Jelena, Pelevic Branislav, *Medunarodni ekonomski odnosi*, Ekonomski fakultet, Beograd, 1997.

4. Conclusion

The protective economic policy customs play a crucial role. The basic tendencies in customs policies in the world are the result of negotiations within the World Trade organizations, they are characterized by tariffs of earlier quantitative restrictions and other non-tariff protection measures and a general lowering of tariffs, but the existence of the so-called tariff peaks, i.e., the highest rates for certain types of products (agricultural products, coal, steel, textiles, etc.). World experience shows that liberalizing the economy to grow faster and that the economic backwardness and social problems, including poverty, the easiest to solve in terms of rapid growth. Hence development program for a small open economy must include among its priorities preparations for negotiations with the WTO, with the goal of faster economic integration and abolition of barriers of international trade.

However, trade liberalization at the international level requires more than reducing tariffs and non-tariff barriers in the translation rate of duty. When you lower the tariffs, it stifles competition in some other way, or if the policy procedures and rules are applied randomly, or if some suppliers possess better treatment than others, the economic model with a positive social impact, as consequence of trade liberalization, can easily fail. In fact, trade liberalization will almost certainly have negative results if the institutions, laws and economic policies, which mean that they are in the background of the economic model, do not exist or are not adequate.

More broadly, I have used the sections of the paper to sketch out the rough contours of the challenge faced by the WTO in dealing the NTMs from the perspective of the economic theories of trade agreements. I have concluded that, when it comes to handling NTMs and specially the choice between shallow and deep approaches to integration, the key questions for WTO appear to be these two: (1) Is it the terms-of-trade problem or the commitment problem (or both, or neither) that WTO member governments seek to solve with their WTO membership?; and (2) Is it market clearing or shoring/bilateral bargaining that is now the most prominent mechanism for the determination of international prices? As empirical evidence seems to support the terms- of-trade theory as identifying the main purpose of the GATT/WTO, I conjecture that answering this second question will be a key input to identifying the best way forward on NTMs for the WTO.

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