APEC Progress on Tariffs:

Implications for a new agenda

A report prepared for the APEC Ministers Responsible for Trade Meeting

Shanghai CHINA 2001

AUSTRALIA

FOREIGN AFFAIRS AND TRADE

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About this report

This report, *APEC Progress on Tariff Reductions: Implications for a New Agenda*, extends earlier studies on the progress that APEC member economies have made in reducing tariffs. Its examination of tariff and trade data goes beyond the traditional analysis of average applied tariff rates to provide a fuller picture of APEC members' achievements in opening markets. In particular, it examines the extent to which goods are traded across APEC at low tariff levels (specifically at the 0-5% tariff range) and the changes in both the levels and dispersion of tariffs.

This report provides evidence that APEC has been translating its commitment to open trade into real and sustained reductions in tariff levels. This has resulted in significant increases in the proportion of trade flows at very low tariff levels. The evidence also underlines that as tariffs continue to come down, increasingly APEC will have to focus on other barriers to trade if it is to maximise the benefits of open markets.

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KEY FINDINGS

- APEC members have reduced tariffs substantially in recognition of the significant benefits that may be gained from open markets.
- APEC's average tariffs have declined significantly. APEC's average tariff declined by one-third from 12% in 1995 to 8% in 2000.
- The reductions in tariff levels have made a real impact on trade flows with imports and exports increasingly taking place at low tariff levels.
- Over two-thirds of the goods imported by APEC economies enter at very low tariff levels. In 2000, 69% of goods imported by APEC were subject to tariffs of only 5% or less. This represents an increase of 17% from 59% in 1995.
- Tariff reductions in APEC have been good for APEC exports. APEC exports, which match or correspond to imported goods with 0-5% tariff levels, increased by 14% from 57% of total exports in 1995 to 65% in 2000. It is likely that imports have also contributed to growth in a broader range of exports by providing lower cost inputs to higher value-added products.
- The proportion of APEC tariff lines in the tariff range of 0-5% increased from 37% in 1995 to 45% in 2000. This was accompanied by a general decrease in the proportion of tariff lines in the high-end categories.
- Tariff reductions in APEC have been applied across sectors, but there is a marked difference in the level of openness between sectors.
- As tariffs continue to come down, it will be important for APEC to also focus on other barriers to trade to ensure the benefits from open markets are maximised and shared by all APEC communities.

Open markets are delivering benefits

APEC members have reduced tariffs substantially in recognition of the significant benefits that may be gained from open markets. An APEC report, *Open Economies Delivering to People: APEC's Decade of Progress*, released last year (2000), highlighted the many benefits that open market policies have delivered to APEC communities.

The Open Economies (APEC 2000) report found that:

- APEC markets are open, reflected by low levels of tariff and high levels of trade, and that open market policies have created jobs and improved the livelihood of ordinary citizens.

- Over the last decade, 195 million jobs were created and poverty was slashed by a third — that is 165 million people in the region were lifted out of poverty, as a result of APEC economies lowering trade and investment barriers and opening their economies to increasing international competition.

- Every 1 percentage point increase in the ratio of trade to GDP (gross domestic product), results in a 2-3 per cent increase in per person incomes or GDP per person (See also Frankel and Romer 1999).

- Over the last decade, APEC economies have generated nearly 70% of global growth; exports (in goods and services) have increased by 113% to over US$2.5 trillion; and foreign direct investment in APEC economies has grown by 210%.

- The wealth generated by this impressive economic performance has underpinned a substantial improvement in a range of key social indicators such as strong investments in health and education.

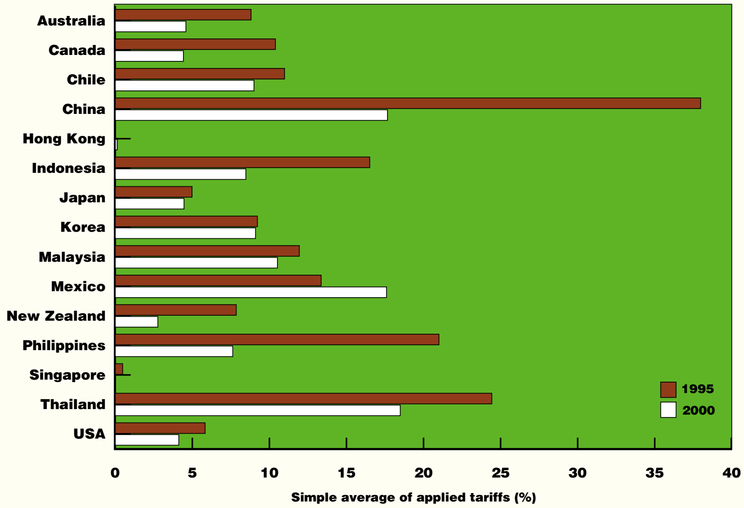
- Open market policies need to be complemented by structural adjustment programs and measures to ensure the net benefits from adjustments are maximised.

Average tariffs continue to fall

Previous studies on tariffs, which were based mainly on simple average and trade-weighted average tariffs, have shown that tariff levels have been falling significantly in APEC (See Technical Note 1). An updated calculation of the simple average tariffs for APEC members confirms earlier findings (See Chart 1).

Simple average tariffs in APEC fell by one-third — from an average of 12% in 1995 to 8% in 2000.

Chart 1: Tariff Averages of APEC economies in 1995 and 2000



APEC tariff line items moving towards low levels

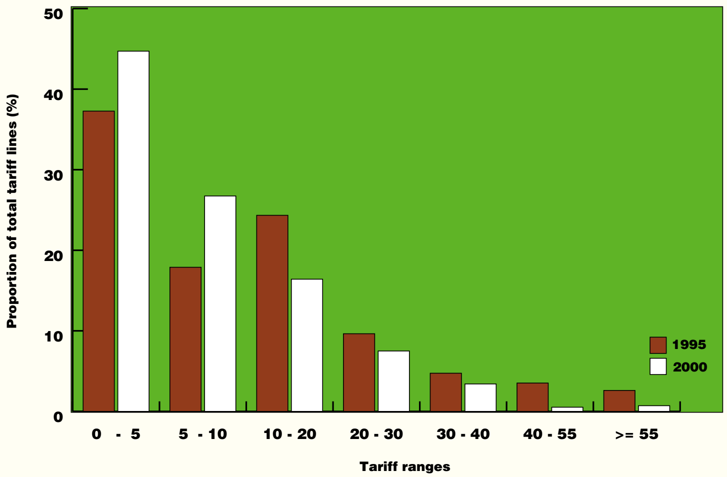
From 1995 to 2000, more tariff line items have moved to the 0-5% tariff range (See Technical Notes 2 and 3), **and proportionally less have fallen within the high tariff categories** (See Chart 2 and Technical Notes 4 and 5).

Chart 2 shows that the proportion of total tariff line items in the tariff range of 0-5% increased by 22% from about 37% of total tariff lines in 1995 to about 45% of total tariff lines in 2000 (see Chart 2 and Technical Notes 6 and 7).

In contrast, there has been a decline in the proportion of total tariff line items in the high tariff categories between 1995 and 2000. The proportion of tariff lines in the 10-20% tariff range declined by 33%; in the 20-30% tariff range the proportion of tariff lines fell by 22%; and for the ranges 30-40%; 40-55%; and greater than equal to 55% the proportion of tariff lines fell by 28%; 85% and 73% respectively.

There is clearly a move among APEC member economies away from imposing high levels of tariffs on imports.

Chart 2: Dispersion based on APEC tariff line items 1995 and 2000



Increasing proportion of APEC trade at low tariffs

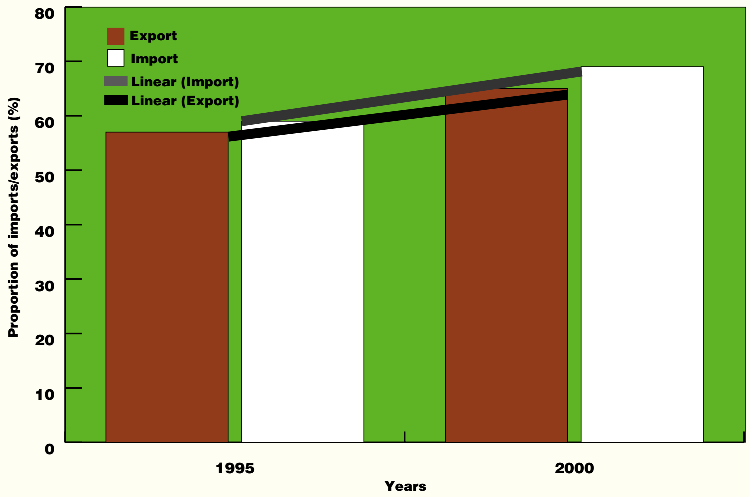
APEC imports in 2000 are estimated to have been US$2 trillion and exports US$1.8 trillion.

The proportion of total imports by APEC economies at very low tariff levels (0-5% tariffs) is high and increasing. It increased by 17% from 59% in 1995 to 69% in 2000.

The increase in the proportion of imports at very low tariff levels has clearly been affected by the increase in concentration of tariff lines at low tariff levels.

Reductions in tariffs do not, of course, only affect imports — they also contribute to increasing exports by reducing input costs and by encouraging domestic producers to be more competitive. The competition effects of the increase in APEC imports at 0-5% tariff levels have led to an increase in APEC exports of similar goods. The proportion of total APEC exports, matching APEC imported goods at 0-5% tariff levels, increased by 14% from 57% in 1995 to 65% in 2000 (See Technical Note 8). It is likely that imports have also contributed to growth in a broader range of exports by providing lower cost inputs to higher value-added products.

Chart 3: Imports and exports at 0-5% tariff range 1995 and 2000



Further evidence of progress

Less open sectors are being addressed but more needs to be done

The proportion of goods imported at 0-5% tariffs has increased across all sectors.

Table 1 shows the proportion of imports at 0-5% tariffs occurring within each sector. It is evident from this table that there is a marked difference in the proportion of imports at 0-5% tariffs occurring in each sector. For example, in 2000 an impressive 80% of the total metal mining imports occur at 0-5% tariffs; but only 23.2% of the total textile, clothing and leather imports occur at 0-5% tariffs.

This difference highlights the fact that while APEC is making progress in liberalising all sectors, there are some sectors that are moving faster towards achieving lower tariff rates than others. Efforts must continue in opening up the slower moving sectors (See Technical Note 9).

Table 1: Percentage of imports at 0-5% tariff range in each ISIC Level 2 Classification

Sector	2000	1995
Metal mining	80.08	75.19
Coal mining	76.36	60.00
Other mining	72.33	58.97
Forestry and logging	70.64	65.63
Petroleum and gas	62.86	54.84
Basic metal	57.05	45.01
Agriculture	56.64	52.61
Metal production, machinery and equipment	50.05	41.03
Chemicals and plastic products	49.83	41.79
Fishing	49.30	47.15
Paper and paper products	47.89	41.38
Non-metal and mineral products	40.77	33.15
Wood and wood products	40.56	34.01
Food, beverages and tobacco	40.47	35.08
Other manufactures	39.78	35.39
Textile, clothing and leather	23.16	22.07

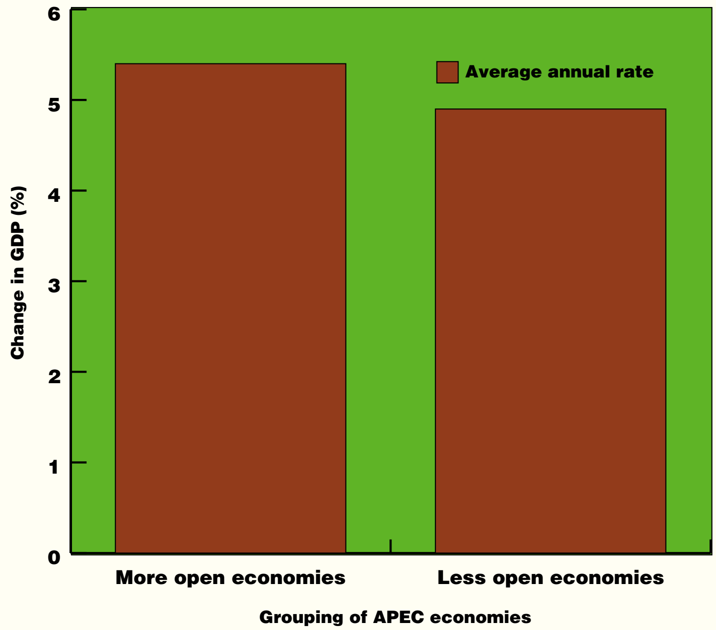
More open APEC economies progressing better

All APEC member economies have demonstrated significant liberalisation. However, there are differences in their level of openness. This is to be expected for a variety of reasons, including their differing stages of economic development. The APEC economies which are more open, however, have achieved higher levels of economic growth (See Technical Note 10).

Although many things contribute to economic growth, the more open economies (the five APEC member economies with the lowest simple average tariffs) achieved an annual economic growth of about 5.4% between 1995 and 2000 — a half a percentage point higher than that achieved by less open economies (the five APEC member economies with the highest simple average tariffs) with an annual economic growth of about 4.9% in the same period.

Higher rates of annual economic growth provide for increased levels of employment and higher wages growth **(APEC 2000).**

Chart 4: Economic growth in more open and less open APEC economies 1995-2000



Looking beyond liberalisation

The analyses and evidence presented in this study confirm that APEC members are continuing to reduce tariffs at significant rates, translating to an increasing proportion of trade at lower or zero tariff levels, and greater trade flows. The findings reinforce earlier studies on APEC progress on tariff reductions and the benefits that liberalisation brings to APEC communities.

This achievement should not, however, be considered as a pretext to moderate further progress in liberalisation. Instead, the achievements should be taken as a confidence-builder to continue, if not increase, the pace of liberalisation in APEC. This needs to include difficult and sensitive sectors where tariff peaks remain.

As traditional trade barriers such as tariffs come down, addressing other impediments to trade in goods and services, such as through trade facilitation and economic and legal capacity building, must take on greater importance.

APEC members, individually and collectively, have done significant work on trade facilitation. Indeed, the trade facilitation agenda is expanding from an initial focus on customs and standards harmonisation to a wider range of activities beyond border protection such as administrative, regulatory and structural impediments affecting business mobility, government procurement, intellectual property, paperless trading and competition issues.

More can be done. In the business mobility area, for example, APEC can expand streamlined temporary residency procedures to include short-term professional and technical staff, and offer advanced (fully automated) passenger and flight information processing for all air travellers.

The business community has identified a myriad of barriers to trade beyond tariffs, particularly in the areas of:

- customs procedures;
- mobility of business people, as well as students and tourists;
- harmonisation of standards and labelling requirements;
- intellectual property protection;
- commercial arbitration;
- mutual recognition of professional qualifications;
- impediments to trans-national manufacturing; and
- consumer protection especially regarding on-line transactions.

Whether in customs, standards or business mobility, there are commonalities in the concerns, which can be addressed by appropriate facilitation policies including by making rules and procedures:

- more simple;
- more transparent; and
- fairer and predictable.

The benefits to be gained from facilitation can be quite significant. Full implementation of APEC's trade facilitation commitments as they stood in 1997 could add an estimated 0.25%

of real GDP (or about US$46 billion in income in 1997 prices) (Economic Committee, Assessing APEC Trade Liberalisation and Facilitation — 1999 Update). The current facilitation agenda is much broader (including mutual recognition arrangements in electrical and telecommunications equipment) which means the potential benefits are higher. Full implementation of the APEC Electrical MRA alone could deliver potential savings of around $US12.5 billion annually for the region's exporters. Stepping up efforts on trade facilitation, in all its forms, will be an important objective for APEC.

Strengthening markets — improving competitiveness through ongoing reform — is also an important element of APEC's agenda. The establishment of the APEC *Principles to Enhance Competition and Regulatory Reform* has been a positive step in this regard. APEC members need to continue to make real efforts in implementing initiatives consistent with these principles, including work on strengthening economic legal infrastructure and strengthening financial markets.

Strengthening economic legal infrastructure is fundamental to building business and investor confidence in an economy, through regulatory and institutional reform, particularly in building capacity and skills of individuals and in improving institutional processes when applying and enforcing rules on corporations and competition.

An additional new challenge for APEC members is to create the ability to take advantage of the opportunities offered by advances in information and communications technologies, which are transforming the global economy. The so-called New Economy holds potential for higher productivity across all sectors (not just in high technology sectors/enterprises).

APEC can strengthen its markets by:

- providing greater transparency in corporate and public sectors;
- enhancing the role of competition to improve efficiency and broaden participation by enterprises;
- improving the quality of regulation and the capacity of regulators to design and implement policies for sustainable growth;
- reducing compliance costs and facilitating business growth; and
- building a favourable regional and international environment for free and fair competition.

APEC economies need to put in place a set of inter-related policies that will ensure "networked information technologies" meet the needs of individuals, firms, markets and governments to improve their competitiveness in the global marketplace and achieve sustained economic growth. APEC members need to establish a regulatory and market environment that promotes and supports:

- well-managed fiscal and monetary policy;
- afair and transparent legal system;
- efficient and deep financial markets;
- the free flow of goods and capital; and
- competition.

(Mann and Rosen, 2001)

Looking beyond liberalisation

There remains a significant "digital divide", which APEC needs to continue to address as part of its forward agenda to complement tariff reductions. This divide reflects differences in the relative cost of information technology and vastly different levels of access to basic telecommunications (See Table 2). Developing and implimenting the APEC action agenda on the New Economy will be an essential part of APEC's efforts on removing barriers to trade and investment.

APEC continues to demonstrate its trade and investment liberalisation and facilitation credentials, particularly in its efforts to reduce tariffs. But while tariffs must continue to come down, it is important that APEC addresses the full range of issues that will ensure the benefits of open markets are maximised, sustained and shared by all APEC communities.

Table 2: Access to information and telecommunications technologies

	Telephone Density	PC Penetration*	Internet Penetration	Wireless Penetration
Australia	52.12	47.06	40.54	34.28
Brunei	24.68		1.19	20.52
Canada	65.45	36.08	42.8	22.65
Chile	20.7	6.66	4.12	15.05
China	8.58	1.22	1.34	3.42
Hong Kong, China	57.57	29.76	26	63.61
Indonesia	2.91	0.91	0.18	1.06
Japan	49.4	28.69	21.38	44.94
Korea	44.14	18.29	32.31	50.03
Malaysia	20.3	6.87	6.88	13.7
Mexico	11.22	4.42	2.49	7.94
New Zealand	49.03	32.65	35.08	23.01
Peru	6.69		0.04	0.15
Philippines	3.95	1.69	1.5	4.02
PNG	1.14		0.62	3.66
Russia	20.64	3.74	6.3	0.09
Singapore	48.2	43.66	41.91	41.88
Chinese Taipei	54.52	19.7	28.84	52.24
Thailand	8.57	2.27	1.65	3.84
USA	68.18	51.05	53.72	31.15
Vietnam	2.68		0.13	0.04

*Figures are percentages per population — except for * which is percentages per household*

1. Previously, progress made on reducing tariffs has mainly been analysed in terms of falling average levels (e.g. PECC 1995). Although providing useful information, there have been a number of difficulties with this approach. For example, it is difficult to determine ad valorem levels (tariffs as a certain proportion of value rather than a specific amount) necessary for inclusion in the average calculations for a number of large tariff items and their exclusion generally biases the averages downwards. Information on ad valorem items is generally provided through frequency measures.

2. 1995 is chosen as the baseline because it relates to PECC (1995) in which the first analysis of tariff reductions using the pilot APEC Tariff Database was undertaken. 2000 information is available from UNCTAD's TRAINS on tariffs and associated imports, although not all economies' tariffs will have been updated to this year. When other trade information was used in the analysis, 1999 information was extrapolated to 2000 to provide clearer trends in the charts.

3. Five per cent is the first non-zero tariff category incorporated in the agreed summary table format for APEC Individual Action Plans (IAPs).

4. Reduction in tariffs can be assessed by analysing whether tariff averages and dispersions are falling. They can also be assessed by analysing whether the proportion of low-tariffs is increasing and the dispersions falling. These are just different ways of representing the same underlying distribution, each with their own advantages and disadvantages. Tackling the analysis of reducing tariffs from the complementary increasing proportion of low level tariffs rather than a declining average tariff has some advantages, such as not being distorted by high specific tariffs, although these will influence the dispersion measures.

   Averages on their own do not present a full picture. For example, averages could be declining but the dispersion of tariffs could be increasing along with the distortion in the efficient allocation of domestic resources with resources moving out of lowly protected sectors into more highly protected sectors. The larger the dispersion in tariffs, the larger the distortion in resource allocation.

   Economies with uniform tariff rates might not face distortions in the allocation of domestic resources but the dynamic benefits of low tariffs, such as those that flow from increased international competition, may be lost.

5. These proportions are calculated from linking imports and exports with TRAINS data base on MFN tariffs. The resultant data base consists of individual data items identifying economies, specific tariff line and trade items, and associated levels of tariffs and trade with nominated partners (both imports and exports for that import tariff line item). These are aggregated to the 6-digit tariff line level (see Technical Note 7

for more details). For a particular tariff line item, one of the imports or exports might be zero but in the aggregation to the 6-digit level there will generally be some low tariff imports and some exports of low import tariff line items. Economies may import at low tariffs because they want low cost input that they may not produce or because they are competitive in these products and hence may export them as well (intra-industry trade). Average tariffs, the number of tariff line items and total trade are calculated in the aggregation process. At this stage allocations can be made to various groupings based on the level of average tariffs, economies and sectors. Individual tariff line item movements in average tariffs and associated total trade are not tracked but some of the groupings such as those based on sectors illustrate the relationship between lower tariffs and increased trade.

TRAINS has a number of 'not available' items that need to be removed from the analysis, for example specific duties or non-ad valorem items, which could affect the estimates. IAPs help provide a useful perspective on the potential impact. On an annual basis APEC shows its achievements and commitments in lower tariffs through the IAPs. These plans highlight what has already been achieved through various dimensions of analysis of tariffs. Some of the IAPs for APEC economies included information on the distribution of tariff items. This enables a comparison of the results obtained from the TRAINS database with those obtained from other comparable data. In the case of Australia, the proportion of low tariff were about the same but in the case of Indonesia the proportion was higher in the case of the IAPs. The IAPs being derived by the individual economies may have been able to allocate the 'not available' items to tariff groups. If this was the case, the IAP result suggests the TRAINS estimates which removed the 'not available' items from the analysis, although impressive, could be under estimates of the proportions of both imports and exports.

6. The estimates are unweighted and based on the APEC economies of Australia, Canada, Chile, China, Hong Kong (China), Indonesia, Japan, the Republic of Korea, Mexico, Malaysia, New Zealand, the Philippines, Singapore, Thailand and the United States of America. Not all APEC economies are included in the estimates as there are no statistics on Brunei and PNG in international trade databases, Peru, the Russian Federation and Vietnam have only joined APEC recently, and Chinese Taipei is not included in many international databases. Import-weighted estimates, which are dominated by the United States, Hong Kong, Japan and Singapore, portray the same growth but from a higher base, increasing from 66 per cent in 1995 to 71 per cent in 1999.

7. An issue that arises in much of the analysis is how should aggregations be weighted. For example, the proportion of imports traded at low tariffs could be determined on an economy basis and require to be aggregated up to the APEC or other levels. An equal weighting for each economy might

misrepresent the true proportion of APEC imports if the import proportions of large importers differed from those of small importers. In this case it would be more appropriate to import weight the economy values. This would give an aggregate value similar to that obtained if the APEC imports were aggregated ignoring individual economy separations.

On the other hand, calculating average tariffs using import weights leads to an inappropriate measure as excessive tariffs which prevent any imports are given zero weight in the aggregation. Here equal weights would be more appropriate as they are a better approximation to the preferred, but difficult to obtain, production weights that reflect resource allocations (for more details see PECC 1995). This is also a more appropriate weighting for tariff line items of which there are a similar number in all the economies' 6-digit schedules. This would give an aggregate value similar to that obtained if the APEC frequencies were aggregated ignoring individual economy separations. It is also consistent with the simple average tariffs calculated at the 6-digit level that are used to allocate tariff line items to low tariff or other classifications.

However, import weighted measures, which would not be difficult to obtain, would be consistent with the import proportion measures as well as not be as distorted by missing high tariffs as the average tariff measures. On occasions, import weighted measures will also be calculated for comparison purposes.

8. The measure of increase in proportion of exports at 0-5% tariffs does not represent the overall impact of tariff reduction on exports, in particular it does not take full account of the influence of imports as lower cost inputs to the competitiveness of all exports. In addition to reducing input costs and exposing domestic producers to competition, reducing tariffs releases resources from import competing sectors which lowers their costs as inputs to exporters. Moreover, there are dynamic gains reflected in aspects such innovation, productivity and quality.

9. There is a danger that without attacking the very high tariffs, more resources could move out of lowly protected sectors into more highly protected sectors with associated economic efficiency costs (see Dee et al 1998 and Productivity Commission 2000).

10. The main benefits from removing tariffs generally go to the economy removing them (see for example Dee et al 1996 for some empirical evidence on this aspect). This is probably more evident from the reverse situation of a domestic economy imposing high tariffs and bearing the main costs in terms of higher priced products, less choice, and so on.

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