

GATT VIOLATIONS THROUGH TARIFF ESCALATION IN DEVELOPING COUNTRIES

by

Pavithra V

ABSTRACT

This research explores the implications of tariff escalation on developing countries within the framework of the General Agreement on Tariffs and Trade (GATT). While GATT aimed to promote trade liberalization and reduce barriers, the persistent practice of tariff escalation has disproportionately affected developing nations, hindering their access to developed markets. Tariff escalation occurs when countries impose higher tariffs on processed goods than on raw materials, discouraging value addition and industrial development in poorer nations. This paper analyzes about the tariff escalation, the background of GATT and Trade Liberalization, and its impact on developing economies. Through a comprehensive review of literature, and analyzing the methodology, the research investigates how tariff escalation disproportionately affects developing countries, stifling their ability to move up the value chain and hindering economic diversification.

Keywords

GATT, Tariff escalation, Trade liberalization, Developing countries, Trade barriers, Economic development, International trade, Non-discrimination, Reciprocity, Trade policy reform.

INTRODUCTION

The General Agreement on Tariffs and Trade (GATT) was established with the primary goal of promoting free and fair trade by reducing trade barriers, including tariffs, among member nations. However, one persistent challenge that has emerged within the GATT framework is tariff escalation, the practice of imposing higher tariffs on processed or value-added goods compared to raw materials. This practice disproportionately affects developing countries, hindering their ability to diversify their economies and move up the value chain.

While GATT and its successor, the World Trade Organization (WTO), are designed to prevent protectionist measures, tariff escalation remains a subtle yet significant violation of the spirit of these agreements. By maintaining lower tariffs on raw materials while imposing steep duties on manufactured goods, developed nations effectively protect their industries and discourage the industrialization of developing countries. This creates an imbalance in global trade relations and undermines the principles of equitable trade that GATT seeks to uphold.

This research seeks to explore how tariff escalation in developing countries constitutes a violation of GATT provisions, particularly within the framework of non-discrimination and special and differential treatment for developing nations. It also examines the broader implications of tariff escalation on economic development, industrialization, and global trade equity.

TARIFF ESCALATION

Tariff escalation refers to the practice where countries impose higher tariffs on processed or value-added goods compared to raw materials. This creates a cascading tariff structure where products in their unprocessed form enter a country at low or zero tariffs, but as these products undergo further stages of manufacturing, the tariff rates increase. This policy is often employed by developed countries as a way to protect their domestic industries that engage in higher-value processing and manufacturing. However, for developing countries, tariff escalation poses a significant challenge to their economic growth and industrialization efforts. Developing nations, which often export raw materials or semi-processed goods, face higher tariffs when trying to export finished goods, making it difficult for them to move up the value chain. The result is that they remain dependent on exporting low-value raw materials while

importing high-value manufactured goods at inflated costs. Tariff escalation also discourages foreign direct investment in processing industries in these countries, as firms face diminished profitability due to higher tariffs on the final output. This protectionist measure runs counter to the principles of trade liberalization advocated by the General Agreement on Tariffs and Trade (GATT), which aims to foster open markets and a more equitable global trading system. Despite the GATT's efforts to reduce tariffs globally, tariff escalation practices continue to exist, undermining the competitive position of developing nations in the global market and hindering their capacity to diversify and expand into value-added industries.

For Example: Tariffs imposed on the processed products (such as refined sugar) have higher tariff rate than on its corresponding primary products (such as raw sugar).

BACKGROUND ON GATT AND TRADE LIBERALIZATION

The General Agreement on Tariffs and Trade (GATT), established in 1947, was a multilateral agreement aimed at promoting international trade by reducing tariffs and other trade barriers. It was initially signed by 23 nations, but over the decades, it grew to encompass over 100 countries before evolving into the World Trade Organization (WTO) in 1995.

GATT's Foundational Principles

The core objectives of GATT were to foster trade liberalization and reduce protectionist policies that had contributed to global economic instability during the interwar period. It sought to achieve this through several foundational principles:

1. **Non-discrimination:** The "Most-Favoured-Nation" (MFN) principle ensures that any advantage, favour, or privilege granted to one member country must be extended to all others. This promotes equality among member nations.
2. **Reciprocity:** This principle encouraged countries to reduce tariffs in return for similar concessions from their trade partners, fostering a cooperative spirit.
3. **Transparency:** GATT required members to publish their trade regulations, promoting transparency in trade practices.
4. **Tariff Binding and Reduction:** The agreement aimed to limit the use of protectionist tariffs by binding them at agreed levels and encouraging countries to progressively lower these levels over time.

Trade Liberalization through GATT Rounds

GATT negotiations were conducted through a series of multilateral trade rounds. Each round focused on reducing tariffs and other trade barriers, contributing to trade liberalization. Some notable rounds include:

- **Kennedy Round (1964-1967):** Focused on tariff reduction, particularly for industrial goods, and introduced an anti-dumping agreement.
- **Tokyo Round (1973-1979):** Addressed non-tariff barriers and expanded the scope of GATT to include developing countries.
- **Uruguay Round (1986-1994):** The most significant round, which led to the creation of the WTO, expanded the coverage to new areas such as services, intellectual property, and agriculture.

Trade Liberalization and Developing Countries

GATT's framework initially prioritized tariff reductions on industrial goods, which mainly benefited developed countries. However, the inclusion of developing nations gained prominence, especially after the Tokyo Round, where special provisions were introduced to accommodate their specific needs. Developing countries were often granted more flexibility in implementing GATT commitments, recognizing their diverse economic conditions.

In the 1980s and 1990s, trade liberalization efforts accelerated as many developing countries embraced open-market policies. GATT provided a platform for these nations to negotiate favorable trade terms, enabling them to integrate into the global economy and benefit from international trade.

Impact of GATT on Global Trade

Over the decades, GATT contributed significantly to the reduction of tariffs, expansion of global trade, and economic growth. Between 1947 and the 1990s, global average tariffs on industrial goods dropped from around 40% to less than 5%. By encouraging a predictable and transparent trading system, GATT facilitated a multilateral trade framework that was crucial for post-World War II economic recovery and the subsequent globalization of trade.

LITERATURE REVIEW

The implications of tariff escalation have been a central topic in trade policy discussions, particularly in the context of developing economies. Several studies have analysed how this practice hinders industrialization and economic development. Tariff escalation occurs when countries impose lower tariffs on raw materials and higher tariffs on processed or value-added products. While this approach is often used to protect infant industries in developing countries, it can lead to significant distortions in global trade, contravening the principles of GATT and WTO.

1. Tariff Escalation in Trade Policy

Tariff escalation remains a prominent feature in the trade policies of both developed and developing nations, with profound impacts on global trade dynamics. Scholars like Bouët, Fontagné, and Jean (2006) highlight how this practice disproportionately disadvantages developing countries. By imposing higher tariffs on processed goods, these nations disincentivize local investment in manufacturing and value-added activities, perpetuating a cycle of dependency on raw material exports and limiting economic diversification.

Moreover, high tariffs from developed countries create barriers for developing nations' processed goods, reinforcing their reliance on low-value exports. Despite GATT's aims to reduce trade barriers, the persistence of tariff escalation indicates that these goals are far from realized.

2. Implications for Industrialization in Developing Countries

Research reveals that tariff escalation undermines industrialization efforts in developing economies. Lall (2000) argues that this practice stifles domestic industries' ability to innovate and invest in advanced manufacturing. By promoting raw material exports over processed goods, developing nations miss opportunities for industrial diversification and sustainable economic growth.

A UNCTAD report (2003) emphasizes that tariff escalation creates structural barriers for sectors like agriculture and textiles. Higher tariffs on finished products hinder the development of competitive domestic industries, which are essential for both local consumption and export. Panagariya (2002) further asserts that tariff escalation contradicts

GATT's principle of "special and differential treatment," locking developing countries into low-value activities and limiting their participation in international trade.

3. GATT/WTO Compliance and the Spirit of Trade Liberalization

While tariff escalation may not directly violate GATT rules, it undermines the agreement's broader principles. Hoekman and Kostecki (2009) argue that such practices conflict with the Most-Favored-Nation (MFN) and National Treatment principles, designed to ensure equal trading conditions. By creating market distortions, tariff escalation disadvantages developing nations, rendering their processed goods less competitive.

WTO reports (2003) stress that this practice restricts developing countries' ability to integrate into the global economy, perpetuating unequal trade relations and economic dependence on developed nations. By maintaining escalated tariffs, countries violate GATT's objective of fostering a level playing field for all members, particularly those seeking to industrialize.

RESEARCH METHODOLOGY

This Research Methodology follows a Doctrinal Approach (i.e) Case Law Approach

The research will adopt a qualitative legal analysis framework, focusing on case laws that highlight violations of GATT through tariff escalation by developing countries. It will aim to examine the legal interpretations made by the WTO Dispute Settlement Body (DSB) and its panels or Appellate Body in relevant disputes. This section will also explore how these cases have been cited and applied in subsequent rulings, offering a historical and doctrinal analysis of tariff escalation disputes.

1. Quantitative Restrictions on Imports of Agricultural, Textile, and Industrial Products - India¹

- **Background:** In this case, the United States challenged India's quantitative restrictions on various agricultural, textile, and industrial products.
- **Relevance to Tariff Escalation:** While this case primarily dealt with quantitative restrictions, it highlighted concerns about tariff policies in

¹(WT/DS90)

developing countries, such as India, where higher tariffs on processed goods discourage imports, reinforcing tariff escalation.

- **Outcome:** The WTO ruled that India's measures were inconsistent with GATT rules, requiring it to eliminate the quantitative restrictions.

2. Regime for the Importation, Sale and Distribution of Bananas - European Communities²

- **Background:** This case involved a challenge by the United States and several Latin American countries against the European Communities (EC) over its banana import regime, which imposed higher tariffs on processed banana products from non-ACP (African, Caribbean, and Pacific Group) countries.
- **Relevance to Tariff Escalation:** This case dealt with a form of tariff escalation, where raw bananas were subject to lower tariffs, but processed products were taxed more heavily, impacting developing countries like Ecuador and other Latin American nations.
- **Outcome:** The WTO ruled in favour of the complainants, emphasizing that the EC's regime violated GATT's principles of non-discrimination.

3. Measures Affecting Imports of Footwear, Textiles, Apparel, and Other Items - Argentina³

- **Background:** The European Union challenged Argentina's safeguard measures, which included tariff increases on various imports such as footwear and textiles.
- **Relevance to Tariff Escalation:** The case highlighted Argentina's strategy of increasing tariffs on processed goods, which is a key aspect of tariff escalation practices.
- **Outcome:** The WTO panel ruled against Argentina, stating that the safeguard measures violated GATT provisions and required Argentina to bring its measures into conformity.

²(WT/DS27)

³(WT/DS121)

4. Measures Affecting Imports of Retreaded Tyres - Brazil⁴

- **Background:** The European Union filed a complaint against Brazil for banning imports of retreaded tyres while allowing domestic production of retreaded tyres, thus giving preferential treatment to its domestic industry.
- **Relevance to Tariff Escalation:** Though not a tariff case per se, it involved trade restrictions and protectionism, where developing countries use different policies to favour domestic industries at the expense of imported products.
- **Outcome:** The WTO ruled that Brazil's measures violated GATT's principles of non-discrimination, although some exceptions under environmental provisions were acknowledged.

5. Measures Related to the Exportation of Rare Earths, Tungsten, and Molybdenum - China⁵

- **Background:** The United States, the European Union, and Japan challenged China's export restrictions on rare earths, tungsten, and molybdenum.
- **Relevance to Tariff Escalation:** While this case is more focused on export restrictions, it reflects China's broader approach to resource management and tariff policy. China imposed lower tariffs on raw materials while keeping higher tariffs on finished goods, similar to practices of tariff escalation.
- **Outcome:** The WTO ruled against China, asserting that its export restrictions violated GATT rules, which generally discourage tariff escalation policies.

FINDINGS

Findings suggest that many developing countries face a disadvantageous tariff structure. Tariff escalation refers to a practice where countries impose lower tariffs on raw materials and higher tariffs on processed or value-added products. This discourages the development of

⁴(WT/DS332)

⁵(WT/DS431, WT/DS432, WT/DS433)

domestic processing industries in developing countries and can be seen as inconsistent with GATT's core principles of reducing trade barriers and promoting free trade. For example, raw agricultural products may face lower tariffs, while processed goods like coffee or cotton textiles are subject to much higher duties. This discourages domestic processing industries in developing economies. Furthermore, the WTO's Trade Policy Reviews reveal that developed countries often impose these escalating tariffs on imports, effectively maintaining a market advantage. These practices violate the spirit of GATT, particularly Article II (Schedules of Concessions) and Article XXVIII (Modification of Schedules) are often central in cases related to tariff measures. Tariff escalation can also implicate other GATT articles related to non-discrimination (Article I: Most-Favoured-Nation treatment and Article III: National Treatment).

IMPACT ON DEVELOPING ECONOMIES

Tariff escalation, where tariffs increase with the degree of processing in goods, has had significant adverse effects on developing economies. While the General Agreement on Tariffs and Trade (GATT) aimed to promote fair trade practices, tariff escalation undermines the competitiveness of developing nations in global markets by discouraging value-added production.

- **Hindrance to Industrialization**

Developing countries often rely on the export of raw materials and agricultural products, facing minimal tariffs in these sectors. However, higher tariffs on semi-processed and finished goods limit their ability to move up the value chain. This creates a disincentive for industrialization, locking them into the role of primary commodity exporters and preventing diversification of their economies.

- **Trade Imbalances**

The tariff escalation practices employed by developed countries often widen trade imbalances. While raw materials enter developed markets at lower tariffs, processed goods from developing nations face prohibitive costs. This limits export revenue and stifles economic growth, perpetuating a cycle of dependency on low-value exports.

- **Loss of Competitiveness**

The inability to develop competitive manufacturing sectors due to escalated tariffs weakens the ability of developing countries to integrate into global supply chains. Consequently, their potential to attract foreign direct investment (FDI) in higher-value sectors diminishes, further entrenching economic disparities between developed and developing nations.

- **Reduced Market Access**

Tariff escalation restricts market access for processed goods from developing economies. This results in reduced export earnings, fewer opportunities for technology transfer, and limited capacity to generate employment in higher-value sectors, slowing overall economic progress.

CONCLUSION

Tariff escalation remains a critical challenge for developing countries, undermining the principles of trade liberalization espoused by the General Agreement on Tariffs and Trade (GATT). Despite commitments to reducing tariffs, the practice of increasing tariffs on processed goods while maintaining lower tariffs on raw materials hinders the ability of developing nations to move up the value chain and industrialize. This violates the spirit of GATT, which aims to promote equitable access to markets and reduce protectionism.

For developing countries, tariff escalation perpetuates dependency on low-value exports and constrains economic diversification. Moreover, it distorts global trade patterns, limiting the benefits these nations could gain from greater market access for higher-value goods. Addressing this issue requires stronger enforcement mechanisms under the World Trade Organization (WTO) framework and a renewed focus on equitable trade policies that support the industrial growth of developing economies.

In conclusion, while GATT has made significant strides in promoting global trade, tariff escalation poses a barrier to the realization of its full potential, particularly for developing countries. Continued efforts to eliminate such practices are essential for fostering more inclusive and fair global trade.

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