FOR AGENDA

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To: Members of the Executive Board

From: The Secretary

Subject: Recent Developments and Issues in Trade Policies

The attached paper on recent developments and issues in trade policies has been scheduled for discussion on Wednesday, September 9, 1987. Issues for discussion appear on pages 21-23.

Ms. Kelly (ext. 8374) or Ms. Kirmani (ext. 8363) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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Recent Developments and Issues in Trade Policy

Prepared by the Exchange and Trade
Relations Department

(In consultation with other Departments)

Approved by L.A. Whittome

July 31, 1987

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N.B. It should be noted that the term country, as used in this report does not in all cases refer to a territorial entity that is a state understood by international law and practice; the term also covers some territorial entities that are not states but for which statistical data are maintained and provided internationally on a separate and independent basis.

I. Introduction

Earlier this year Executive Directors reviewed the analytical underpinnings to protection (EBM/87/53, 3/23/87) on the basis of the staff paper "Protection and Liberalization - A review of Analytical Issues," SM/87/43 (2/3/87). The last comprehensive trade policy survey "Trade Policy Issues and Developments" (SM/85/60, 2/19/85) was discussed by the Board in March 1985.

This paper is based on information available at headquarters. It is therefore more limited in scope than the previous trade survey which benefited from staff visits to a number of industrial and developing countries and to international organizations dealing with trade. It covers trends in protection, their causes and effects, and the prospects for trade reform. It also reviews the Fund's contribution in the trade area and highlights the main issues for discussion.

II. Trends in Protection

1. Incidence 1/

a. Industrial countries

The 1980s have witnessed a strong drift toward protectionism in industrial countries, though markets for manufactures in these countries remain relatively open. This has occurred against the background of the deceleration of growth of both world trade and output compared with earlier decades, as well as a further narrowing of the margin by which growth of trade has exceeded that of output (Table 1).

Limited instances of liberalization, including tariff cuts agreed in the Tokyo Round, have been overshadowed by increased resort to protectionist measures, especially during the early 1980s. Protectionist pressures in recent years have intensified, and existing trade procedures have been applied more rigidly, leading to increased confrontations among industrial countries. This, together with a broadening of the range of industries in which conflicts may arise, has contributed to a marked deterioration in the trading climate.

As regards the United States, there has been no significant change in the Administration's basic policy of free and fair trade as formally enunciated in September 1985. However, there has been an intensification of protectionist pressures in the U.S. Congress. This reflects

1/ Annex I provides indices of nontariff import measures in industrial countries. Annexes II and III describe major trade measures in agriculture and industry. The forthcoming Annual Report on Exchange Arrangements and Exchange Restrictions provides information on trade policy developments in 1986 for both industrial and developing countries.

a significant erosion of the influence of traditional free trade lobbies in the face of increasing public frustration with large U.S. trade deficits, the sectoral and regional effects of increasing foreign competition both at home and in third markets, and perceptions of "unfair" foreign trading practices. A variety of restrictive trade bills are being considered by the U.S. Congress, which are disturbing to trading partners and the U.S. Administration. 1/ However, the Administration has signaled a probable Presidential veto of new trade legislation if it contains restrictive provisions.

Table 1. Growth of World Merchandise Trade and Production, 1960-86

(Average annual percentage change in volume)

	1960-70	1970-80	1980-86	1985	1986
Exports					
All merchandise	8½	5	2½	3½	3½
Agriculture	4	4½	1½	0	1
Mining	7	1½	-1	-1	7
Manufacturing	10½	7	4½	5½	3
Production					
All merchandise	6	4	2	3	3
Agriculture	2½	2	2½	2	3
Mining	5½	2½	-1½	-½	5
Manufacturing	7½	4½	2½	4	2

Source: GATT, "International Trade in 1986 and Current Prospects," Geneva, March 1987.

In the past several years the scope of import restrictions and/or export subsidies in the United States has been expanded or intensified in traditional sectors (textiles, steel, agriculture) and in new areas (e.g., machine tools), and trade conflicts have intensified in these and other areas (e.g., semiconductors). The coverage of U.S. imports affected by nontariff measures rose significantly between 1981 and 1986

1/ The U.S. House of Representatives has passed an omnibus trade bill (H.R. 3) which, inter alia, reduces Presidential discretion on trade actions, expands the scope of antidumping and antisubsidy measures and of agricultural subsidies, and requires retaliation against trading partners who do not reduce "excessive" bilateral trade surpluses with the United States. The Senate has passed similar legislation. Restrictive global quotas on textiles, apparel and footwear are also being considered.

(Annex I). The U.S. Administration has, however, resisted protectionist proposals by Congress (e.g., in the case of footwear in 1985 and the Presidential veto of the textile bill in 1986). In some instances, the Administration has taken limited trade measures to neutralize pressures for more restrictive actions.

In the early 1980s, the European Community resorted to restrictive measures in agriculture, textiles, steel, automobiles, and electronics. While most earlier trade barriers are still in place, new trade restrictions recently have been directed mainly at Japan and some of the higher income developing countries. In recent years the EC has endeavored to complete the liberalization of technical and fiscal barriers, standards, and other requirements affecting the internal market and its international competitiveness. The share of imports affected by nontariff measures in the EC rose moderately during 1981-86 (Annex I). The operation of the EC's Common Agriculture Policy (CAP), has led to growing agricultural surpluses and an increase in export subsidies, and has become an increasing source of friction in agricultural trade. Partly in response, the United States has increased resort to competitive agricultural export subsidies under its new Export Enhancement Program. Alarmed at the potential reach of these subsidy "wars," other agricultural exporters have organized "the Cairns Group" 1/ to intensify efforts at agricultural reform. This group and some other major agricultural trading nations are seeking a far-reaching reduction in agricultural trade barriers and subsidies in the Uruguay Round; in particular the United States has proposed that all subsidies and barriers to agricultural trade be eliminated and health regulations be harmonized by the year 2000. In part to prevent escalation of trade conflicts, the EC Council has postponed a decision on the proposed tax on oils and fats.

Recently Japan has undertaken a series of market opening measures. Under the three-year action program started in July 1985, tariffs on 1,860 industrial and agricultural items are being reduced and 88 measures enacted to ease certification and technical standards for imports. Japan has also improved market access under its GSP. However, foreign exporters continue to question the openness of the Japanese market. As measured by the level of tariffs and the range of goods over which standard nontariff barriers exist, formal protection of nonagricultural sectors by Japan is quite low. "Informal" barriers are difficult to quantify and their effects on trade flows are controversial. Some argue that the volume of trade flows are consistent with relatively low barriers; others--based partly on anecdotal

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1/ The group derived its name from Cairns, Australia and includes industrial countries such as Australia, Canada, and New Zealand, as well as developing countries such as Argentina and Brazil.

evidence--suggest "informal" barriers may be high. 1/ In agriculture Japan has traditionally maintained a highly restrictive trade regime. A recent OECD study estimated that Japan had the highest rate of agricultural subsidization among major OECD countries (Annex II). Japan has recently taken measures to stimulate domestic demand and imports, partly to allay protectionist pressures abroad.

b. Developing countries

Many developing countries have traditionally maintained tariff and nontariff barriers of greater complexity and at substantially higher levels than in industrial countries. In a number of cases, the exchange and trade system is further distorted by reliance on export levies, state purchasing and distribution, and multiple exchange rates. In the aftermath of the oil crisis, world recession, and rising debt problems, resort to exchange and trade restrictions rose in many developing countries. Recently, however, a number of developing countries have taken trade liberalization measures, often in the context of adjustment programs supported by the Bank and the Fund, and an overall trend toward liberalization may be emerging.

In some recent cases, exchange reform and realignment of exchange rates preceded or were accompanied by trade liberalization. For example, some countries that adopted floating exchange rate regimes also eliminated major import restrictions (The Gambia, Guinea, Nigeria, and

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1/ In the draft paper "Japanese Trade Policies," for the Institute of International Economics, Bela Balassa provides anecdotal evidence from businessmen about informal barriers to penetrating the Japanese market and contends that these may explain Japan being an "outlier"--i.e. having low import to GNP and import penetration ratios among industrial countries. However, C.F. Bergsten and W.R. Cline (The United States-Japan Economic Problem, Institute for International Economics, Washington D.C., 1985) analyze comparative ratios of imports to GNP, after taking into account country size, natural resource endowments, and transportation costs, and suggest that Japan shows no special aberration of low imports that might be attributable to "informal" or "intangible" barriers. The low share of manufactures in Japan's total imports is largely explained by comparative advantage which is understandable given Japan's limited endowment of natural resources. G.R. Saxonhouse in "The Micro- and Macroeconomics of Foreign Sales to Japan" (Trade Policy in the 1980s, ed. W.R. Cline, Institute for International Economics, Washington D.C., 1983), argues that Japan's relatively low ratio of imported manufactures to total consumption of manufactures can be explained without a big role for informal protection; there were informal barriers in Japan as well as other countries and it was not proven that the former had higher informal protection. The staff examined Japan's trade in manufactures (in SM/86/36, 3/4/86) and found that Japan's trade pattern in these goods can be adequately explained within the framework of traditional theory by the relative factor endowments of the country.

Sierra Leone) while others narrowed the scope of restrictions. Some of the newly industrialized developing countries (NICs) have begun to open their markets. For example, Korea launched a program in 1984 to raise the share of liberalized items in total imports to 95 percent by mid-1988. Mexico, which recently joined the GATT, also initiated a major new import liberalization program in mid-1985 to raise the share of liberalized items to 88 percent of total imports, reduce the height and dispersion of tariffs, and phase out export subsidies. Another example is India which is embarking upon a market opening strategy. 1/

In the 1980s many developing countries began to use countertrade arrangements more actively in an attempt to reduce external deficits, service debts, diversify exports, and overcome protectionist barriers in industrial countries. Estimates of the importance of countertrade as a proportion of total world trade vary widely, ranging from 1 percent (IMF, 1980), 8 percent (GATT, 1985), "significant" (OECD), to 40 percent (private sector estimates), and, in part, reflect differences in timing, definition, and coverage. The lack of transparency and data availability on such deals, as well as a large degree of price distortion also complicate statistical compilations. Despite the known disadvantages of such arrangements, an UNCTAD sponsored report 2/ suggests that countertrade practices may be on the increase in Africa and Latin America, including South-South trade, where it often reflects the desire to reduce the outstanding level of involuntary export credit. A number of Eastern European countries continue to rely on countertrade arrangements.

2. Characteristics of recent moves to protection

Protectionist measures in the 1980s may be characterized as follows.

--Trade actions increasingly are being tied to action by trading partners on such aspects as bilateral trade surpluses, exchange rates, and workers' rights.

--As tariffs in industrial countries have been bound in the GATT at successively lower rates in past multilateral trade negotiations, nontariff trade measures have proliferated.

--A variety of such measures have been employed, but the most common has been the mechanism of "voluntary" export restraints (VERs). Many VERs involve complex and not fully publicized bilateral deals outside GATT rules. The GATT has identified around 100 known, major VERs or equivalent measures.

1/ Section V and Annex VI provide information on trade liberalization in Fund-supported adjustment programs.

2/ UNCTAD, "Countertrade Policies and Practices by Selected African and Latin American Countries," UNCTAD/ST/ECDC/32, March 30, 1987.

--A particularly troublesome feature has been the increased resort to discriminatory measures. Discrimination undermines adherence to the most-favored-nation principle, which is the cornerstone of international trade rules. It has been aimed at the most efficient supplier(s), and has been especially in evidence against Japan and the NICs.

--Protectionism has tended to proliferate, within and among sectors and countries. Limits on the exports of the principal supplier(s) have encouraged others to expand exports, eventually leading them to be perceived also as a threat to the domestic industry.

--The semipermanent character of protection, which has been in evidence for many years in such traditional sectors as agriculture, steel, and textiles, has come to infect new areas such as automobiles and consumer electronics.

--Trade conflicts have arisen more frequently in recent years over subsidies and dumping. Compared with the late 1970s resort to subsidy and dumping practices may not have increased (except in agriculture, and also in some high technology sectors). Sensitivity to the effects of such practices has increased, however, and has been manifested in the more aggressive use of countervailing duties (CVD) and antidumping (AD) provisions. Protection to combat the adverse effects of subsidies and dumping has a multilaterally agreed basis in the GATT; however, GATT rules and coverage in this respect remain to be fully defined and clarified. In some cases, unilateral changes have been made in the rules and scope of CVD and AD, and on occasion investigations have had the effect of harassing foreign exporters.

--The concern with "unfair" foreign competition has been broadened to encompass demands for reciprocal access to bilateral markets as well as conditions of competition in third countries, e.g., the U.S.-Japan dispute over trade in semiconductors.

--Greater use has been made of retaliation and counter-retaliation to encourage trading partners to reform their practices, e.g., recent U.S. tariff measures on certain Japanese electronic exports, and the U.S.-EC pasta dispute. This partly reflects frustration with the sometimes slow and cumbersome mechanisms of multilateral mediation and dispute settlement.

--National trade legislation has extended the scope and automaticity of measures to combat "unfair" competition, e.g., trade legislation in 1984 in Canada, the EC, and the United States, the recent expansion of EC antidumping laws to include components, and the current omnibus trade bills in the U.S. Congress. Restrictive trade legislation invites imitation and retaliation, and even its possibility may be a potent threat to foreign exporters.

III. Causes and Effects of Protection

1. Factors influencing protectionist pressures

Although the benefits of open trade are recognized, efficiency considerations have often been sacrificed for special interest group objectives and, faced with political realities, governments frequently have succumbed to protectionist pressures. The staff paper "Protection and Liberalization--A Review of Analytical Issues" (SM/87/43) found that most reasons given for protection had little or no merit. A brief description of these reasons is given below.

--Protection has been increasingly justified to combat the effects of macroeconomic imbalances including trade and current account deficits, misaligned or fluctuating exchange rates, and debt problems.

--A traditional argument is to preserve employment, which took on heightened importance in the early 1980's due to unemployment problems. In many developing countries, unemployment is ingrained and pressures to guard industrial sector jobs are intense.

--Strategic reasons have traditionally been used to justify protection for farming, but similar claims have also been put forward by industries such as steel, textiles, footwear, high technology, and machine tools.

--Protection for agriculture is also defended on environmental grounds, and to preserve small farmers' way of life.

--Reliance on the infant industry argument for protection is common in developing countries; industrial countries use similar arguments to support new high technology industries through a learning period, for external benefits such as technical spinoffs, and to gain new comparative advantage.

--Arguments for protection based on unfair advantage sometimes have gone beyond subsidies and dumping to include other aspects such as cheap labor or low wages; the low wage argument, which sometimes is stated in terms of concern for foreign workers' rights, attacks the very basis of trade--differences in comparative advantage.

--Related aspects are demands for a "level playing-field" and protection as a "lever to open markets" both of which carry the danger of inducing governments to adopt practices they wish others to dismantle.

--Ultimately, retaliation and counterretalation could be used as justifications for protection.

In examining the validity of the various arguments for protection, Directors contended that under flexible exchange rates protection was not likely to reduce trade and current account deficits; it did not preserve overall employment; and strong arguments could not be made for high protection of agriculture, clothing, and textiles in developed countries. Some felt there was a case for infant industry protection, on a temporary basis, in developing countries. 1/

2. Structural issues

Most protection is introduced to avoid the consequences of economic change. Thus, recession and instability in the international economy in the 1980s have aggravated protectionist pressures arising from more fundamental structural changes. The rise in Japan's share of other OECD imports of manufacturers coincided with an increase in the share of newly industrialized developing countries (NICs) from 1980 onward, resulting in substantial competitive pressures on some OECD countries' import-competing industries. At the same time, the new markets created in the NICs for OECD exports were intensely competitive which led some OECD exporters to demand help from their governments in such forms as subsidized loans and tying trade to aid projects. Labor market rigidities in industrial countries have contributed to demands for protection.

In recognition of the importance of structural adjustment for successful and sustained trade liberalization, international institutions have increasingly analyzed the linkages between trade and other structural issues. Such analysis has been important in the formulation of growth-oriented adjustment programs supported by the Fund and the Bank. OECD ministers recently concluded that their economies were still hampered by major distortions and rigidities, which compounded current macroeconomic problems. In their view increased competition in product markets, greater responsiveness in factor markets, and more efficient public sectors would increase growth potential; a phasing out of subsidies and open trade policies would help achieve these objectives. 2/

In industrial countries, rapid structural adjustment has enabled some industries to eschew import protection, (e.g., the U.S. motorcycle manufacturer asked for the removal of import restrictions on motorcycles one year ahead of schedule). In other cases, there has been substantial structural adjustment (e.g., in the textiles sector) but these sectors continue to be protected along with related sectors (e.g., the clothing industry) where adjustment has proceeded at a slower pace. In still other cases, structural changes underway for many years (e.g., steel) have proved insufficient partly because of massive overcapacity. In the case of the petrochemical and fertilizer industries new capacity emerging in some developing countries requires rationalization of older

1/ The Chairman's Summing Up (Buff 87/50, 3/31/87) at the conclusion of the discussion of SM/87/43.

2/ OECD, "Economic Performance and Structural Adjustment," January 1987.

plants in other countries; structural changes in the United States since 1980 have enabled most plants to produce at efficient utilization rates largely through the elimination of excess capacity; adjustment has been slower in some other industrial countries.

In developing countries, too, long-term structural adjustment is required to enhance efficiency and expand the stock of physical and human capital. It will require more efficient public sectors and reduced reliance on market-distorting mechanisms. Adoption of outward oriented trade strategies, which involve removing the bias against exports, replacing quantitative restrictions with tariffs, and more realistic exchange rates, is a necessary part of structural reform.

3. Costs of protection 1/

Advocates of protection have a clear advantage of preaching a doctrine whose short-run benefits to particular industries or sectors are easily visible, while its real costs for the economy as a whole are less transparent, complex, and difficult to measure.

It is well known, both in agriculture and industry, that domestic consumer and welfare costs of protection as well as the costs of job preservation through protection are high. Trading partners and the world economy as a whole are also harmed through direct effects of protection (e.g., on export earnings and incomes) and its indirect effects (e.g., the effect on world commodity prices of agricultural surpluses induced by costly farm support programs).

Open markets contribute to efficient national and international resource use. Protection entails costs due to foregone specialization--benefits lost by not adapting the international production structure to that of factor endowments--as well as losses in terms of scale economies, product differentiation, R and D efficiency, and technology transfer. Administrative costs of compliance with restrictions are large in the case of quota systems because scarce talent is diverted to nonproductive channels and rent-seeking activities.

4. Implications for developing countries 2/

Trade relations between developed and developing countries have become increasingly strained in recent years. Developing countries have faced increasing protectionist barriers to their traditional industrial exports (such as textiles, clothing, footwear, leather goods), and selected agricultural products. For textiles and clothing, some restraints have been applied for nearly three decades, and the

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1/ Annexes II and III provide information on the costs of protection in agriculture and industry, including the results of selected recent studies.

2/ The World Development Report, 1987 discusses extensively the implications of industrial protection on developing countries.

Multifibre Arrangement (MFA) has been progressively tightened (Annex III). Where developing countries successfully exploit their comparative advantage and diversify into new areas (such as steel, shipbuilding, automobiles, consumer and industrial electronics, and petrochemicals), they often face discriminatory protection.

Industrial countries' nontariff barriers (NTBs) against developing countries have been "porous," allowing imports from developing countries to rise, as indicated by declines in home producers' share of their domestic markets in industrial countries in textiles, clothing, footwear, and steel in the past decade. But even "porous" NTBs do economic harm. They encourage developing countries to adopt inefficient stratagems compared to a situation of free trade or nondiscriminatory restrictions.

The scope for increased trade between developing and industrial countries continues to be large, as evidenced by substantial differences in the production costs of a number of products. The potential large gains in developing countries' export earnings from improved market access in industrial countries have been well documented. Studies of individual developing countries affected by voluntary export restraints (VERs) show that these bring about quota rents, but the gains may be small in relation to the growth in exports which trade restrictions may have frustrated. Furthermore, VERs create uncertainty, incentives for lobbying and corruption, diversion of energies from management to rent seeking, and also encourage costly product upgrading and diversification, with the threat of new restrictions down the line.

Countervailing duty (CVD) and antidumping duty (AD) procedures used by industrial countries impose a heavy cost on developing country exporters, because of the administrative procedures involved. 1/ Developing countries are also particularly vulnerable to possible abuses of these procedures. Many AD and CVD petitions have a valid basis, although some of these cases involve extremely small amounts or products whose quantities are already restricted by quotas. In some instances determination of injury is not applied unless the country being investigated has signed the GATT subsidy code or a bilateral subsidy agreement with the investigating country. These procedures can slow exports or convince exporters that negotiated VERs are better than existing trade proceedings. Distinctions between fair and unfair trade are difficult to establish even in developed market economies; in many developing economies where the government plays a significant role in production, the distinction can be even more obscure.

Industrial countries' protection policies have particularly adverse effects on developing countries: they limit opportunities for developing countries to overcome their balance of payments and debt

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1/ UNCTAD estimates that the cost of a fairly routine antidumping proceeding can easily exceed US$100,000 which may have to be borne by a single exporting firm.

difficulties, discourage new investment and diversification, and impede successful implementation of outward oriented development strategies. Indeed, the close links between trade, finance, and structural adjustment suggest that industrial policies restricting trade flows have harmful effects on developing countries both directly through limitation of market access, and indirectly through aggravating structural and macroeconomic problems for the world economy as a whole. Of course, it has also been widely recognized that adoption of more open trade policies by developing countries themselves is beneficial to their efficiency and growth performance, irrespective of liberalization by industrial countries. But restricted market access for developing countries' exports is especially detrimental to the restructuring efforts currently underway in many developing countries, including the highly indebted countries. The growth and development prospects of developing countries will thus be importantly affected by the stance of industrial policies of developed countries. Hence, it is particularly worrisome that trade conflicts between developed and developing countries have emerged or intensified in a number of sectors such as textiles, steel, consumer electronics, and petrochemicals. An example of emerging trade frictions is the petrochemical industry where new capacity has come on line in some Middle Eastern and other countries which have a comparative advantage in this area, and which has exerted increasing pressure on older plants in some industrial countries. Trade in petrochemicals is distorted by disparities in tariff and nontariff barriers among industrial countries; it may also be distorted by subsidies in some countries. The Gulf countries have been concerned about the operation of the EC's generalized system of preferences (GSP) for petrochemicals, which is based on the graduation principle (see below, and Annex III). More generally, they are concerned about potential dangers of protection abroad inhibiting diversification into areas of their comparative advantage. While the merits of specific disputes in petrochemicals and other sectors such as steel, textiles, and consumer electronics, cannot be judged in this paper, it is important to stress the need to deal with them in a nondiscriminatory manner according to liberal trade principles. The frequency of such disputes would be reduced if the necessary structural adjustment in a number of industrial countries were to occur more rapidly and if trade liberalization in all countries provided more room for expanded trade on the basis of comparative advantage.

Industrial countries are increasingly reluctant to accept the existence of widespread and long standing trade restrictions in developing countries. In particular they have questioned the extended use of protection on infant industry and balance of payments grounds. And they have called for greater reciprocity from, and improved market access to, developing countries' markets in traditional sectors as well as in new areas such as services. They suggest that as developing countries (especially the newly industrialized countries) progress through higher stages of development, they should be expected to "graduate" to greater obligations under the GATT, through, inter alia, more open markets, eschewing export and domestic subsidies, "binding" tariffs, 1/ phasing out GSP benefits, and more active participation in multilateral trade negotiations by exchanging concessions. Greater "integration" has also been recommended by an independent group studying the international trading system. 2/ In recent years industrial countries have acted more readily against developing countries for alleged "unfair" trading practices, and have tied benefits to reciprocal trade measures by developing countries.

Over the past decade, most industrial countries have operated GSP schemes, which involve a unilateral extension of preferential treatment for developing countries. Based on the graduation principle, some of these schemes have been expanded progressively for low income developing countries but tightened for those with higher per capita incomes. In a recent GATT Council meeting, Brazil, supported by a number of other developing countries, expressed concern that some GSP schemes may be moving away from the original principle that preferences be granted on a nondiscriminatory and nonreciprocal basis. It pointed out, for example, that some GSP schemes have excluded benefits on the basis of criteria not foreseen in the GATT, such as workers' rights, review of developing country practices on intellectual property rights, and access for services and foreign investments. Many industrial countries have argued that preferences should be granted in a dynamic manner consistent with the level of development of beneficiaries. Controversies over the GSP are likely to continue as the issue is related to the broader, unresolved question of the appropriate scope and use of the GATT's provisions on special and differential treatment for developing countries. However, if all countries made steady progress toward trade liberalization on the basis of comparative advantage, the issue of preferences within restrictive regimes would probably dissipate.

Finally, the issue of reciprocity of market access has not been confined to industrial country demands on developing countries. Some developing countries such as Hong Kong, Saudi Arabia, and Singapore have open import regimes but have not received reciprocal treatment from their trading partners.

IV. Prospects for Reform

Against the background of an intensifying protectionist climate, GATT trade ministers met in September 1986 at Punta del Este, Uruguay, to launch a new round of multilateral trade negotiations ("the Uruguay Round"). This initiative was given a boost at the political level by

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1/ Typically, at least 70-85 percent of imports of developing countries may be subject to an "unbound" tariff, i.e., it may be unilaterally raised at any time. Two notable exceptions are Chile and Mexico which maintain "bound" tariff schedules at maximum tariff rates of 35 percent and 50 percent, respectively.

2/ A group of seven eminent persons, including some from developing countries, chaired by Fritz Leutwiler, was invited by the Director-General of GATT to study the problems facing the international trading system, and put its recommendations in the document "Trade Policies for a Better Future" (GATT, 1985).

the recent OECD and Venice Summit Communiqués. The new round is the most complex ever undertaken. It addresses almost all aspects of trade, including that in sectors such as agriculture, which have received little or no attention in previous rounds. In addition, new topics such as services and trade related investment measures are to be the subject of negotiations. It has been widely acknowledged that trade issues require urgent attention as a lack of progress may erode confidence in multilateralism and give greater impetus to bilateral, discriminatory trading solutions. This in turn requires governments to demonstrate the political courage to override sectoral interests and translate the Uruguay Round, OECD, and Venice Summit mandates into concrete measures for liberalization and establishment of clearer rules and disciplines based on the principle of nondiscrimination.

The success of multilateral trade initiatives will be influenced by at least three major factors. First, sustainable trade liberalization will require concomitant progress in resolving financial and structural problems which inhibit the establishment of a stable economic environment. Second, adherence to the "standstill" and "rollback" agreement of the Uruguay Round is of crucial importance. Third, a major strengthening of multilateral surveillance of trade is essential, if new multilateral agreements are to be adhered to.

1. Uruguay Round 1/

The new trade round aims at advancing through simultaneous action on several broad fronts.

--It aims to carry forward the process of market opening through further reductions in tariffs--the classic part of GATT rounds--as well as the more challenging task of reducing nontariff barriers.

--It will examine ways of returning normal GATT discipline to sectors that have been relegated to separate regimes through multilateral action (textiles and clothing), as well as ensuring GATT disciplines for segments of international trade which are now increasingly subject to so-called gray area measures, (e.g., VERs in steel, automobiles, household electronics, and machine tools).

--It will seek to establish predictable and equitable conditions of competition subject to agreed rules. This includes the appropriate use of safeguard measures for temporary import protection, and export and production subsidies.

--The existing lack of consensus in respect of these rules and disciplines affects all sectors of international trade, but most particularly agriculture. For the first time in the history of GATT rounds, agricultural trade is at the center of negotiations.

1/ Annex IV describes in more detail the activities of the various negotiating groups of the Uruguay Round.

--To reinforce the legal and institutional role of the GATT, the Punta del Este declaration calls for a review of its articles and of the codes and agreements of the previous multilateral trade negotiations.

--It examines the functioning of the GATT system including the question of more effective surveillance and collaboration with other international organizations.

--It includes new areas such as trade related aspects of intellectual property rights, trade related investment measures, and trade in services. Services are a major component of developed economies and of growing importance in developing countries; they represent over one fifth of world trade, with major potential for long-term expansion. Yet they remain one of the least analyzed aspects of economic activity--there is not even a multilaterally agreed operational *definition of trade in services. This has influenced the nature of* barriers to trade in services, which mostly consist of nontariff measures such as limits on access to national distribution systems and restrictions on establishment rights. Given that many services require production to be undertaken on the site of consumption, their liberalization is bound to have implications for such issues as foreign direct investment and labor mobility which go beyond the trade area.

--It is hoped that the effective participation of developing countries in the Uruguay Round will be greater than in previous rounds, without sacrificing the principle of special and differential treatment for developing countries.

To conduct the negotiations, a Trade Negotiations Committee (TNC) was established with two subsidiary bodies, the Group of Negotiations on Goods (GNG) and the Group of Negotiations on Services (GNS). In January 1987 the GNG set up 14 subgroups and the GNS agreed to determine the scope for negotiations on trade in services. The surveillance body to monitor the "standstill" and "rollback" commitment was also established. The negotiating groups will spend 1987 ("the initial phase" of the negotiations) preparing the ground for the future exchange of concessions. Thus far, discussions mainly have been devoted to general statements outlining initial positions and proposals and the steps necessary to move the negotiations forward.

The industrial countries, first at the OECD in May 1987 and later at the Venice Summit in June, endorsed the objectives of the Uruguay Round. The OECD agreement on agriculture, which was reinforced by the Venice Summit, is of particular importance, and includes a comprehensive set of principles for the progressive reduction of assistance to, and protection of, agriculture on a multicountry basis. The Venice Communiqué also recognized the importance of strengthening the GATT and liberalizing the trading system.

2. Trade-finance links

Unless macroeconomic and structural issues are addressed effectively, protectionism is likely to persist causing governments to become increasingly vulnerable to pressure groups. Therefore progress toward reducing fiscal and trade imbalances and promoting conditions for noninflationary sustainable growth are necessary conditions for the abatement of trade tensions. In this regard, the Fund has an important role to play, both in the context of its surveillance over exchange rate policies of members, and in the context of debt, adjustment, and financing issues.

Trade-finance links also need to be addressed through greater cooperation and consultation among trade and finance officials both at the national and international levels, so that mutual effects of policy interactions can be better taken into account. Those responsible for trade policy cannot use macro-misalignments as a reason for protection--indeed liberal trade policies are needed to make macroeconomic policies more effective. Similarly, finance officials must realize that macroeconomic and structural adjustment are essential to sustainable trade reform. Meaningful participation by developing countries in the GATT negotiations inevitably will require attention to the links between trade policy, external adjustment, and development. The Uruguay Round provides an opportunity to investigate possibilities of improved market access for developing countries. This would also help these countries in resolving their debt problems.

3. Surveillance and related issues

Trade policy formulation could be improved by widening its base and increasing its transparency. National trade agencies need to adopt more open decision-making processes which allow, and take into account, the views of those affected by protectionism, especially consumers and exporters. Furthermore, systematic economic evaluations on a public and independent basis of specific trade policy measures could help publicize the costs and benefits of protection. 1/ The scope for improvement in these respects remains large in most countries, developed and developing alike. These evaluations would need to cover trade policies of individual countries as well as common policies implemented in the framework of regional integration arrangements.

Effective multilateral surveillance requires that the international community be able to challenge the actions of individual countries and make critical analyses and assessments which could be presented as a multilateral "view," "finding," or "judgment." A strengthening of the

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1/ A noteworthy recommendation in this regard is the proposal of the independent group (see p. 12, footnote 2) in its report "Trade Policies for a Better Future," that costs and benefits of trade policy actions, existing and prospective, should be analyzed through a "protection balance sheet," and that private and public companies should be required to reveal information on official subsidies.

GATT (perhaps beyond its current contractual character) would help accomplish this more effectively. It is therefore welcome that the Uruguay Round will examine the functioning of the GATT system including its surveillance over trade policy.

In specific terms, GATT's effectiveness could be improved if trade conflicts were brought to it at an early stage for speedy and binding adjudication. It could also be strengthened if its Secretariat had increased authority to initiate discussions, request notifications, and provide independent appraisals of trade policies. This would help contracting parties to better take into account the international as well as the domestic impact of their trade policies.

Among the specific issues under consideration in the Uruguay Round, the question of safeguards is of prime importance. The proliferation of discriminatory trade measures outside the GATT, especially in industrial countries, reflects difficulties in reaching a consensus on acceptable conditions (notwithstanding the existence of Article XIX) under which import measures are instituted to safeguard domestic industries while structural adjustment is underway. Some have argued that the selective application of safeguards in practice would make it more feasible to contain and exercise surveillance over voluntary restraint arrangements; others have argued for preserving the principle of nondiscrimination in any new agreement on safeguards.

An aspect of safeguards of particular interest to the Fund is the possible re-examination of trade restrictions for balance of payments purposes; GATT Articles XII, XIV, XV, and XVIII, which deal with balance of payments safeguards, have been placed on the agenda of the group on GATT Articles. 1/ Especially in view of the fundamental changes in the international monetary system in the past two decades, in particular the introduction of generally more flexible exchange rate arrangements in both developing and industrial countries, the original rationale for temporary import barriers to safeguard a country's external financial position has lost some of its force. Indeed, the Fund discourages use of quantitative import restrictions for this purpose. If a broad consensus to renegotiate the GATT provisions in this area emerges, issues needing consideration would include the appropriate degree of discipline applicable to balance of payments induced trade restrictions, and whether and how possible reforms in this area are related to other aspects of the GATT negotiations. Reduced reliance on trade restrictions is more likely to be built into the GATT framework if developing countries expect that there would be a substantive liberalization of trade in their important foreign markets. In this respect effective surveillance of the trade policies of all countries--including industrial countries--is important.

1/ Annex V provides information on GATT provisions on trade restrictions for balance of payments purposes.

V. Role of the Fund

The Fund seeks to influence trade policies through Article IV consultations, adjustment programs supported by use of its resources, multilateral surveillance in the context of the World Economic Outlook (WEO) and other multilateral exercises, Board papers dealing specifically with trade issues, and speeches by the Managing Director to outside organizations and groups.

1. Trade policy in Article IV consultations

On several occasions, Directors have stressed the importance of trade policy issues in the context of Fund surveillance, and have supported expanded coverage of trade issues in Article IV consultations, including efforts to quantify the effects of trade measures. Accordingly, starting in 1982, the staff has attempted assessments of the impact of protection on domestic adjustment and on trading partners, the impact of protectionism abroad on the consulting country, and analysis of specific trade issues. In so doing, the staff has been guided by the following operational principles. (1) Adequate coverage should go beyond description and include an assessment of the member's trade policy stance. (2) Initially the focus of expanded coverage was on the major industrial economies, but this approach was to be broadened to cover an increasing number of countries.

The coverage of trade issues in Article IV consultations was reviewed in connection with the 1985 Board discussion on trade issues (SM/85/60) and the 1986 surveillance review (SM/86/4), which suggested that such coverage was improving, at least in the reports on major trading nations. To analyze recent developments, the staff surveyed a sample of reports on Article IV consultations carried out in 1986, covering industrial countries (17) and the larger developing countries without a Fund-supported adjustment program (7). The survey focused mainly on comparisons of coverage of trade issues in the most recent reports with those reviewed earlier. 1/

For industrial countries, the survey indicated that most reports at a minimum presented a factual description of the thrust of trade policy, which was used to assess the relative openness of the trade regime. The process of gradually extending the description and discussion in staff reports and recent economic development reports has continued, and only two reports (in the sample) contained no explicit assessment of the country's overall trade policy stance. As a new element in the 1986 reports, the discussion often included reference to the authorities' approach to the (then) proposed new GATT round of trade negotiations. Trade policies were analyzed more extensively for the largest industrial

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1/ Cross country comparisons are difficult and need to take account of: (i) differences in complexity of trade regimes; (ii) the recentness of measures; (iii) data availability; and (iv) attitudes of the authorities--coverage of trade issues is facilitated in countries where these are actively analyzed and publicly debated.

countries, particularly those with national autonomy over trade policies. For members of regional arrangements where trade policy is formulated in a regional context, coverage of trade issues in consultation reports was relatively less extensive, particularly for some of the smaller members of the EC. Thus, although coverage of trade issues in consultations with industrial countries has increased, further improvement is desirable.

For developing countries in the sample, trade issues received comprehensive treatment in most reports. The emphasis of the analysis was different from that of the major industrial countries. For the latter the impact on trading partners was a special concern. Reports on developing countries tended to emphasize the effects of trade policies on the domestic economy as well as the impact of protectionism abroad on the country in question.

In most cases it has not been feasible to give priority to an in depth analysis of the impact of trade measures. Some recent reports have indeed examined various aspects of the member's trade policies thoroughly. For example, reports on the United States have contained quantitative analysis of restraints in the automobile and steel sectors; the 1985 consultation report on Spain contained a special annex analyzing the impact of accession to the EC; and the report for Australia analyzed the macroeconomic impact of trade measures, especially their effects on inflation. Notwithstanding these and other attempts to provide more in-depth analysis, there is room for improvement. In particular, more rigorous examination of the impact of the consulting country's trade policies on its domestic economy and on other members, including on developing countries, would be useful.

2. Trade policies in programs supported by Fund resources 1/

There has been a notable increase in the frequency and depth with which trade reform issues are featured in adjustment programs supported by Fund resources. Nearly all programs supported by stand-by arrangements approved in 1986 included some measures to liberalize trade (normally not as performance criteria), beyond the standard "standstill" commitment on import restrictions for balance of payments purposes. Trade reform was also featured in most programs supported by the Structural Adjustment Facility. Recent emphasis on trade liberalization can be attributed, in part, to an unwinding of restrictions that had been intensified with the onset of debt problems in 1982-83; it also reflects a heightened awareness of the importance of undertaking structural adjustment measures in conjunction with growth-oriented stabilization policies.

The focus of specific trade liberalization measures continues to be on import restrictions. More than half of the programs supported by

1/ Annex VI provides more information on the trade content of adjustment programs supported by Fund arrangements, including selected case studies.

stand-by arrangements approved in 1986 aimed to reduce the scope of quantitative import restrictions. A number of these programs included comprehensive tariff reforms aimed at lowering tariff rates and reducing tariff dispersion. Abolition of import/export monopolies and other measures to liberalize exports were also included in some programs. Reduced reliance on export subsidies has also been featured in some programs as part of the strategy of moving to more realistic exchange rate levels.

The extent and pace of trade liberalization is linked, in part, with the status of the exchange system and the appropriateness of the exchange rate. Rapid dismantling of restrictions is in some cases adopted together with major reforms of the exchange system, while a gradualist approach may be required in others. In some instances, import licensing for balance of payments purposes was abolished in conjunction with, or shortly following, the adoption of a market-determined floating exchange rate system. In other cases, quantitative import restrictions were reduced under a phased liberalization program, often in conjunction with a tariff reform. In still other cases, membership in a currency union prevented changes in the exchange rate, and efforts were made to eliminate remaining quantitative import restrictions in the context of industrial policy reform packages.

Fund-Bank collaboration in the trade area has been especially intense in determining the trade content of adjustment programs. The Bank, in its economic work and its structural adjustment and trade policy lending, has addressed structural problems that must be resolved if sustainable trade liberalization is to be achieved. The Bank examines trade policies in individual countries as well as on a broader basis such as its analysis of agriculture and industrial protection in the World Development Reports of 1986 and 1987, respectively. The Fund staff consults closely with the Bank staff in formulating trade proposals. In many cases, trade reform is already a significant part of a structural or sector adjustment lending program supported by Bank resources. In these cases, the Fund staff tries to ensure that the trade liberalization element of the Fund-supported adjustment program complements and amplifies that of the Bank-supported program.

3. Fund-GATT collaboration

Cooperation between the Fund and the GATT has been pursued at two levels--in regard to general matters of mutual concern, and in terms of the Fund's participation (given determinant effect by the GATT articles) in the GATT's consultations with contracting parties maintaining trade restrictions for balance of payments reasons. Directors generally have supported the principle of increased Fund-GATT collaboration, noting that the Fund should complement the role of the GATT within its own sphere of competence. While there has not been much support in the Board for systematic and institutionalized collaboration on missions between the staffs of the two institutions, 1/ Directors have encouraged the staff to obtain GATT inputs in the context of Article IV consultations with major trading countries. On several occasions in the past four years, Fund staff have had informal discussions with GATT officials en route to Article IV missions (e.g., in the case of France, Germany, Italy, Japan, the United Kingdom, and the United States).

Directors have also encouraged close contacts with the GATT Secretariat on more general trade policy issues. Steady progress has been made in this respect. Senior Fund staff and GATT officials have been in regular contact on matters of mutual concern as a result of which better understandings have developed. Fund staff members (usually from the Geneva Office) observe nearly all of regular meetings of GATT bodies and will observe a number of Uruguay Round negotiating groups. The Managing Director addressed the November 1982 GATT ministerial meeting in Geneva, and a statement on his behalf was delivered by the Counsellor and Director of the Exchange and Trade Relations Department to the GATT ministerial meeting in September 1986 at Punta del Este. The Managing Director and the Director-General of the GATT exchange views periodically; the latter also makes a statement on current trade issues to the Development Committee.

Fund-GATT contacts in the context of the Uruguay Round are likely to increase: (1) At the request of the GATT Secretariat, Fund staff has provided information on statistical and analytical aspects of services, and the Director of the Fund's Bureau of Statistics recently made a presentation to the GATT Group on Negotiations of Services. This area is of particular interest to the Fund because of the importance of the services sector in the analysis and computation of balance of payments statistics, and the Fund jurisdiction over restrictions on service payments. (2) The group on functioning of the GATT system will look into the experience of the Fund and other international institutions regarding their organizational set-up and surveillance mechanisms, and will also investigate ways of improving cooperation with them. (3) The interrelationships between trade, financial, and structural policies argue for more intensified exchange of views and information between trade and financial officials at the national and international level so that the wider policy repercussions of actions in their respective fields can be better taken into account. It remains to be determined whether this can be accomplished through intensified use of existing mechanisms or whether supplemental mechanisms are needed. (4) If GATT contracting parties decide to negotiate modifications of the GATT articles dealing with balance of payments safeguards, the Fund would need to consider its implications for balance of payments adjustment and other aspects related to Fund surveillance.

1/ See Chairman's Summing Up at the Conclusion of the Discussion on Developments in International Trade Policy, Buff 82/170, September 27, 1982, corrected 10/5/82.

VI. Issues for Discussion

A reduction in global trade barriers is an essential element in the resumption of sustainable growth in the world economy and the resolution of the debt problem. The Fund can assist this process in two major ways.

First, within its overall surveillance responsibilities, the Fund must continue to encourage its members to implement appropriate measures to eliminate macroeconomic imbalances and reduce structural distortions. While macroeconomic imbalances do not justify trade restrictions, it is clear that progress in resolving problems in the nontrade area would enable governments to more easily resist pressures for protection and enhance the prospects for a successful Uruguay Round. Second, in the various forums in which the Fund addresses trade issues directly, it must continue to stress that protection is costly--both to the country that protects and to its trading partners--and encourage its members to adopt open trading systems. Such policies, through their beneficial effects on resource allocation, benefit the country that liberalizes; they also expand the scope for multilateral trade on the basis of comparative advantage.

A number of areas in which the Fund could strengthen its work in the trade area are discussed below. These proposals would require increased staff resources and time--which so far have limited the work on trade. Directors views on these proposals and the priority to be attached to them would, therefore, be welcome. In this context it will be useful to consider the type of Fund input which can best persuade governments to adopt more liberal trade policies.

With regard to Article IV consultation reports, further efforts could be made to quantify the effects of protection keeping in mind that quantification is difficult--particularly for nontariff barriers--and that the staff is, to a large extent, dependent on national authorities for input. For industrial countries this could include the effects of their trade policies on the domestic economy and on other countries, particularly developing countries. For members of regional arrangements, assessments of individual country policies might be supplemented with assessments of regional policies.

The trade content of adjustment programs supported by Fund resources might be further examined within the context of staff work on the structural aspects of adjustment. Some issues arising from country experience include the need to identify areas of trade reform that offer the best prospects for fast results, their optimal sequencing and relationship with other reforms, and practical steps to ensure successful implementation of trade policies. This work could draw upon World Bank experience in these areas. It might also be useful to explore steps that could be taken to discourage countries from reversing trade liberalization measures taken during a Fund arrangement if balance of payments pressures subsequently re-emerge. The use of trade restrictions for balance of payments reasons, which is permitted under GATT, may, in part, reflect a desire to avoid use of exchange restrictions which are subject to Fund jurisdiction. Agreement by countries within the context of the Uruguay Round to avoid or reduce their use of such restrictions would encourage sustained import liberalization efforts and enhance the prospects for addressing balance of payments problems with more appropriate policies.

In the area of multilateral surveillance it may be useful to explore whether the Fund could play a larger role in airing trade issues and the costs of protection, within and outside the Fund. In the past, comprehensive trade reports which benefit from visits to major trading countries and to international organizations dealing with trade have been prepared on a two to three year cycle. (These reports were published in revised form after Board discussion.) The Fund is well placed to prepare such reports and, subject to Board agreement, the staff would continue this practice. A comprehensive trade survey could be prepared for Board discussion prior to next year's Annual Meetings. The Fund is not equipped to do independent estimates of the costs of protection on a frequent or regular basis. However, a more systematic attempt might be made to collect and disseminate estimates prepared by national authorities and elsewhere within and outside the Fund.

During the discussion of SM/85/60 it was decided that, on an experimental basis, the Board could be kept informed through trade information notices of major trade developments taking place in between Article IV consultations. 1/ Partly because of constraints on staff time only two notices have been issued to date. In some cases, however, it was decided to cover major developments in subsequent Article IV consultations. Trade information notices could be retained as a vehicle for informing the Board of trade issues. Given limited staff resources, however, they would need to be confined to major issues. During the Board discussion of SM/87/43, some Directors suggested that the staff might prepare a six-monthly fact sheet on trade developments. Since 1985, the GATT secretariat has been preparing a biannual survey of major trade developments. 2/ This survey, which is based on changes in trade policies notified to the GATT by contracting parties, as well as trade developments reported in the financial press (confirmed, where possible, with contracting parties), is quite comprehensive. 3/ It would be

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1/ The procedures for these notices were set out in the staff paper "Information Notes on Trade Policy - Suggested Features," SM/85/225, 8/8/85.

2/ The survey covering April to September is normally available as a restricted document in November, and is made available outside GATT a few months later. Similarly, the survey covering October to March is available as a restricted document in June and subsequently unrestricted.

3/ Fund staff in the Geneva Office attend GATT Council discussions of these reports, and prepare brief descriptions of the report and discussions. See the latest report on the meeting of the GATT Council SM/87/183, 7/28/87.

duplication for the Fund to produce a similar survey. It may be useful, however, if the GATT survey could also be issued for the information of the Executive Board prior to meetings of the Interim and Development Committees. The feasibility of this proposal could be explored with GATT officials, including the modalities of issuing this document to the Executive Board (possibly in its restricted version).

The complementarity between financial and trade issues requires close collaboration between the Fund and the GATT. There are several areas where collaboration could be further enhanced. First, GATT staff could be invited to Fund headquarters to conduct seminars on the Multilateral Trade Negotiations and on possible ways to improve trade aspects in regular Fund work. Second, as indicated in Section V.3, Fund-GATT contacts are likely to increase in the context of the Uruguay Round. The Fund will respond positively, to the extent that it can, within the area of its competence and jurisdiction, to requests from the GATT for technical and other information that could assist in the successful conclusion of the Uruguay Round. More generally, the staff would welcome the views of Executive Directors on the degree of cooperation which they would consider appropriate in the future between the Fund and, a possibly strengthened, GATT.

Import Coverage Indices of Selected Nontariff Measures (NTMs) in Industrial Countries, 1/ 1981-86

(Index Numbers, 1981 = 100)

	Nontariff Trade Measures 2/					
	1981	1982	1983	1984	1985	1986
	I. Total Imports					
Austria	100.0	100.0	100.0	100.0	100.0	98.0
Canada	100.0	101.6	103.1	103.4	103.4	103.4
EC (10)	100.0	102.0	105.5	104.8	103.9	103.9
Finland	100.0	100.0	100.0	100.0	100.1	100.1
Japan	100.0	99.3	99.4	99.4	99.4	98.9
Norway	100.0	101.0	96.6	87.3	80.1	79.1
New Zealand	100.0	100.0	100.0	100.0	90.4	84.0
Switzerland	100.0	100.3	100.3	100.3	100.3	100.3
United States	100.0	103.5	95.8	115.4	121.7	122.6
Total	100.0	101.6	102.4	105.8	106.5	106.5
	II. Non-Fuel Imports					
Austria	100.0	100.0	100.0	100.0	100.0	97.9
Canada	100.0	102.0	103.4	103.9	103.9	103.9
EC (10)	100.0	103.6	109.8	108.6	106.9	106.8
Finland	100.0	100.0	100.0	100.0	100.7	100.7
Japan	100.0	99.1	99.1	99.1	99.1	98.4
Norway	100.0	101.1	96.3	94.3	86.5	85.3
New Zealand	100.0	100.0	100.0	100.0	90.4	84.0
Switzerland	100.0	100.4	100.4	100.4	100.4	100.4
United States	100.0	103.4	95.8	115.4	121.7	122.6
Total	100.0	102.4	103.4	108.6	109.6	109.6

Sources: UNCTAD TD/B/1126/Add.1, January 22, 1987; UNCTAD Data Base on Trade Measures.

1/ The accuracy of the NTM information has been verified to UNCTAD by some industrial countries, and is being verified by other countries. Accordingly, the figures in the table are to be regarded as preliminary and subject to revision. It is to be noted that import coverage ratios and indices have certain limitations. They are used as an indicator of the extent of NTMs. They are by no means a measure of the severity of the restrictiveness of NTMs, since such a measurement does not distinguish between NTMs that are more or less severe. Another drawback is that more restrictive NTMs tend to receive lower weight than less restrictive ones because the former tend to reduce imports more. For example, a country whose NTMs are more restrictive tends to import less of an item covered than a country whose NTMs are more permissive. Yet it is the latter that will appear to have more trade subject to NTMs. Finally, if a country protects sectors not included in these ratios or uses measures other than those selected (either because data are not available or the measures concerned are not clearly defined) the import coverage ratio or index would underestimate the extent of protection.

2/ Excludes para-tariff measures, countervailing and antidumping duties, and import surveillance.

Developments in Policies Affecting Agricultural Trade

I. Background

Agriculture trade is subject to widespread distortions and imbalances in world markets. Farm support programs have led to marked increases in world supplies and stocks of surplus agricultural commodities. As effective demand for agricultural products has shown little growth, world market prices for most temperate zone products have plummeted. For example, the real prices of wheat, maize, and rice, the most widely consumed cereals, are at or near their lowest levels in fifty years; meat, dairy products, and sugar are in a similar situation. The price declines have taken place despite accumulation of huge official stocks of various commodities. For example, stocks of butter held in the OECD countries are currently over twice the level of annual exports, world stocks of cereals are two and a half times the annual volume of international cereals trade, and those for sugar are over a third of annual consumption. Policies insulating production decisions from world market prices have contributed to the current overproduction crisis, the increased instability of world food prices, and the dramatic shifts in geographical production patterns. Hence, while developing countries were net exporters and industrial countries net importers of food until the late seventies, these roles have been reversed in the 1980s.

Governments have become increasingly involved in the intense competition for maintaining or increasing shares in stagnant markets. Widespread use of agricultural trade barriers and subsidies have increasingly led to bitter disputes among various countries and regions. In recognition of the growing costs of agricultural protection, a number of initiatives have been made recently toward solving the crisis in agriculture. The group of countries most adversely affected by the situation are the efficient producers, which under conditions of comparative advantage would increase their shares in world export markets and receive higher prices for their products. Fourteen of these "nonsubsidizing" producers, 1/ met in Cairns, Australia in August 1986 to discuss strategies for reforming world agriculture. This so-called Cairns group has been seeking a prominent role for agriculture in the new round of multilateral trade negotiations (MTN), and has emerged as a major force in these negotiations. Trade ministers and their representatives from 24 countries also met in an informal session in Taupo, New Zealand, in March 1987, to explore ways of accelerating progress on issues of farm protection under the MTN. Work toward multilateral solutions to the agriculture crisis has for

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1/ These include industrial countries such as Australia, Canada, and New Zealand as well as large developing country producers such as Argentina and Brazil. Australia and Canada have recently felt it necessary to pay subsidies to grain farmers to compensate for low world market prices.

some time been carried out in the OECD. Participants to the economic summit in Tokyo last year recognized this work and undertook to seek solutions to these problems in the multilateral framework being studied at the OECD. The analysis and recommendations of these studies were endorsed by the OECD Council of Ministers in May 1987. This agreement, in turn, was reaffirmed at the Venice Summit in June 1987, providing added impetus to the discussions on agriculture under the Uruguay Round. The United States recently has tabled far-reaching agricultural reform proposals for discussion in the Uruguay Round; these proposals call for the elimination of all agriculture subsidies and trade barriers, and the harmonization of health regulations over the next decade.

The remainder of this annex describes selected major developments in agricultural policies in 1986-87, including recent measures and reform proposals of the Common Agricultural Policy of the EC and the Export Enhancement Program of the United States, and also summarizes some recent evidence on the costs of agricultural protection. 1/

II. Common Agricultural Policy of the European Community

1. Main features of the Common Agricultural Policy (CAP)

The objectives of the CAP, as specified in Article 39 of the Treaty of Rome, include improving agricultural productivity through technical progress and efficient use of resources, ensuring fair income levels for farm population, stabilization of markets, and guaranteeing regular supplies at reasonable prices. The policy approach designed to achieve these objectives is based on the principles of free internal trade, community preference, and shared financial responsibility.

In practice, these principles have been implemented through several mechanisms to intervene in the markets for agricultural products. The most important intervention instruments are: (1) purchasing arrangements at intervention prices; (2) variable levies on imports to ensure that foreign products are not sold in the Community at prices below support levels; and (3) variable export restitutions, or subsidies, covering the difference between world market prices and Community support prices. In addition to these instruments, the Community uses a number of other intervention methods to affect both prices and quantities of agricultural products in the market.

1/ A comprehensive description of the institutional framework of agricultural support systems in major industrial countries was provided in SM/85/60. The World Development Report, 1986, deals extensively with agriculture protection issues.

The financial and economic welfare implications of the CAP have been increasingly questioned within and outside the EC. Differences between support prices and world market prices (if the former exceed the latter, as has ordinarily been the case) are financed by restrictions on foreign producers (e.g., through variable import levies), in the form of higher prices for domestic consumers, or through recourse to the EC budget. Given the limitations that the established Community policy sets on the "own" resources of the budget and the fact that various support payments under the CAP already constitute about two thirds of total Community budget expenditures, increased discrepancies between agricultural support prices in the Community and world market prices have in recent years put considerable pressures on Community finances.

At the time of its inception, the Community of Six was mostly self-sufficient in temperate zone products and a significant net exporter only of dairy products. Since the late 1960s, when the CAP became fully operational, agricultural production in the Community has grown at an average annual rate of some 2 percent, while the rise in consumption has been considerably less (some 0.5 percent per year on average). Thus, while the Community is still a net importer of agricultural products, 1/ it has become a major exporter in world markets for several temperate zone products, such as cereals, sugar, dairy products, and beef. The Community's agricultural exports account for over one tenth of the total value of world agricultural exports. The EC is a dominant trader in certain products; it accounts for almost 15 percent of world production and trade of wheat, over 15 percent of world sugar exports, 16 percent of world production of beef and veal, and 50-70 percent of world exports of butter, and condensed and powdered milk. Given that support prices for these export commodities have consistently exceeded world market levels by wide margins, disposal of Community surpluses through exports has required significant Community budget resources. Similarly, efforts to keep domestic production competitive with potential imports through variable levies has resulted in the establishment of considerable protective barriers around Community agriculture.

Recent studies analyzing the effects of the CAP have generally concluded that EC policies have significantly increased the supply of commodities to world markets, thereby depressing prices, and may also have contributed to destabilizing market prices. Export subsidization and the protective barriers against third-country exports to the EC have probably resulted in trade patterns that are considerably different from those implied by the principle of comparative advantage.

1/ EC agricultural imports consist mostly of products which cannot be produced within the Community in large enough scale to satisfy demand (e.g., coffee, cocoa, tea, tropical and citrus fruits).

2. Recent measures under CAP and reform proposals

a. Commission "Green Paper" of 1985

The problems associated with the CAP have been recognized for some time within the Community, and calls for reform have intensified recently. On the basis of a "Green Paper" published in July 1985 1/ and subsequent consultations with various Community groups, late in 1985 the EC Commission presented guidelines for a general strategy for CAP for years to come. 2/ Recognizing that the disequilibrium between supply and demand lies at the root of the problems of the CAP, the Commission proposed that, while maintaining the original goals mentioned in the Treaty of Rome, a gradual reduction in the output of surplus products should be one of the main objectives of policy in future years. The Commission also stressed the importance of market-related pricing in determining production and the necessity of structural adjustment. Hence, it recommended that market intervention be restored to its role as a "safety net" to contain short term fluctuations in prices. To alleviate the transitory costs to farmers deriving from this approach, the Commission proposed the increased use of income support mechanisms not based on the level of production.

b. Agricultural prices and related measures for the marketing year 1986-87

The concerns expressed in the "Green Paper" were reflected in the decisions taken by the EC Council in July 1986 on the prices of agricultural products for the 1986-87 marketing year and related measures. The general principle followed by the Council in arriving at the new prices was to freeze the common prices in nominal ECU terms at the previous season's level, probably implying further reductions in the relative terms of trade for farmers. There were some exceptions to the overall principle. The price of durum wheat (used to make pasta) was reduced to shift the relative incentives toward growing common wheat. Similarly, the price of fodder grains was reduced to encourage improvements in quality. The price of olive oil was lowered to contain the growing support given to this product in the last few years.

Perhaps the most important new initiative contained in the Council decision was the introduction of a 3 percent co-responsibility levy for wheat. This was intended to be a means whereby growers contribute to the cost of exporting surplus wheat at lower prices than the intervention prices paid by the Community. The levy thus results in an effective reduction in the intervention price paid to farmers, but does not correspondingly lower consumer prices. Quotas on milk production,

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1/ COM(85) 333 final; Newsflash, Green Europe, No. 33, July 1985, Brussels.

2/ COM(85) 750 final. See also Bulletin of the European Communities No. 12, 1985.

introduced in 1984 and reduced in 1985, were cut back by another 3 percent. However, to cushion the impact on the income of dairy farmers, the quota reduction was to be phased in gradually over a three-year period. The Council also depreciated the "green" rates of most member states' currencies after the recent realignment in the European Monetary System. Hence, prices in domestic currency received by farmers increased correspondingly, in part offsetting the deterioration in farm incomes caused by the lower real prices in ECU terms.

c. Policies and proposals for the 1987-88 marketing year

The most important new developments regarding the CAP in the 1987-88 marketing year include: (i) reforms of the milk and beef sectors approved by the Council of Agriculture Ministers; (ii) the set of socio-structural measures passed in March 1987; and (iii) the Commission's proposals concerning prices and related measures as well as direct income support payments for the next few years.

The situation of oversupply has, over the years, become particularly acute for milk and beef. Hence, in December 1986, agriculture ministers agreed to a package of measures designed to slow down further the production of these commodities. For milk, the aim is to reduce production by 9.5 percent over the two year period starting in April 1987 through a 8.5 percent reduction in production quotas and limitations on the amounts of intervention purchases of milk powder. Further measures to cut back on excess dairy production included a lowering of the amounts of intervention purchases of butter, agreed by the ministers in March 1987. In March, the Council also adopted a program to dispose of almost 1 million tons of butter stocks through sales in domestic and international markets at whatever subsidy is necessary up to ECU 3.3 billion in the current year. The Commission expects these two programs to lead to a reduction in butter stocks to some 300,000 tons by end-1988, compared with an estimated 1.5 million tons at the end of 1986. For beef, the Council decided to lower the intervention price by 13 percent, which is estimated to have a significant impact on production in future years. In the short run, however, the expected culling of dairy levels following the decisions on milk is likely to add to beef supplies.

In April 1986, the Commission proposed an extensive set of measures designed to help solve major structural problems facing EC agriculture. These should complement price and related measures by providing parallel incentives as well as by alleviating the adverse impact on farmers and rural areas of the envisaged transition to a more market-based agricultural system. After almost a year of negotiations, ministers agreed on a much weaker and less costly program of structural measures than proposed by the Commission. This program includes incentive payments to reduce yields of surplus products through less intensive farming methods, aid for investments with a contribution toward conservation and environmental protection, and special aid for less advantaged areas. Recently the Commission presented the Council with a package to provide direct income support for farmers. This includes a scheme of incentives for older farmers to retire their acreage or restructure their operations. The Commission is also proposing a program of direct income support (unrelated to production) to be cofinanced by the Community budget and member states. Contributions by member states to the scheme would vary from 30 percent for the poorest regions to 90 percent in the wealthier areas. This part of the proposal has been particularly controversial, as it would increase significantly the role of national governments in Community agriculture.

The Commission presented its proposals for agricultural prices and related measures for the marketing year 1987-88 to the Council of Ministers in February 1987. The underlying principle behind the Commission's package was a price freeze for most products in ECU terms, with lower prices for sugar, cereals, certain oilseeds, and wine. The proposed prices would undoubtedly have involved another reduction in real farm incomes, and were opposed actively by various farm groups in the Community. As a step toward reverting to the situation where intervention operated as a "safety net," the Commission proposed that intervention for cereals and olive oil be limited to only certain times of the year. The proposals also included the elimination of positive monetary compensatory accounts (MCAs), 1/ a measure which would imply a lowering of domestic currency prices paid to farmers in countries whose currencies have appreciated relative to the ECU (mainly Germany and the Netherlands). In addition, the Commission proposed a "stabilization measure" (commonly referred to as the "tax") on all domestically produced and imported oils and fats. This measure was intended to transfer part of the rising costs of intervention in this sector from the Community budget to consumers (in the form of higher prices) and to processors and foreign producers (in the form of lower margins). In making the proposal, the Commission argued that the tax would not affect the total volume of consumption. But this was challenged by trading partners, both industrial and developing countries, which strongly objected to the proposed tax on oils and fats; the United States threatened to retaliate if the tax was adopted.

The agreement finally reached in mid-1987 did not adopt the controversial oils and fats tax; however, this still remains on the table and will be subject to additional study and consultation with trading partners. The agreement also watered down the Commission's proposals on reform of the MCA system, by allowing for the gradual dismantling, in three stages, of the existing positive MCAs (to be compensated in part by national aid up to the end of 1988). Other Commission proposals were accepted with some modifications which made the terms of the final settlement considerably less severe than the Commission's original proposals. EC ministers agreed to alter the

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1/ MCAs are taxes/subsidies on farm trade designed to offset the effects of currency fluctuations among EC members.

intervention system for cereals so that it will be activated only when the average Community market price falls below the intervention price; the price offered will be 94 percent of the intervention price (compared with 93 percent in the Commission's proposals) implying an effective 6 percent cut in the intervention price; the buying-in period would be limited to 7 months of the year compared with the Commission's proposal of 5 months. Prices of rapeseed and soya are to be cut by 3 percent (compared with the 6 percent cut proposed by the Commission), and sunflower seed prices will be frozen (rather than being cut by 3 percent under the Commission's proposals).

d. Assessment of recent developments

The main components of the proposed strategy for the CAP in future years--viz., a reduction in surplus production and increased reliance on market price signals in production decisions--are essential to global solutions to the current crisis in agriculture. The pricing and related policies carried out by the Community in the marketing year 1986-87 probably were sufficient to prevent a widening of the major imbalances, but hardly enough to begin to reduce them. The policies concerning the dairy and beef sectors adopted for 1987 and beyond appear to go significantly further in this direction. Regarding direct income aid to farmers, the measures would represent a policy reform along the lines advocated by OECD ministers, viz., a gradual replacement of incentives for overproduction by income support unrelated to production. The tax on oils and fats, while seemingly attractive from the point of view of providing relief to the Community budget, does not address the fundamental issues of overproduction, and could have adverse international repercussions if eventually adopted. The price package eventually agreed by EC ministers for the current marketing year represents a step in the right direction though it falls short of the adjustment envisaged in the Commission's original proposals and only partially addresses the fundamental problems. The new price package will result in a marginal price cut in ECU terms from the 1986-87 level for the EC of Ten; after taking account of changes in MCAs, the overall impact in national currency terms in the EC of Ten would be an increase in prices of about 2.6 percent. The estimated savings from the new package have been estimated at ECU 230 million in 1987 and ECU 400 million in 1988 compared with the planned savings implicit in the Commission's proposals of ECU 1.1 billion in 1987 and ECU 884 million in 1988.

III. Recent Agricultural Export Subsidy Programs of the United States

1. Export Enhancement Program of the United States 1/

The Export Enhancement Program (EEP) was established in May 1985, and was modified in December 1985 by the Food Security Act of 1985 and again by the Food Security Improvements Act of 1986. Under the EEP, an amount in the range of US$1 billion-US$1.5 billion in surplus agricultural commodities owned by the Commodity Credit Corporation (CCC) is to be made available over a 3-year period ending in September 1988 as a bonus to U.S. exporters to expand sales of specified U.S. agricultural commodities in targeted markets. In effect, it is a subsidy in kind to enable U.S. exporters to lower prices to be competitive with "subsidized" foreign agricultural exports. The objective of the EEP is to increase U.S. agricultural exports, and thus, regain lost U.S. market shares while disposing of surplus agricultural commodities. It was also viewed as a means of persuading the EC to enter into negotiations of its export restitution program.

As of May 1987, 68 initiatives covering 42 countries and 12 commodities 2/ had been announced. Sales of these commodities totaled US$1.8 billion and total bonuses (subsidies) were about US$860 million. Reflecting continuing congressional and farm sector pressure, in 1987 the EEP has been expanded significantly with wheat initiatives made to several countries including Bangladesh, China, Iraq, Nigeria, Poland and the U.S.S.R. This broadening of the program has meant targeting markets where "nonsubsidizing" competitors (Argentina, Australia, and Canada) have had significant shares, though efforts were to be made to minimize harm to such exporters. Of course, even when directed at subsidizing competitors (as originally intended), the program inevitably has spillover effects on nonsubsidizing competitor countries.

The report indicates, that given the multiple independent variables affecting U.S. exports of wheat and other agricultural commodities, it is difficult to determine the impact of the EEP. Data for 1986 do not clearly indicate that the EEP has resulted in increasing U.S. shares in world exports of wheat and other agricultural commodities. In that year, total world exports of wheat and wheat flour declined by about 17

1/ The description above of the EEP is mainly based on the report "Export Enhancement Program, U.S. Foreign Agricultural Market Cooperator Development Program," Statement by Allan I. Mendelowitz (Senior Associate Director, National Security and International Affairs Division), to the House Sub-Committee on Department [of Agriculture] Operations, Research, and Foreign Agriculture Committee on Agriculture, March 17, 1987, US GAO, T-NSIAD-87-15. This statement is referred to above as "the report."

2/ Wheat, wheat flour, rice, poultry, barley malt, semolina, eggs, dairy cattle, poultry feed, barley, and vegetable oil.

percent, while U.S. exports of these commodities fell by 34 percent; the U.S. share of world wheat and wheat flour exports declined from about 37 percent in 1985 to 29 percent in 1986. As regards the direction of exports, U.S. exports of wheat and/or wheat flour increased to certain markets targeted under the EEP--viz., to Algeria, Egypt, Iraq, Jordan, the Philippines, Turkey, Yemen, Yugoslavia, and Zaire. Exports of U.S. wheat to markets not targeted under the EEP decreased significantly, with dramatic decreases occurring for Brazil, China, and the U.S.S.R.

In response to the EEP, the EC made a determined effort to protect what it considered its market by providing increased and country-specific restitution (subsidy) payments for sales to countries targeted under the EEP. 1/ While the EEP appears to have brought about a reduction in EC wheat sales in the Mediterranean region (e.g., to Algeria, Egypt), total worldwide Community exports of wheat and wheat flour declined by about 12 percent in 1986, or less than the decrease in overall world exports and of U.S. exports. However, the operation of the EEP may have exerted further pressures on the financial costs of the CAP. The report notes that Argentina, Australia, and Canada have been adversely affected by the EEP, at least through lower prices, though this was not intended under the EEP. Concern of these countries became most vocal with the broadening of the program both in terms of commodities and markets targeted (e.g., to the U.S.S.R. in August 1986).

Regarding the cost of the EEP, the program was designed to be budget neutral, 2/ but the report identifies cases in which EEP sales will likely result in higher government outlays. For example, bonuses for EEP poultry sales released soybeans and corn on the domestic market which had a value greater than that of the soybeans and corn used in raising the exported chickens. As the government is likely to end up buying back an amount equal to the extra corn and soybeans originally given away as a bonus, the budget neutrality condition may not hold.

The report points to the ineffectiveness of the EEP to resolve the current subsidy dispute between the United States and the EC. It notes that the EEP deals with the symptoms and not the fundamental causes of the problems facing world (and U.S.) agricultural markets. The report concludes that more fundamental changes in national and international agricultural policies and programs are required to restore equilibrium in agricultural markets.

1/ Producer and consumer subsidy equivalents calculated for the period 1982-84 by the U.S.D.A. ("Government Intervention in Agriculture: Measurement, Evaluation and Implications for Trade Negotiations," January 1987) show subsidies for wheat, the main beneficiary of the EEP, and dairy products to have been on broadly the same level in the EC and the United States.

2/ Neutrality is defined here as "not increasing government outlays." In that sense, original outlays on the commodities released as "bonuses" are already accounted for in the budget.

2. Dairy Export Incentive Program of the United States (DEIP)

A new U.S. export program for dairy products, working along the same lines as the EEP, was established on February 4, 1987 1/. The new DEIP, which will expire on September 30, 1989, is expected to promote exports of targeted dairy products 2/ to 33 selected destinations, mostly in Africa, Latin America, and the Middle East. Export sales of dairy products from commercial sources will be subsidized with dairy products from the inventory of the CCC. The quantities involved--140,000 tons of butter and butter-oil, 372,500 tons of milk powder, and 73,000 tons of cheese--represent substantial shares of world trade. Other dairy exporting countries have been concerned that these quantities could have a detrimental effect on the world market for dairy products.

IV. Costs of Agricultural Protection

The economic consequences of market distorting measures in agriculture have been studied extensively in recent years. While there may be debate on the exact magnitudes involved, there is little controversy about the generally high incidence of protection. A number of studies documenting the costs of agricultural protection from the point of view of implied price distortions, budgetary impact and effects on international trade were reviewed in SM/85/60. The *World Development Report*, 1986, also contains a thorough discussion of the economic effects of agricultural protection in the industrial countries. This section reviews some of the recent evidence on the impact of agricultural policies. 3/

A recent OECD report 4/ quantified for the period 1979-81 the levels of assistance resulting from the diverse national policies, using producer subsidy equivalents (PSEs), which measure the degree to which farmers' incomes are being supported, and consumer subsidy equivalents (CSEs). 5/ Detailed country studies were made for Australia, Austria,

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1/ GATT, Developments in the Trading System (October 1986-March 1987), C/W/517, May 1987, p. 14.

2/ Eligible bulk dairy products are butter, butter-oil, anhydrous milkfat, nonfat dry milk, whole milk powder, cheddar cheese, and bulk American cheese for manufacturing.

3/ The costs of agricultural support policies in the United States and other major countries is reviewed in Appendix VIII of the Recent Economic Developments paper for the Article IV consultation with the United States (SM/87/173, Sup. 1, 7/28/87).

4/ OECD, *National Policies and Agricultural Trade*, May 1987.

5/ PSEs are calculated as the ratio of government support to producers to total agricultural income; CSEs are ratios of the value of government transfers to consumers to total consumer spending on the commodity.

Canada, the EC, Japan, New Zealand, and the United States. The studies showed that Japan has the highest agricultural subsidies among OECD countries, with average PSEs for all available commodities representing about 60 percent of the value of production, compared with nearly 45 percent in the EC, and over 15 percent in the United States. In terms of individual commodities, Japanese PSEs reached 108 percent for soybeans (compared with 7 percent in the United States), 83 percent for dairy products (compared with 67-69 percent in Canada and the EC, and 48 percent in the United States), and 96 percent for wheat (compared with 17-18 percent in the United States and Canada, and 28 percent in the EC). The report further showed that dairy products benefited from assistance far more than any other commodity, receiving 39 percent of the total assistance in OECD countries, compared with the next highest 19 percent for beef and meat. In terms of the overall share of total assistance within the OECD for the period studied, the EC is far ahead, representing about 46 percent of the total; the United States and Japan each account for around 17 percent. Over 70 percent of assistance measures come in the form of price supports. Overall, the analysis revealed that assistance accounted for more than one-third of the value of output of OECD producers for the products examined, with one-half from consumer transfers.

The OECD report factored the PSE and CSE values into a multicountry, multicommodity model, and estimated that reductions in assistance would result in declines in production, modest increases in consumption, a reduced volume of exported commodities, increased imports, and rising world prices for several commodities. The effects would be significantly lower if the reduction in assistance is applied by all OECD countries simultaneously rather than by unilateral action. Reductions in assistance will benefit exporting countries and hurt importing countries. However, the estimated price changes for cereals, the main agricultural import of developing countries, were thought to be very small.

A recent Australian study 1/ attempts to quantify some of the economy wide effects of the CAP. Using a general equilibrium model for the four largest EC member states--France, Germany, Italy, and the United Kingdom--the study assesses the effects of agriculture protection on other sectors in terms of aggregate unemployment, exports and factor markets. The main channels of adverse influence of the CAP on the rest of the economy come through distortions in trade patterns, worsening terms of trade for the Community, increasing unemployment in the relatively labor-intensive industries (in view of wage rigidities), and promotion of research and investment in relatively inefficient industries. The study concludes that the total costs imposed by the CAP

1/ Jens Breckling, Sally Thorpe, and Andy Stolckel, "Effects of EC Agricultural Policies, a General Equilibrium Approach, Initial Results," Bureau of Agricultural Economics and Centre for International Economics, Canberra, 1987.

on member economies far exceed the direct budgetary costs and have adverse effects on the macroeconomic performance of the Community. Agricultural protection does not save jobs, but instead worsens unemployment in other sectors and the Community overall. The CAP also results in significant net transfers of income between countries and has a serious negative impact on other sectors, mainly manufacturing.

Several studies have focussed on the impact of Japan's agricultural protection policies on its economy and their more general effect on world trade in agricultural commodities. The estimates vary with the loss to the Japanese economy in the second half of the 1970s ranging to as high as US$6 billion a year, or about 1 percent of gross domestic product. 1/ Studies of the impact of the grain and meat policies of Japan, Korea, and Taiwan Province of China on world market prices indicate that they have depressed prices by between 2-3 percent for coarse grains and for non-ruminant meat, and 9 percent for ruminant meat. It was also estimated that these economies would gain substantially from a partial liberalization, particularly Japan where the present value of the net gain in economic welfare would be more than US$2,000 per person. 2/ Another study estimated that in the case of Japan, while removal of Japanese and U.S. tariffs and nontariff barriers would lead to a sharp contraction (50.2 percent) in employment in the agricultural sector, employment would expand in virtually all manufacturing industries. 3/ A recent study indicated that the mechanisms used by Japan to protect its agricultural industries have changed little during the 1980s, but the combined effect of the yen appreciation, the fall in world prices, and extensive quantitative import restrictions has led to a marked increase in the effective protection afforded Japanese agricultural industries; hence, transfers of income from Japanese consumers to Japanese farmers, the extent of resource misallocation within Japan, the burden of protection borne by Japanese exporting industries and the distortion of world trading patterns are all likely to have increased sharply in recent years. 4/

1/ M.D. Bale and E. Lutz, "Price distortions in agriculture and their effects: an international comparison," American Journal of Agricultural Economics, 1981, 63(1), pp. 8-22.

2/ R. Tyers and K. Anderson, "Price, trade and welfare effects of agricultural protection: the case of East Asia," Review of Marketing and Agriculture Economics, 1985, 53(3), pp. 113-40.

3/ G.R. Saxonhouse, "Japan's intractable trade surpluses in a new era," World Economy, 1986, Trade Policy Research Centre, London, 9(3), pp. 239-57.

4/ Bureau of Agricultural Economics, Japanese Agricultural Policies: An Overview, Australian Government Publishing Service, Occasional Paper 98, Canberra, 1987.

Developments in Industrial Trade Policy

This annex describes selected major trade policy developments affecting nonagricultural sectors in 1986-87. The sectors covered are automobiles, consumer electronics, high-technology, petrochemicals, steel, and textiles. The costs of protection are also featured.

1. Automobiles

No major new restrictions were imposed in this sector in 1986-87. Restrictions imposed in earlier years in the forms of quotas, voluntary export restraints, licensing, surveillance, industry-to-industry understandings continued in force in a number of industrial countries. Although the U.S. Administration declared in 1985 that it would no longer seek restraints on Japanese automobiles (after four years of restraints), Japan has continued to enforce the "voluntary export restraint" at 2.3 million units. Canada and Japan agreed on an "understanding" which would subject Japanese car exports to Canada to a monitoring system in 1986. Canada and Korea also reached an understanding on orderly marketing of Korean car exports to Canada. The EC decided to continue during 1986 its surveillance of imports from Japan. Among the items to be monitored are motor vehicles, motor cycles, and trucks. It has also been reported that, for 1987, the Japanese car manufacturers have accepted the need to make "orderly exports" to the EC by limiting monthly exports to 1986 levels (GATT, C/W/517, p. 26). Individual arrangements limiting imports of motor vehicles include those of Italy (a quota of 2,300 cars per year), the United Kingdom (11 percent of new car sales per year), and Spain (a quota of 2,000 cars per year from third-countries). France maintains a de facto stabilization of Japanese automobile sales at about 3 percent of the French market.

2. Consumer electronics

The EC has annually rolled over restraint or monitoring arrangements introduced in 1983 on imports of Japanese videotape recorders (VTRs) and on other consumer electronics. The EC and Japan agreed that from January 1 through December 31, 1986, the Japanese authorities would monitor the quantity, and, if necessary, the prices of videotape recorders, color TV tubes, color TV sets, NC lathes, and machine centers. In February 1986, the EC introduced a monitoring system for imports of VTRs from Korea. In addition, on May 27, 1987 the EC increased tariffs on imports of Japanese-made microwave ovens, digital cassette players, electric organs, videotape recorder parts, compact disc players, and amplifiers, to compensate for increased Japanese sales to the Community due to the entry of Spain and Portugal to the EC in 1986.

In late 1985, the President of Brazil instructed the Special Secretariat for Information to place restrictions on multinational suppliers of digital telephone exchanges (central-office switches).

3. High technology

a. Semiconductors

Trade frictions in the semiconductor sector increased sharply in 1986-87. In late 1985, the U.S. Administration filed antidumping proceedings against Japanese semiconductor firms. In May 1986, the U.S. International Trade Commission (ITC) made a final ruling that Japanese electronics manufacturers had been selling 256k memory chips in the United States for less than the cost of production, thus clearing the way for imposition of antidumping duties on certain chip imports from Japan. The complaints against Japanese chipmakers eventually led to talks between the United States and Japan, which subsequently gave rise to the bilateral agreement signed in July 1986. The bilateral agreement contained provisions for greater access by U.S. chipmakers to the Japanese chip market; agreement by Japan not to sell semiconductor chips below the "fair value" in the U.S. market, to monitor Japanese cost and export prices of a broad range of semiconductor products, and to provide the data on costs and export prices to the U.S. Department of Commerce. A novel feature to the bilateral agreement was to extend the price monitoring system by Japan to cover chips exported to third countries including Europe. The agreement also included the suspension by the United States of major dumping cases covering Japanese memory chips, as well as consultation clauses.

The agreement drew sharply unfavorable reaction from several other countries, particularly from the EC, on the controversial third-country price monitoring system. The EC was concerned that the third-country clause of the U.S.-Japan agreement would affect prices to be paid by European users, would contravene the GATT antidumping code, and contained preferential (thereby discriminatory) treatment for U.S. semiconductor exports to the Japanese market. A GATT investigative panel has been established following the EC's complaint to the GATT about the pact.

In late 1986 and early 1987, concerns resurfaced among U.S. officials and the U.S. Semiconductor Industry Association (SIA) about alleged nonobservance by Japan of the agreement. The SIA alleged that Japan continued to sell products at below cost in the U.S., and even more so in third-country markets. Moreover, the U.S. share of the Japanese market for semiconductors had hardly increased following the 1986 accord and may have declined, as prices in Japan dropped to levels even lower than before the accord, presumably because of oversupply created by falling U.S. demand. The glut in Japan may have prompted some chipmakers to sell their surplus to brokers who found ways to dodge pricing controls on chips bound for the U.S. market. As a result, disparities continued between third-country prices of Japanese chips and their official U.S. prices.

On March 27, 1987 the U.S. announced that it would impose retaliatory tariffs of 100 percent on US$300 million worth of Japanese goods, because Japan, according to the U.S. Government, had violated the semiconductor pact by allowing its chipmakers to sell their products at below-cost prices in third-country markets; on April 17, 1987 these tariffs were imposed on imports of Japanese made 16-bit portable and desktop computers, 18-20 inch color television sets, and selected power tools. On June 8, 1987 President Reagan announced that in view of improving Japanese compliance, the United States would lift the penalty tariff on 20-inch color televisions, equivalent to 17 percent of the total value of the retaliatory tariffs.

The U.S. action on tariffs prompted two further reactions. First, it lead to a complaint by Japan to the GATT and a GATT investigative panel has been established. Second, concerned that Japanese exports may be diverted to the EC following the U.S. action on tariffs, on May 27, 1987 the EC foreign ministers adopted a standby 100 percent tariff on the same three groups of products targeted by the United States for retaliation. The tariffs will be imposed if the monitoring system already in place shows that Japanese firms are diverting exports of these products to Europe.

b. Machine tools

In response to a 1983 petition by the National Machine Tool Builders in the United States, which asserted that imports of 18 types of machine tools constituted a threat to U.S. national security, the President decided on May 20, 1986 to seek voluntary restraint agreements on exports of these machine tools from the Taiwan Province of China, the Federal Republic of Germany, Japan, and Switzerland. Japan agreed to restrict exports to the United States of six machine tool categories: machine centers, milling machines, and computer-controlled and noncomputer-controlled lathes, and punching and shearing machines. Taiwan Province of China agreed to restrict exports of machine centers, milling machines, and computer-controlled and noncomputer-controlled lathes. The United States also suggested limits on exports of machine tools from Germany and Switzerland, and cautioned Korea, the United Kingdom, Singapore, Brazil, Spain, Italy, and Sweden not to allow their exporters to fill the gap caused by new restraints. However, Germany and the EC refused to recognize the upper limits on market shares as binding, and considered that the measures announced by the U.S. Administration violated both Article XI of the GATT and the "standstill" commitment of the Uruguay Round. Switzerland also refused to enter into a voluntary export restraint arrangement.

4. Petrochemicals--EC application of GSP

The present controversy between the EC and the Gulf countries concerning the imposition of duties by the EC on imports of petrochemicals from the Gulf countries exemplifies the linkages between trade and structural adjustment issues. The entry of the Gulf countries and particularly of Saudi Arabia in the petrochemicals industry dates back to the beginning of the 1980s when European production was still high. Due to availability of ethane gas, which is a major input in production of petrochemicals, at a price substantially below that in developed countries, the Gulf countries enjoy a cost advantage in the petrochemical industry. This led to substantial investments in this industry, in conjunction with foreign partners, and production was planned to cover 5 to 6 percent of the world market in the 1990s. Meanwhile, the European petrochemicals industry, faced with substantial overcapacity and old and unprofitable plants, was attempting to reduce sharply its refining capacity from 850 million tons annually in 1977/78 to 580 million tons in 1985.

Imports of petrochemicals by the EC increased from ECU 1 million in 1980 to more than ECU 200 million in 1985, which led domestic industries to put pressure on the EC to strictly apply its GSP scheme under which these products were imported.

The EC's GSP scheme covers imports of all manufactured and semi-manufactured products from countries in the Group of 77 and provides duty-free access for more than 95 percent of the products considered. This duty-free access is, however, quantitatively limited for a few sensitive items. Imports from any of these countries are either subject to a duty-free tariff quota system--automatic imposition of the MFN duty when these imports reach specified amounts--or to a duty-free tariff ceiling system--imposition of duty if imports exceed ceilings and if a local supplier and its government request it.

The ceiling system had been applied to petrochemicals from Saudi Arabia and Kuwait, when in June 1984, the EC decided for the first time to levy a 13.5 percent most-favored-nation (MFN) tariff on methanol imports from Saudi Arabia after such imports exceeded their ceiling by more than tenfold. In 1985, the duties were applied to three products: methanol, polyethylene and glycol. In 1986, the list of products under ceilings was widened and tariffs were introduced on many other products. On January 6, 1986 a 12.5 percent duty was imposed on high density polyethylene after Saudi Arabia had reached its 1986 ceiling. A 12 percent tariff on methanol came into force on January 14, 1986; an 11 percent tariff took place on urea from Kuwait on February 22, and on urea from Saudi Arabia on February 21, 1986. An 8 percent tariff was imposed on Saudi melamine at the beginning of March, and on May 12, the EC imposed a 6 percent duty on Saudi Arabian styrene. Moreover, an antidumping proceeding was initiated against imports of urea from Saudi Arabia and other countries resulting in a provisional antidumping duty in May 1987.

In 1987, the European Community Council of Foreign Affairs Ministers further decided to automatically apply MFN tariffs on petrochemical imports under GSP from some countries once quotas are exceeded, thereby transforming in these cases the duty-free tariff ceiling into a duty-free tariff quota system. The products placed under quota system were liquid ammonia melamine from Saudi Arabia and Romania; urea from Saudi Arabia, Kuwait, and Libya; methanol from Saudi Arabia, Bahrain, Malaysia, and Libya; ethylene glycol from Saudi Arabia and Mexico; diethylene glycol from Saudi Arabia; linear polyethylene from Saudi Arabia and Argentina; and high density polyethylene from Saudi Arabia. Other suppliers to the EC, including some with which the EC had association agreements and some competing directly with the Gulf countries, continued to benefit from the more liberal provisions of the ceiling system.

The imposition of duties was a source of concern for Saudi Arabia and the Cooperation Council for the Arab States of the Gulf. They argued that the duties were striking at infant industries essential to their countries' development, and that the Gulf states themselves were not applying any tariff on a large part of their imports from the EC. 1/ They questioned the decision to graduate from a ceiling system to a quota system, particularly as such a decision was not applied in a similar fashion to all third-country competitors in the EC market. They were concerned that the EC actions represented a drift toward protectionism.

The EC responded by pointing out that the duties were imposed in implementation of the provisions already incorporated in the GSP; that products from the Gulf remained competitive despite customs duties, as evidenced by the fact that the quotas have been significantly exceeded; that the EC also considered that the Gulf petrochemical industries were no longer infant industries. Moreover, it noted that the GSP was intended to help the less developed countries, whereas the Gulf countries had a per capita income significantly higher than that of the EC, and that they were not granted any "preferences" in petrochemicals either by the United States or Japan. As a consequence, the EC felt that absorption of output of the Gulf State refineries should be more evenly shared with other industrial countries, which should also bear part of the burden of the adjustment in the petrochemicals sector.

5. Steel

There has been a steady proliferation of restrictions in the steel sector in the 1980s.

Following the filing of numerous countervailing duty petititions by the domestic steel industry in the United States, the latter negotiated bilateral arrangements with the EC, limiting EC exports of carbon steel during 1982-85, and pipes and tubes in 1985-86. In late 1985, these two arrangements were combined into a new agreement covering the period January 1986-September 1989 including products not covered by previous agreements; the United States also limited EC sales of semifinished steel to the U.S. market. Furthermore, in the past two years, the scope

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1/ Saudi Arabia, for example, has no quantitative restrictions. More than half of its imports are accorded duty-free status and only 4 percent are subject to protective tariffs of 10-20 percent.

of restraints on steel exports to the United States has expanded to cover 17 other suppliers, including Austria, Brazil, Japan, and Korea. These restraint arrangements were designed to limit the import share of steel mill products to 18.5 percent of U.S. apparent consumption over the five-year period, ending September 1989.

The U.S. speciality steel industry recently has been granted an extension through September 1989 of import restrictions imposed in 1983 and due to expire this year; the U.S. Federal Trade Commission estimates that ending the protection would save U.S. consumers US$44 million a year, but would cost the U.S. industry US$10 million a year.

The EC has had agreements in the 1980s regulating steel imports with the majority of its traditional suppliers, including Australia, Brazil, Bulgaria, Czechoslovakia, Hungary, Korea, Poland, Romania, and South Africa. The 1986 agreements were designed to contain imports at about 10 percent of internal consumption, and the EC has renewed them in 1987, except that Australia has been dropped and Venezuela has been included for the first time among countries restraining steel exports to the EC. Regulation of Japanese exports of steel to the EC was also renewed. Steel imports from EFTA countries--Austria, Finland, Norway, and Sweden--are covered by exchange of letters of understanding and have no ceilings. However, shipments of steel from EFTA countries to the EC are subject to a monitoring system with respect to volumes and prices.

6. Multi-Fibre Arrangement (MFA)

Trade in textiles and clothing among developed countries accounts for some half of total world trade in these products, and has continued under normal GATT procedures and rules. However, trade in textiles and clothing between developed and developing countries has been subject to restrictions for close to three decades. The Arrangement Regarding International Trade in Textiles, generally known as the Multi-Fibre Arrangement (MFA), was extended in July 1986 for the third time for a period of five years, from August 1, 1986 to July 31, 1991. Like its predecessors, the current extension--known as MFAIV--is in the form of a protocol referring to certain understandings of the GATT Textiles Committee. The new understandings were reached by 43 participants, including the 12 members of the EC as a single entity.

According to a study by the GATT Secretariat, 1/ MFAI was a period of modest liberalization of textile trade, as unilateral and arbitrary pre-MFA restrictions were dismantled and replaced by the "discipline" of the comprehensive agreement. MFAII saw a general increase in both the number and the intensity of restrictions. Moreover, many small suppliers who could have been entitled to special treatment under the Arrangement, increasingly saw their exports come under restraint.

1/ GATT, Textiles and Clothing in the World Economy: Background Study, Geneva, July 1984.

In its 1984 review, the Textiles Surveillance Board (TSB) concluded that the restraints introduced under MFAIII often were more extensive and more restrictive than in the Arrangement's previous phases. The TSB also noted that the Arrangement may have made some positive contribution to orderly markets, but no progress had been made under it toward liberalizing world trade in textile products.

MFAIV contains several new provisions that are likely to have a significant bearing on the way the Arrangement will be implemented. Some of these, when invoked in bilateral agreements, would tend to result in a more restrictive regime in textile trade, while others could be used to allow some flexibility and growth in textile trade. A major new element in the Agreement is the extension of coverage from cotton, wool, and synthetic fibers, to other materials directly competitive with those already covered by the Arrangement. This refers to vegetable fibers such as ramie, sisal, and jute, as well as blends containing vegetable fibers and silk. Given the increases in developing country exports of products using some of these materials in recent years (e.g., exports of ramie products from China to the United States), this extension in coverage can be expected to have a significant restrictive impact on world textile trade. Furthermore, under MFAIV the importing country can extend unilateral restrictions for an additional 12 months (beyond the first 12 months) without a new finding of market disruption.

Provisions that could have the effect of relaxing the Arrangement's restrictiveness include: an understanding that bilateral agreements under the Arrangement should provide for increased market access to imports in overall terms; a recognition that, for the purpose of introducing safeguard measures, the existence of serious damage to domestic producers, or threat thereof, should not be based solely on the level or growth of imports, but should also be substantiated by relevant factual information on identifiable segments of the domestic industry; an understanding that countries wishing to introduce changes in the implementation or interpretation of bilateral agreements or of the Arrangement itself should, wherever possible, inform the affected countries and initiate consultations with them prior to these changes; and an understanding that exports from least developed countries, as well as those from small suppliers and new entrants, normally should not be made subject to restraints. Adherence to these provisions can only be known in the context of actual implementation of bilateral agreements.

MFAIV also contains an agreement to enhance cooperation in preventing circumvention of the Arrangement through false customs declarations or other means and notes concern over infringements of registered trade marks and designs. The new extension contains for the first time the objective of an eventual application of GATT rules to trade in textiles. Although this may be of little immediate importance for the practical implementation of the Arrangement, the acceptance of the principle by all participants may be significant. However, no time limit is specified for reaching this objective.

Because of the varied provisions of the new Arrangement and its sometimes ambiguous wording, it is difficult to assess accurately its likely overall impact. This will depend on how the Arrangement is administered. However, some indication is provided by recent developments in bilateral arrangements. In the past, bilateral arrangements under the MFA were normally negotiated after all the MFA provisions had been agreed upon. The process appears to have been reversed to some extent this time, as large importers were carrying out negotiations on bilateral agreements with a number of exporting countries concurrently with the deliberations of the Textiles Committee on extending the MFA. Thus, the United States had concluded a bilateral agreement with Hong Kong already in July 1986 (and also with Taiwan Province of China, which is not a participant in the MFA but an important exporter that has been given similar access as other dominant suppliers in the past), and with Korea in early August 1986. The EC also had initialled agreements with a number of suppliers in July 1986 and was negotiating with others before MFAIV was in place.

In addition to extending the coverage of the agreement to new fabrics as included in MFAIV, the U.S. agreements with Hong Kong, Korea and Taiwan Province of China appear relatively restrictive with respect to the growth provision; quotas for Hong Kong and Taiwan Province of China provide an increase of 0.5 percent per annum during 1986-88 and slightly more in 1989-91, while the agreement with Korea limits the increases in textile imports to less than 1 percent per year. The agreements between the EC and some exporters, who have relatively small shares of the EC market, contain room for considerable flexibility; for the dominant suppliers, the new agreements tend to contain some provision for liberalization, but this appears marginal.

7. Costs of protection 1/

Although there can be little doubt that growth of world trade has contributed greatly to raising the efficiency of resource use, this proposition has been difficult to quantify or rigorously model. Nonetheless, there is strong evidence supporting the general proposition, based on detailed micro-studies supporting the general proposition, as well as evidence bearing on national economies and industrial structures. For example, a striking feature of postwar growth was that small countries which relied most heavily on international trade generally grew more rapidly than their larger counterparts. Moreover, their growth depended heavily on products characterized by economies of scale in production. Cost savings permitted by scale economies in the integrated European market increased productivity in the major EC countries by five to ten times more than

1/ This section is partly based on OECD, "Economic Performance and Structural Adjustment," January 1987.

originally envisaged. 1/ Exploiting scale economies was closely linked to the perception that market opening was a largely irreversible process--a perception which reshaped corporate strategies. 2/ Recent estimates using computable general equilibrium models suggest that the impact of trade liberalization on domestic efficiency in small economies may be much greater than had earlier been thought. 3/ A comparison of the experiences of small countries which opened their markets to international trade more than others showed the former had far higher rates of growth of manufacturing productivity than the latter; this was closely linked to the fact that the former became increasingly specialized both within industries and between them.

These gains provide a benchmark against which the costs of the recent drift toward protection can be assessed. 4/ At the microeconomic level, the costs are those of foregone specialization--i.e., of the benefits lost by not adapting the international structure of production to that of factor endowments. Protection also entails significant, though still less easily quantified, losses in terms of scale economies, product differentiation, and R and D efficiency. These are most readily assessed when markets are fragmented, forcing manufacturers to adapt their product lines to diverse national requirements. For example, fragmentation of the European telecommunications equipment market by conflicting technical and regulatory norms increases R and D costs in certain products by as much as 40 percent. 5/ Uncertainties created by administrative or contingent protection also impose efficiency losses as firms opt for more flexible but less cost-effective production and marketing strategies compared to a situation of no protection. There is little quantitative evidence in this respect, but case studies of particular industries, notably textiles, steel, and consumer electronics, discern a growing risk-averseness in export-oriented firms; this is viewed as a significant factor underpinning increasing reliance by OECD firms on contractual arrangements, such as international

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1/ G.R. Denton (ed.), Economic Integration in Europe, Weidenfeld and Nicholson, London 1969.

2/ J. Müller, "Competitive Performance and Trade with the EEC: Generalizations from Several Case Studies with Specific References to the West Germany Economy," mimeo, 1983; and N. Hood and S. Young, Multinationals in Retreat, Edinburgh University Press, 1982.

3/ R.G. Harris "Applied General Equilibrium Analysis of Small Open Economies with Scale Economies and Imperfect Competition," Queens University Discussion Paper, No. 524, 1983; and R.G. Harris (with assistance of D. Cox) "Trade, Industrial Policy, and Canadian Manufacturing," Economic Council, 1984.

4/ A detailed review can be found in OECD, Costs and Benefits of Protection, Paris, 1985.

5/ J. Müller, et. al., Economic Evaluation of Telecommunications Investment, D.I.W., Berlin, 1985.

subcontracting, relative to more conventional forms of foreign investment in developing countries. 1/

The greatest costs may derive from the erosion of competition. Over the last 20 years, underlying trends in technology have tended to raise the size of plants and firms, reinforcing the oligopolistic character of a broad range of product markets. 2/ In this environment, the pressures to increase productivity, upgrade products and processes, and reduce prices have increasingly come from international competition--from the ease with which an established foreign firm could enter a market through lower prices or more innovative products. 3/ The spread of controls over imports has a drastic impact in this respect, for it has become increasingly common for discriminatory measures to be applied against foreign firms whose competitive behavior is considered too aggressive, for antidumping and countervailing actions to be employed to harass importers who cut prices, and for negotiated "price undertakings" to be used to control the competitive process. 4/

Protection also entails macroeconomic costs. High unemployment, large external imbalances, and unprecedented swings in real currency values experienced in the last several years, have accentuated protectionist tendencies. But policies aimed at alleviating pressure from particular industries have not corrected problems rooted in saving-investment imbalances, uncertainty about inflation and financial prices, and deterioration of broader macroeconomic performance. Even though protection or trade interventions have redistributed the burdens of these macroeconomic imbalances, they have exacerbated them by further weakening adjustment processes. The economic costs associated with maladjustment or nonadjustment could be substantial.

Various studies have estimated consumer and welfare costs of industrial protection. 5/ For example, costs to consumers of protection for textiles and apparel and for steel in the United States are

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1/ C. Oman, New Forms of Foreign Investment, OECD, 1986; and J. Grünwald and M. Flamm, The Global Factory, The Brookings Institution, Washington, D.C., 1985.

2/ F.M. Scherer, Industrial Market Structure and Economic Performance, Rand McNally, 1980, pp. 81-150.

3/ P.A. Geroski and A. Jacquemin, "Imports as a Competitive Discipline," Recherches Economiques de Louvain 47, September 1981, pp. 197-208; A. Jacquemin, "Imperfect Market Structures and International Trade," Kyklos, Vol 35, No. 1, 1982; B. Lyons, "International Trade, Industrial Pricing and Profitability: A Survey," University of Sheffield, September 1979; and T.A. Pugel, "Foreign Trade and U.S. Market Performance," Journal of Industrial Economics 29, December 1980, pp. 119-30.

4/ Also, see article by C.F.J. Boonekamp on "Voluntary Export Restraints," in Finance and Development, forthcoming.

5/ See World Development Report, 1987.

estimated at many billions of dollars; for cars, they are estimated at US$1-6 billion dollars for the United States 1/ and a quarter billion dollars for the United Kingdom; for video cassette recorders in the EC, they are estimated at nearly half a billion dollars. The welfare costs for the economy as a whole of restrictions on textiles and apparel are estimated as ranging from US$1.4 billion to US$6.6 billion in the EC and the United States, and nearly US$2 billion for steel in the United States.

The costs of job preservation through protection are high. For example, each job preserved in the automobile industry is estimated to have cost consumers between US$19,000 and US$48,000 a year in the United Kingdom and between US$40,000 and US$108,500 a year in the United States. Looked at another way, the cost to consumers of preserving one U.K. and U.S. worker in car production was respectively equivalent to four and six workers earning the average industrial wage in other industries. VERs in the U.S. steel industry cost consumers US$114,000 for protected jobs each year; for every dollar paid to steel workers who would have lost their jobs, consumers lost US$35 and the U.S. economy as a whole lost US$25.

Protection for employment purposes can be obtained more cheaply through other mechanisms such as financial compensation and retraining. Protection may not even succeed in preserving threatened jobs, except perhaps in the short run. For example, between 1970 and 1984 employment declined by 54 percent in the U.S. steel industry, and by 46 percent in the EC's textile industry, despite the protection accorded to these industries. A recent study on the trade and employment effects of VERs on steel exports to the United States concluded that these restraint agreements would result in a net employment loss in the U.S. economy, though steel industry employment would rise. 2/ A recent OECD study 3/ also showed that protectionism has negative net employment effects. It noted that import restrictions have only a limited positive impact on employment in the protected sectors (on the order of 2 to 3 percentage points), and any job maintenance benefits are often offset by adverse macroeconomic effects, such as higher taxes (if protection is combined with subsidization) and higher wage levels. Even if protectionism under specific conditions may be an instrument used to maintain jobs in a particular industry, its net effect on a macroeconomic level is likely to be negative, as it reduces the flexibility of the economy and replaces export-oriented activities--

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1/ Also, see C. Collyns and S. Dunaway, "The Cost of Trade Restraints: The Case of Japanese Automobile Exports to the United States," IMF Staff Papers, Vol. 34, No.1, March 1987.

2/ José A. Méndez, "The Short-Run Trade and Employment Effects of Steel Import Restraints," Journal of World Trade Law, Vol. 20, 1986, pp. 554-66.

3/ OECD, Protectionism in International Trade and Its Consequences on Employment and Economic Growth, Paris, May 1987.

which would contribute more to overall productivity and real income--by lower-pay, lower-quality jobs.

A recent study of the potential impact of the proposed Textile and Apparel Trade Bill of 1987, currently under discussion in the U.S. Congress, identified substantial costs. 1/ Consumers would pay an estimated US$10 billion a year in higher retail prices to protect less than 47,000 textile, apparel, and footwear jobs; the cost per job would amount to US$233,000. Over 52,000 retail jobs would be lost due to decreased consumer spending on textile products, apparel and footwear as a result of higher prices--5,700 more jobs would be lost in the retail sector than would be protected in the manufacturing sector. By 1996, when the first official evaluation of the Act is required, consumers would have paid a total of US$88 billion due to higher prices for a reduced supply of goods. This would contribute to inflation by increasing textile and apparel import prices by 6 percent and domestic textile and apparel prices by 2 percent, as well as footwear import prices by 9 percent, and domestic footwear prices by 10 percent.

Some recent studies do not support the popular view that unfair trading practices and protectionism abroad are responsible for existing trade imbalances. One such study 2/ contended that, while foreign trade barriers and declining U.S. competitiveness were continuing problems, they did not account for the sharp rise in the trade deficit since 1980, because they had changed little in recent years. The report cited estimates by experts that the dollar appreciation accounted for 50 to 60 percent of the increase in the U.S. trade deficit since 1980, the strength of the economy for 15 to 25 percent, Latin American debt (and consequent reduction in demand for U.S. exports) for 10 to 20 percent, and other factors for about 5 percent.

Another study 3/ also refuted the arguments, advanced by protectionists in the current trade policy debate in the U.S. Congress, that "protectionism is justified by a trade deficit," and that foreign trade practices caused the deficit. The study found that nearly all U.S. industries experienced declining trade balances during the 1980s and that there was a fairly direct relationship between the deficits and macroeconomic factors.

1/ Industrial Business and Economic Research Corporation, "Analysis of the Costs of the Textile and Apparel Trade Act of 1987," Washington, D.C., 1987.

2/ The U.S. General Accounting Office, "International Trade: The U.S. Trade Deficit: Causes and Policy Options for Solutions," April 1987 (GAO/NSIAD-87-135).

3/ U.S. Federal Trade Commission, "Competitiveness and the Trade Deficit," Washington, D.C., May 1987.

The Uruguay Round

Since the Second World War there have been seven rounds of multilateral trade negotiations (MTN) under GATT auspices. The last MTN ("Tokyo Round") took place during 1973-79. The Uruguay Round is intended to be completed in the period 1987-90. This annex describes the work of the various negotiating groups established under the Uruguay Round.

I. Group on Negotiations on Goods

1. Tariffs

Tariffs are GATT's traditional and most successful field of activity. In principle, the tariff is the only instrument of protection allowed by GATT. When contracting parties "bind" their tariffs, they become fixed and can only be raised if compensation is negotiated. Developing countries are accorded more favorable treatment enabling them to raise tariffs to promote the establishment of an industry.

Although the seven rounds of trade negotiations held in GATT since 1947 have lowered the level of tariff protection in industrial countries to a point where they are of minor significance in their trade, there are still some peaks of tariff protection for sensitive goods whose export is often of interest to developing countries. The level of tariff protection is generally higher for agricultural products than for manufactures. In developing countries, not only is the level of customs duties higher than in developed countries on average, but the degree to which such duties are bound is much less; as a result, they can be raised at will and without engaging in negotiations for compensation.

Discussions thus far in the group on tariffs have focused on approaches to a tariff cutting exercise, i.e., whether it should be based on a request and offer basis, or on a mathematical formula as in the Kennedy Round, affecting most products and sectors. Japan has suggested that developed countries eliminate all tariffs on industrial products. Most industrial countries have asked for a greater degree of tariff bindings by all contracting parties including developing countries. The GATT Secretariat is preparing a note on the tariff negotiations in the Kennedy and Tokyo Rounds and a paper on tariff bindings by countries participating in the GATT's ongoing tariff studies.

2. Nontariff measures

A more challenging and substantive issue concerns the reduction or elimination of nontariff measures, including quantitative restrictions. The initial discussions of the group on nontariff measures have covered whether distinction should be made between GATT legal and illegal measures, and whether liberalization of nontariff barriers should be negotiated irrespective of their legality under the GATT. Negotiations in this area would require compilation of a substantial data base.

3. Natural resources-based products

The group on natural resources-based products has as its negotiating objective the achievement of the fullest liberalization of trade in this area including processed and semi-processed forms. The initial phase will establish a factual and common basis for negotiations, and determine their techniques and modalities. A starting point has been the work done by the Working Party on Trade in Certain Natural Resource Products, established in 1984, which covered nonferrous metals and minerals, forestry products, and fish and fisheries products.

4. Textiles and clothing

Another area of special interest to developing countries pertains to the eventual integration into GATT of trade in the textiles and clothing sector on the basis of strengthened GATT rules and disciplines. In discussions of this group thus far, many developing countries emphasized the need to return to normal GATT rules. Most developed countries felt that it would be difficult to determine the approach in this sector until some experience had been obtained on the working of the recently extended Multifibre Arrangement (MFAIV). The GATT Secretariat is updating its 1984 study on textiles and clothing.

5. Agriculture

The liberal trade principles of the GATT have not been applied as strongly to agriculture as to manufactured products, and this imbalance has been at the heart of many recent trade conflicts. At Punta del Este some industrial countries, particularly the EC, felt that the special social and economic characteristics of agriculture set limits on the extent of liberalization that is feasible in this sector; other countries, including traditional agricultural exporters, considered that farm support programs, particularly export subsidies, may displace them from third-country markets, and felt that these programs should be reduced according to a predetermined phase-out period. The compromise that emerged at Punta del Este was intended to satisfy both concerns. Contracting Parties agreed to the urgent need to bring more discipline and predictability to world agricultural trade; in particular, restrictions and distortions, including those related to structural surpluses, need to eliminated, so as to reduce world market imbalances. The negotiations aim to bring all measures affecting import access and export competition in agriculture under strengthened and more operationally effective GATT rules and disciplines. Market access and the competitive environment would be improved through, inter alia, a reduction of import barriers; better discipline on the use of all direct and indirect subsidies and other measures affecting agricultural trade; and a phased reduction of the negative effects of such practices. The adverse effects of sanitary and phytosanitary regulations would be minimized. Thus, agriculture would be covered in all its broad formulation.

Since the establishment of the group on agriculture, discussions revolved around the scope of liberalization. Some GATT members (e.g., the United States and certain other countries) stressed the harmful effects of subsidies and domestic support measures, whereas others (e.g., the EC and Japan) emphasized the difficulties created by the presence of large surpluses. There was some discussion of the merits of a product-by-product approach versus a measure-by-measure approach. The GATT Secretariat prepared a summary of the major problems and issues relevant to negotiations in agriculture. The Secretariat is revising this paper and is also preparing a paper on agricultural trade problems of developing countries. The United States proposed elimination, over a ten year period, of all subsidies and import barriers affecting agriculture, and harmonization of sanitary and health regulations.

6. Tropical products

Although trade in tropical products does not represent a large percentage of world trade, it is important to developing countries, many of which largely depend on tropical products for their export earnings. Recognizing this, contracting parties agreed to give special attention to liberalization in this sector. In the initial phase, seven tropical products are to be covered--tropical beverages (coffee, tea, and cocoa); spices, flowers and plants; certain oilseeds, vegetable oils and oilcake; tobacco, rice and tropical roots, tropical fruits and nuts; tropical wood and rubber; jute and hard fibers. Developing countries have called for full tariff and nontariff trade liberalization of tropical products. A number of industrial countries have indicated that participation by developing countries in accordance with their level of development would help ensure progress in negotiations.

7. GATT Articles

The group will review existing GATT articles, provisions, and disciplines as requested by interested contracting parties, and, as appropriate, undertake negotiations. In discussions thus far, interest was expressed in reviewing a number of articles. The most frequently mentioned Articles were XXIV (customs unions and free trade areas), XXVIII (rules on tariff schedules), XII, XIV, XV, and XVIII (restrictions for balance of payments and infant industry purposes) and articles dealing with agriculture and subsidies.

8. MTN agreements and arrangements

Negotiations aim to improve, clarify, or expand, as appropriate, agreements and arrangements negotiated in the Tokyo Round. In discussions thus far, some participants wondered why more developing countries had not become signatories to the various Tokyo Round codes.

Some thought the codes presented little interest or benefit to certain countries, the required administrative and legislative changes were onerous, or that lack of clarity and uniformity of interpretation and application of certain codes discouraged membership. Some participants wished to review aspects of MTN agreements relating to import licensing and technical barriers to trade, anti-dumping, and subsidies. One participating developing country, supported by some others, was concerned that anti-dumping actions were in some cases resulting in real trade barriers because of application of domestic legislation inconsistent with the code.

9. Safeguards

GATT already has a code on safeguards, as embodied in its Article XIX provisions which permit temporary imposition of trade barriers on a nondiscriminatory basis, in order to protect producers suffering or threatened by serious injury. Many countries have had difficulties in meeting its conditions, and this, in turn, has encouraged "gray" area measures outside GATT. A comprehensive agreement on safeguards is thus of particular importance to the strengthening of the GATT system and to progress in the MTN. The discussions on safeguards will include elements of transparency, coverage, objective criteria for action including the concept of serious injury, temporary nature, degressivity and structural adjustment, compensation and retaliation, notification, consultation, multilateral surveillance, and dispute settlement. Most contracting parties have indicated that negotiations should be conducted on a priority basis and should not be conditioned on the progress on other matters.

10. Subsidies and countervailing measures

An issue of increasing contention in international trade concerns the use of subsidies, including export and domestic subsidies. The new round seeks to review and improve GATT disciplines relating to subsidies and countervailing measures. Discussions thus far have featured the need to review in depth the nature and operation of relevant articles of the GATT (Articles VI and XVI) and the Tokyo Round Subsidies Code. Some countries suggested that negotiations on subsidy rules were opportune in view of the budgetary problems faced in many countries and growing awareness of the limited economic return on the use of subsidies. Some suggested that discussions should first take up matters such as the definition of a subsidy, the criteria to determine injury, and the use of countervailing duties. There was some ambiguity in these areas, and as a result, trade frictions have escalated in many cases. Many developing countries that wished to participate fully in the subsidies negotiation drew attention to the harmful effects on their exports of some countervailing duty practices. Initial discussions also covered the treatment of subsidies affecting primary products.

11. Trade-related intellectual property rights, including trade in counterfeit goods

To promote effective protection of intellectual property rights, and to ensure that enforcement of such rights does not create trade barriers, the negotiations aim to clarify GATT provisions and elaborate, as appropriate, new rules and disciplines in this area. Negotiations also aim to develop a multilateral framework of principles, rules and disciplines dealing with international trade in counterfeit goods, taking into account work already undertaken in the GATT. These negotiations are to be without prejudice to other complementary initiatives that may be taken in the World Intellectual Property Organization (WIPO), and elsewhere, to deal with these matters. In discussions thus far, a number of industrial countries stressed that satisfactory results in this area were necessary to achieve an acceptable overall balance of results in the Uruguay Round. The group considered submissions by several industrial countries on trade problems in connection with intellectual property rights. These dealt with inadequacies in the availability or scope of intellectual property rights, ineffective procedures and remedies for their enforcement, and national rules which discriminate against imports. Some countries wanted to examine trade distortions arising in these ways, but some others doubted that these issues were primarily trade-related. The GATT Secretariat is compiling an inventory on problems arising from counterfeit goods and intellectual rights trade, and consulting with the Customs Cooperation Council, UNESCO, and WIPO on existing work in this area.

12. Trade-related investment measures

The group on trade-related investment measures has begun discussions to examine the operation of GATT articles related to the trade restrictive and trade distorting effects of investment measures. Given the relatively little work done previously in this area, the group's starting point was submissions by participants on the adequacy of existing GATT articles in covering the topic. Some participants felt the group should not be too ambitious in its work in light of the subject's complexity and dearth of information at present. Some developing countries stressed that negotiations should not undermine the right of governments to control investment for justifiable domestic policy purposes. The group considered four submissions identifying investment measures with trade restrictive or distorting effects, including local content and export performance requirements, domestic sales and trade balancing requirements, local equity and technology transfer requirements, and remittance restrictions. The GATT Articles cited as relevant included Article III (national treatment), Article VI (anti-dumping and countervailing duties), Article X (publication of trade regulations, with respect to transparency), Article XI (quantitative restrictions), Article XVI (subsidies), and Article XVII (State trading). Many delegations pointed out the possible relevance of Article XVIII in the context of restrictions to safeguard the balance of payments and government assistance to economic development. In their preliminary views, many countries acknowledged the potential trade effects of some of these measures, but stressed their necessity in regulating direct foreign investment and promoting national development objectives.

13. Dispute settlement

The prompt resolution of trade disputes under multilateral surveillance is of vital importance to the smooth functioning of the GATT. Since 1948, there have been about 100 complaints under Article XXIII. These represent a small portion of disputes because most of them are settled through bilateral consultations without any involvement of the Contracting Parties. About half of the complaints brought to the GATT (52) led to the submission of a report by a panel; the other cases were settled during sessions of Contracting Parties, by working parties, by groups of experts or through bilateral consultations before the panel had met. Fifty of these reports were adopted or led to a withdrawal of the complaint, or, in two cases, were implemented without adoption. In two cases, the reports did not result in a resolution of the dispute. Since 1982, the time between the Council's decision to establish a panel and its decision to adopt the panel report has averaged slightly more than 12 months. On average, panels have completed their task within about six months. The dispute settlement procedures of the Codes have also been used. However, the three reports presented by panels established under the Subsidies Code were not adopted because they raised fundamental questions concerning interpretation of certain articles of the Code, on which difference of opinion emerged in the Committee.

In discussions thus far, many participants noted that the main causes of the difficulties in this area in recent years lay in the existence of vague GATT provisions and differences in their interpretation, inadequate panel reports, the lack of political will to resolve disputes, and nonobservance or abuse of the proceedings. Nevertheless, there was agreement that improvements to the procedure could add to the reliability and speediness of the system. Suggestions were made for accelerating the establishment of panels; increased use of non-governmental experts as panelists; the imposition of time limits on the work of panels; an enhanced mediation role for the Director-General; a binding arbitration process; and possible deviations from the consensus rules for adoption of panel reports in the Council. Some participants pointed to the disadvantage of smaller and developing countries which are unable to take retaliatory measures when major traders fail to implement panel recommendations. It was also suggested that there be continued surveillance of compliance with adopted panel recommendations. A number of participants stressed the conciliatory character of the dispute settlement procedure.

14. Functioning of the GATT system

Negotiations on the functioning of the GATT system aim to enhance GATT's surveillance, and better monitor the trade policies of contracting parties; to improve GATT's effectiveness and decision-making; and to increase GATT's contribution in achieving greater coherence in global economic policymaking through strengthening its relationship with other international organizations responsible for monetary and financial matters.

In discussions thus far in the group dealing with these matters, participants stressed the need for greater cooperation between the GATT, IMF, and IBRD. They also emphasized the importance of respecting the separate institutional competence of each organization, with the GATT taking the leading role in trade policy questions. Discussions also concerned expanded GATT surveillance 1/ over trade policies and the feasibility of increased involvement by trade ministers in the work of the GATT. While some participants saw a ministerial body modeled upon the Consultative Group of Eighteen as a possibility, others saw difficulties in limited representation. Several participants pointed to the value of surveillance as an early warning system, and proposals to tighten surveillance were put forward. Some participants called for regular reviews of the trade policies of each of the biggest (say, thirty) trading nations, with others subject to ad hoc examinations. A more significant role for the GATT Secretariat in surveillance was also suggested. While it was widely accepted that effective surveillance was an important means of ensuring transparency and predictability in policy making, views differed on whether its prime purpose was to monitor and ensure compliance with GATT provisions or to provide a more general overview of trends in trade policy. Thus, some participants favored a collective assessment of trends rather than a country-by-country review system. Views also differed on whether a new standing surveillance body would be necessary.

The GATT Secretariat is preparing a paper on GATT's existing surveillance functions; the history of the GATT Consultative Group of Eighteen; experience with involvement of officials at senior or political levels from capitals in the GATT's work; and the respective mandates of the GATT, IMF, and IBRD, the institutional relationship between the GATT and the IMF and the IBRD, and the institutional arrangements for the involvement of ministers in the work of the IMF and IBRD.

1/ Existing GATT bodies with a surveillance role include the Uruguay Round Surveillance Body overseeing the standstill and rollback; twice-yearly special Council meetings; the Committee on Trade and Development; the Balance of Payments Restrictions Committee; the Committees of the Tokyo Round MTN codes; and the Textiles Surveillance Body (MFA).

II. Group on Negotiations on Services (GNS)

The Punta del Este declaration launched negotiations on a multilateral framework of principles and rules for trade in services. Specific disciplines may be elaborated for individual service sectors. At the suggestion of the developing countries, the declaration states that the framework "shall respect the policy objectives of national laws and regulations applying to services and shall take into account the work of relevant international organizations." GATT procedures and practices are to apply to these negotiations.

In discussions thus far of the GNS, participants debated the elements in the program for the initial phase of the negotiations. These elements include definitional issues, statistical issues, broad concepts on which principles and rules for trade in services might be based, coverage of the multilateral framework for trade in services, existing international disciplines and arrangements, and measures limiting trade in services. A number of industrial countries, desirous of an early agreement on a multilateral framework, asked that priority be given to agreement on coverage of sectors, as well as to an inventory of measures affecting trade in services; and agreed regimes should be based on the principle of nondiscrimination. In the view of many developing countries, however, the GNS should give priority to an agreed definition of trade in services.

On the elements of the negotiations, industrial countries preferred to consider them in the context of the examination of the trade rules and principles that might be applicable to services; for example, the GATT was negotiated without definition and statistics on trade in goods. Others, mainly developing countries, considered it difficult to proceed in specific negotiating areas unless the GNS had a clear picture of the services sectors and of trade in services.

Discussion on the role of statistics in the negotiation and on the work of individual countries and international institutions in collecting and refining statistics on trade in services, suggested that it could be many years before data on services could have the sophistication and credibility comparable to those on trade in goods. Views differed on the necessity of a reliable statistical data base for the negotiating process. The discussion on concepts, on which principles and rules covering trade in services might be based, included some detailed proposals. Some participants listed "mutual advantage," "transparency," "national treatment," "increasing international competition," and "progressive liberalization" as important, but emphasized that such concepts might be defined differently than those which apply in the goods area. Some countries felt that an illustrative list of obstacles to trade in services was necessary in future negotiations.

Trade Restrictions for Balance of Payments Purposes in the GATT

The GATT's balance of payments provisions (Articles XII and XVIII) allow countries to impose trade restrictions for balance of payments reasons. These may be maintained under Article XII for developed countries and under the more liberal provisions of Article XVIII:B for developing countries. GATT Article XV requires Contracting Parties to consult fully with the Fund in all cases in which they are called upon to consider or deal with problems concerning monetary reserves, balance of payments, or foreign exchange arrangements. 1/

The GATT Committee on Balance of Payments Restrictions is formally charged with carrying out the consultations on behalf of the Contracting Parties and preparing a report on the individual consultations for adoption by the GATT Council. Although membership of the Committee is open to all contracting parties, in practice the Committee is composed of about a dozen members. The GATT Director-General and the IMF are each represented by a senior staff member of the respective institution. In conducting the consultation, the Committee has before it a basic paper submitted by the consulting country, outlining the balance of payments problems facing it and the specific trade restrictions it justifies under the GATT's balance of payments provisions; a factual background paper prepared by the GATT Secretariat, describing the trade aspects of the measures taken; and background documentation supplied by the IMF--usually the latest Recent Economic Developments report on the consulting country prepared by the Fund staff for its Board and made available for the GATT consultation to the Contracting Parties.

Under the simplified procedures introduced in 1972, a "mini" consultation is held wherein once every two years developing countries acting under Article XVIII:B submit a written document on the nature of the balance of payments difficulties, the system and methods of restrictions, the effects of the restrictions, and prospects of liberalization. This document serves as the basis of consideration by the Committee of whether a full consultation is desirable. Unless a Committee member requests a full consultation, the requirement of consultation under Article XVIII:B is deemed to have been fulfilled for that year. If requested, a full consultation is scheduled for a subsequent session of the Committee. The simplified procedures under mini-consultations were intended to maintain the effectiveness of the consultations with developing countries while lessening the burden on the GATT and the developing countries concerned, and it was hoped this would encourage a greater number of developing countries to consult with

1/ A detailed description of the relevant GATT provisions and operations is contained in S.J. Anjaria, "Balance of Payments and Related Issues in the Uruguay Round of Trade Negotiations," IMF Working Paper, WP/87/36, 4/30/87.

the GATT. The simplification does not appear to have increased substantially the frequency with which contracting parties consult with the GATT on trade measures for balance of payments purposes.

On the occasion of a full consultation, the IMF representative presents a statement on the consulting country, which is approved by the IMF's Executive Board. In recent years, such statements have generally included an assessment of economic and financial trends and prospects in the consulting country, including in particular the balance of payments situation and policy measures taken by the authorities to deal with the external imbalance and to reduce reliance on exchange and trade restrictions.

In practice, since the early 1970s, developed countries have generally invoked Article XII only sporadically and for strictly temporary periods, while developing countries have relied more extensively on Article XVIII:B, and in some cases have done so for protracted periods. Twenty-four contracting parties have consulted with the GATT under Articles XII or XVIII:B on one or more occasions since 1974. However, full consultations with developing countries under Article XVIII:B were relatively infrequent; for example, over the 1974-86 period, full consultations were held most frequently with Brazil (four times), followed by Korea and Yugoslavia (three times each), the Philippines (twice), and only once with a number of other countries. For a few countries, including Bangladesh and Sri Lanka, full consultations were not held during the entire 13-year period. Furthermore, a number of developing countries that appear to be applying restrictions for balance of payments reasons have not notified these restrictions to GATT and thus have remained outside GATT surveillance. Although it might be intuitively expected that trade restrictions for balance of payments reasons would most likely be across the board, in many developing countries this has not been the case. The proportion of the tariff nomenclature notified to the GATT under Article XVIII:B has been relatively small, ranging from only a handful of product categories, in some cases, to more than 50 percent of tariff lines in only half a dozen cases. It is also possible that demarcation of the type of restriction by purpose has not always been made by some countries. The GATT has applied relatively restrictive notification and compensation requirements for invoking Article XVIII:C which deals with developmental or infant industry provisions. Some developing countries may have found it relatively easy to obtain "GATT cover" for infant industry protection under the guise of "balance of payments" reasons under the more liberal provisions of Article XVIII:B. It is surprising that in recent years only one developing country (Indonesia) has formally invoked GATT Article XVIII:C.

The Declaration on Trade Measures adopted by the Contracting Parties in November 1979 stipulated that, in applying restrictive import measures for balance of payments purposes, GATT members should give preference to the measure which has the least disruptive effect on trade--an implicit recognition that price-related restrictions, such as import surcharges, are often preferable to quantitative restrictions; that the simultaneous application of more than one type of trade measure for balance of payments reasons should be avoided; and that whenever practicable, contracting parties should announce publicly a time schedule for the removal of the measures.

Trade Liberalization under Fund-Supported Adjustment Programs

1. Overview

A central objective of adjustment programs implemented by Fund members and supported by the use of Fund resources is the restoration of a viable external situation without reliance on measures such as trade and payments restrictions which may be harmful to the member itself, as well as to its trading partners. For a number of years, all Fund stand-by arrangements have included, as a performance criterion, a "standstill" provision on import restrictions for balance of payments purposes. 1/ In addition, specific measures aimed at liberalizing the trade system have been featured in a large and growing proportion of Fund-supported adjustment programs, although this has been accomplished without increased use of performance criteria on trade measures. A survey by the staff indicated that almost all of the 22 stand-by arrangements approved in 1986 were in support of programs that included some trade liberalization measures. 2/ In contrast, of the 143 stand-by and EFF programs approved between January 1979 and August 1984 (the period reviewed in SM/85/60), only about half included trade liberalization as a program objective, and specific trade liberalization measures were contained in only about two fifths of all programs. Some of the recent emphasis on trade liberalization represents an unwinding of restrictions that had been intensified with the onset of the debt crisis in 1982-83, while in other cases it reflects a heightened awareness of the importance of undertaking structural adjustment measures in conjunction with stabilization policies in order to promote the achievement of a viable external payments position with satisfactory and sustainable growth. Many of the programs supported by the use of Fund resources under the Structural Adjustment Facility have also featured trade liberalization as an important objective.

a. Reduction of quantitative restrictions

More than half of the countries entering into stand-by arrangements with the Fund in 1986 sought to reduce the scope of quantitative import restrictions as part of their adjustment program, or had largely completed the liberalization of quantitative restrictions in recent years. In one group of countries (e.g., Bolivia, Guinea, Sierra Leone, Zambia), import licensing for balance of payments purposes was virtually abolished in conjunction with, or shortly following, the adoption of a market-determined floating exchange rate system. Prior to undertaking these reforms, countries in this group typically had maintained highly restrictive import licensing systems in an attempt to contain severe

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1/ See Selected Decisions of the International Monetary Fund, Twelfth Issue, Washington, D.C., April 30, 1986, Decision No. 6838-(81.70), pp. 64 and 69.

2/ In some cases, trade liberalization was mainly carried out under previous programs or in the period immediately preceding approval of the arrangement.

external imbalances associated with a sharply overvalued exchange rate.

In a second group of countries (e.g., Burundi, Mexico, Morocco, the Philippines, and Tunisia), quantitative import restrictions were to be reduced under a phased liberalization program, often in conjunction with a tariff reform program that was supported by technical and financial assistance from the World Bank. In some of these cases (Mexico, the Philippines), the countries concerned had initiated the process of trade liberalization under previous Fund-supported programs, and their adjustment programs for 1986 represented a continuation or acceleration of those efforts. Following a substantial liberalization earlier in the year, the Mexican authorities intended to eliminate nontariff barriers on a further 5 percent of all products before the end of 1988. In the Philippines, the authorities established a comprehensive timetable to remove most remaining quantitative restrictions by April 1988 (see below). In other cases (e.g., Burundi, Tunisia), a phased import liberalization program was initiated in 1986, following a major adjustment in the exchange rate. In Burundi, quantitative import controls were initially lifted from items other than certain domestically produced items and a limited number of luxury goods. Remaining import restrictions were to be eliminated by end-1987 according to a timetable to be established during the first program review. In Tunisia, the authorities established a comprehensive timetable to eliminate prior authorization requirements for all imports, excluding a few items judged to be luxury goods by 1991 (see below).

The case of Ghana falls between these two types of liberalization processes, but is closer to the first. Under Ghana's Fund-supported Economic Recovery Program (1983-85), the exchange rate of the cedi was devalued very sharply (97 percent in foreign currency terms) through large, discrete adjustments, over a period of three years; and external payments arrears were sharply reduced, while the basic structure of the import licensing system remained intact. Following the adoption of a foreign exchange auction market in 1986, the exchange rate depreciated further, prior import approval procedures were eliminated for a large number of products, and a schedule was established to abolish the remaining restrictive licensing practices over a relatively short period of time (see below).

Countries in a third group (Côte d'Ivoire, Senegal) are distinguished by their membership in a currency union with a fixed exchange rate and exchange systems free from restrictions on current international transactions. These countries traditionally have made only limited use of quantitative import restrictions. However, recognizing the need to improve the competitiveness of their industrial sectors, they have undertaken to eliminate remaining quantitative import restrictions as part of a package of industrial policy reforms supported by technical and financial assistance from the World Bank. Under its 1986-87 Fund-supported adjustment program, Senegal lifted all quantitative import restrictions, except for a limited number of items where restrictions will be phased out over a period of two years. Similarly, Côte d'Ivoire has stated an intention to replace all remaining restrictions with import surtaxes which would subsequently be reduced over time.

b. Tariff reform

Tariff reform has been a second important element of trade liberalization in adjustment programs supported by stand-by arrangements. Comprehensive tariff reforms have typically been designed in collaboration with the World Bank and have often been supported by World Bank loans. Most tariff reforms have aimed at lowering the average nominal tariff rate and reducing their dispersion in order to improve competitiveness of the economy. In some instances, when adequate information was available, tariff adjustments were designed specifically to lower the average level and dispersion of effective rates of protection, although normally this was also the expected result when the simpler approach was adopted. Comprehensive tariff reforms have typically been implemented according to a phased schedule, often in conjunction with a phased reduction in quantitative restrictions (e.g., Burundi, Mexico, Morocco, the Philippines, Senegal, Tunisia). In other cases, initial steps were taken under the 1986 program, pending the preparation of a more comprehensive tariff reform program.

c. Other measures

Fund-supported adjustment programs have included other types of trade liberalizing measures suited to the problems and institutional structures of the countries concerned. Abolition of import or export monopolies has been an important feature in programs for certain franc zone countries (e.g., Congo, Senegal, Togo), while liberalization of export licensing procedures has been important in others (Madagascar, Togo).

2. Selected case studies

The history of trade liberalization in four countries that received stand-by arrangements from the Fund in 1986 is described below.

a. Ghana

Ghana's economy reached a critical point at the end of 1982. For more than a decade, the economy had been characterized by declining or stagnant real GDP and high rates of inflation. The fiscal situation deteriorated, as evidenced by large budget deficits, and these were mostly financed through domestic credit expansion. Rapid money growth fueled inflation, which, in the absence of corrective policies, led to a very large real appreciation of the cedi. The resulting sharp dislocation of relative prices drove resources away from the traded goods sector, giving rise to severe imbalances in Ghana's external payments position. In an effort to contain the deterioration in the balance of payments, imports into Ghana were tightly controlled within the framework of an annual import program and licensing system. The distortions arising from these and other controls (including controls on prices, distribution, and interest rates), led to a weakening in confidence, a rise in parallel market activities, and an aggravation of internal and external imbalances.

Faced with a marked deterioration in the economic situation, in April 1983, the Government of Ghana undertook an Economic Recovery Program (ERP) for 1983-85. Key elements of this program, which was developed in close consultation with the staffs of the Fund and the World Bank, included the realignment of relative prices in favor of directly productive activities and exports, as well as the progressive liberalization of import and price controls. The program was supported not only by substantial use of Fund resources, through two successive stand-by arrangements in 1983-84 and 1984-85, but also considerable financial assistance from the World Bank.

To achieve its basic objectives, the ERP placed particular emphasis on a movement toward a realistic and flexible exchange rate system. Accordingly, the official exchange rate of the cedi was progressively adjusted from ₵ 2.75 per U.S. dollar in April 1983 to ₵ 90 per U.S. dollar in January 1986. The depreciation of the official exchange rate permitted critically needed increases in the producer price for cocoa, Ghana's major export. At the same time, the extensive system of price controls was dismantled, allowing a full pass-through of higher import costs to most domestic prices, including those of petroleum products. Although the annual import program and the licensing system remained in effect, a number of improvements were introduced in import procedures to facilitate the implementation of an enlarged import program and the utilization of licenses. These included the streamlining of the system of special import licenses, redefining products more clearly, aligning more closely the issuance of licenses to inflow of foreign exchange, and expediting the timing of the opening of letters of credit.

In October 1986, the Fund approved a new 12-month stand-by arrangement for Ghana in support of an adjustment program that seeks to continue the stabilization process initiated in 1983-85 while implementing new structural measures, including a fundamental reform of the exchange and trade system. As regards the latter, as a transitional arrangement, a dual exchange rate system was introduced, consisting of a first-window exchange rate, fixed at ₵ 90 per U.S. dollar, and a second-window exchange rate determined in the context of a weekly auction. Under this system, the first-window exchange rate applied to earnings from exports of cocoa and residual oil, import payments for petroleum products and essential drugs, and service payments on government debt contracted before January 1, 1986. All other external transactions through the official banking system were settled at the auction rate.

To complement the reform of the exchange system, with effect from October 4, 1986, the import licensing system was liberalized, as the authorities began issuing "A" licenses that allow importers to cover their foreign exchange needs by bidding in the auction. The "A" licensing scheme resulted in two important improvements in the exchange and trade system. First, whereas the licenses that were previously issued under the annual import programs were limited in number and distributed on an ad hoc basis, "A" licenses are now being issued to all applicants for a nominal fee. This change has eliminated the monopoly rent that previously accrued to importers because of the limited availability of licenses. Second, while only a limited number of imports were covered by the licenses issued under the annual import programs, virtually all nonconsumer goods imports are now funded from the official foreign exchange market. Moreover, all goods, except for five items on a negative list, can still be imported with Special Import Licenses (SILs) as long as they are financed from the importers' own foreign exchange resources.

The dual exchange rate system, which was introduced on September 19, 1986 was intended only as a temporary arrangement. Accordingly, effective February 21, 1987, the official exchange rates were unified at ₵ 150 per U.S. dollar, and since then, all external transactions through the official banking system are being settled at the exchange rate determined in the weekly auction. Following the exchange rate unification, the scope of the auction market was broadened substantially. With effect from March 13, 1987 bids for foreign exchange to cover service and transfer payments approved by the exchange control authorities became eligible for participation in the auction. In addition, as of March 20, 1987, goods amounting to about 40 percent of the value of all goods previously excluded from the "A" licensing scheme and imported under the SIL scheme were moved onto the "A" list of goods eligible for funding through the auction. The recent expansion of the "A" list permits the import of a significant number of nonluxury consumer goods to be financed through the auction. The remaining goods being financed through the SIL scheme will be progressively made eligible for funding through the auction, following a review of the tariff structure in the coming months, and a complete integration of the official foreign exchange and SIL markets is to take place by January 1988.

b. Mexico

Mexico's industrial strategy was based traditionally on a policy of import substitution. Although reliance was initially placed on tariffs to shelter new domestic industries from foreign competition, by 1975, virtually all imports had been made subject to prior authorization requirements; export controls were also put in place for certain products to ensure that the domestic market was adequately supplied. Although trade controls were tightened in the 1970s, it was recognized that solutions to Mexico's long-term problems of declining productivity and growth, rising inflation and unemployment, and mounting external imbalances would require better integration in the world economy. In 1977, the Government initiated a revision of trade policies; this formed part of an adjustment program that was supported by a three-year extended arrangement from the Fund. More than 5,000 items, representing 76 percent of all tariff lines, were freed from prior import requirements during 1977-80, raising the share of unrestricted items from virtually zero to about 41 percent in value terms.

Initial adjustment under the extended arrangement was effective. The revival of economic activity, which owed a great deal to the emergence of Mexico in 1977 as a large oil producer, was accompanied by improvements in employment, inflation, and the balance of payments. However, signs of overheating emerged in 1979. Notwithstanding the rapid growth in total export receipts, Mexico's external current account deficit increased fourfold from 1978 to 1981, the stock of external debt doubled, and the servicing of the external debt came to represent a heavy burden for the economy. Faced with a rapid loss in reserves, the authorities reimposed prior licensing requirements on several hundred import items in the second half of 1981. Mexico's external position continued to weaken, however, and in September 1982, prior licensing requirements were reimposed for virtually all imports.

In the final weeks of 1982, the authorities put in place an adjustment program, supported by a three-year extended arrangement from the Fund. The program envisaged the eventual dismantling of import restrictions, but initial emphasis was placed on tight fiscal and credit policies, flexible exchange rate management, and foreign debt restructuring. In the area of import liberalization, a number of items were exempted from licensing, subject to certain limits. In 1984 the list of products exempt from licenses was increased to 2,842 items, representing about 17 percent of imports by value, but all domestically produced goods remained subject to quantitative restrictions. In addition, tariffs on a large number of products were reduced in 1983 and 1984. The adjustment program achieved significant initial results, but slippages in Mexico's adjustment efforts began to appear in late 1984, with serious problems in policy implementation in evidence by 1985.

In an effort to reverse these trends, in mid-1985 the authorities sought to tighten financial policies, while improving the implementation of structural measures. The exchange rate was moved more quickly to compensate for recent declines in competitiveness, and a major new import liberalization program was announced which raised the share of unrestricted items to 88 percent of Mexico's 8,068 tariff positions. The liberalization program also specified that the maximum tariff rate would be lowered from 100 percent to 50 percent, and the number of tariff rates reduced. In addition, as part of an understanding concluded with the United States, Mexico undertook to phase out export subsidies.

Mexico's already serious internal and external imbalances were exacerbated by devastating earthquakes in late 1985 and by a steep decline in world oil prices in early 1986. Faced with an extremely difficult financial situation, the authorities sought to accelerate the economy's structural adjustment, particularly in the area of trade reform. Additional import restrictions were eliminated with the result that, as of mid-1986, 90 percent of all tariff positions, representing about 61 percent of the value of imports, were free from prior permit requirements. In April, the Government lowered the maximum tariff to 45 percent, and the dispersion of other tariffs was narrowed. In support of Mexico's trade liberalization efforts, the World Bank approved a US$500 million Trade Policy Loan in July, and following a relatively brief period of negotiation, Mexico signed a protocol of accession to the GATT. Under the terms of its GATT accession, Mexico agreed to bind with immediate effect all tariffs at rates of 50 percent or less. 1/ Mexico also agreed to eliminate its official reference pricing system for purposes of customs valuation by no later than end-1987; to phase out gradually import licensing to the extent possible; and to justify all residual restrictions under the relevant GATT provisions. Mexico also approved a foreign trade law that set the stage for a comprehensive evaluation of antidumping practices and for a system to protect local industries from dumping by other countries.

Against this background, in November 1986, the Fund approved a new stand-by arrangement in support of Mexico's adjustment program for the period through April 1988. The program places considerable emphasis on structural adjustment policies, including continuation of the far-reaching reform of the trade regime that was initiated in the preceding year. Before the end of 1986, nontariff barriers (including import permits and official reference prices) were eliminated on a further 5 percent of products. In addition, the authorities have agreed to limit all tariffs to a range of 0-30 percent, with no more than five tariff levels by October 1988. To encourage the diversification of the export base, export procedures will continue to be simplified.

c. The Philippines

During the 1970s, imports were tightly controlled in the Philippines by means of both exchange and trade restrictions. Partly in an effort to control the balance of payments situation, prior approval from the Central Bank was required to purchase foreign exchange for several categories of consumer goods, and in practice many of these items were effectively banned. Restrictions were also extensively applied through the licensing system for purposes of sectoral protection.

1/ Mexico reserved the right to apply surtaxes, not to exceed 50 percent of the base tariff rate, whenever necessary, but for a period of no longer than eight years.

Efforts to liberalize the Philippines' trade and payments system were initiated in late 1980 in the context of an economic adjustment program that was supported by a stand-by arrangement from the Fund and a structural adjustment loan from the World Bank. The liberalization program aimed at the elimination of all import licenses and restrictions that had been imposed either for balance of payments or protective reasons, with the exception of restrictions relating to "progressive manufacturing programs." Under the plan, the removal of quantitative import restrictions would be accompanied by a comprehensive tariff reform aimed at lowering the overall level of protection and achieving a more uniform structure of rates across and within sectors.

The stand-by arrangement remained largely on track in 1980, but in early 1981, domestic financial policies turned sharply expansionary, driving the adjustment program off track. As external demand weakened in 1982, the Philippines' external current account deficit rose to a record level, leading to a rapid accumulation of external debt that was increasingly concentrated in shorter maturity categories. Despite the steady deterioration in the economic situation, the tariff reform program remained largely on track. As regards the import liberalization program, restrictions on 921 of the 1,304 items classified in two consumer goods categories had been lifted by late 1983. However, the liberalization did not extend to raw materials and intermediate goods falling into the "regulated" category, that required approval from agencies other than the Central Bank. Following a continued deterioration in the economic situation in 1983, the authorities intensified significantly exchange and trade restrictions to manage a precarious foreign reserve position. These measures were both inefficient and ineffective, and substantial arrears accumulated, even on payments which the authorities considered to be of the highest priority.

Progressively in 1984, the authorities tightened financial policies, allowed the exchange rate to depreciate, and rolled back most of the restrictive practices that had been introduced in 1983. An 18-month stand-by arrangement from the Fund was approved in December 1984, and in early 1985, the authorities undertook to resume their trade liberalization program. Specifically, they intended to liberalize an additional 904 items by end-1985, and a further 328 items, in stages, during 1986 and the first half of 1987. According to this plan, only three categories of items would continue to be restricted after June 1987: (i) items regulated for health, safety, and national security reasons (about 100-150 items); (ii) items under "progressive" manufacturing programs (100-200 items), which were to be reviewed with the World Bank staff as part of an industrial policy program; and (iii) some miscellaneous goods (160 items or less).

Performance under the program was mixed. Among the achievements were the elimination of external payments arrears by end-December 1985 and the containment of the external current and overall balances within program targets. The tariff reform program was completed on schedule.

Maximum tariff rates were reduced from 100 percent to 50 percent, which lowered the average nominal tariff rate from 43 percent to 28 percent and resulted in a substantial narrowing of the dispersion of effective rates of protection. However, delays were encountered in reducing import restrictions. Weaknesses were also apparent in the implementation of other important structural measures, and the economy experienced a large, unexpected decline in real activity.

In the months following the change of Government in early 1986, it became apparent to the authorities that a new economic policy framework was required and the stand-by arrangement for 1985-86 was cancelled in June 1986. Nevertheless, between May 1 and September 30, 1986, about 95 percent of the 904 items initially scheduled for liberalization at end-1985 and twice deferred were liberalized. This resulted in the liberalization of important raw material and intermediate inputs, capital goods, and selected consumer products. In late October, the Executive Board approved a request by the Philippines for a new arrangement. Trade liberalization under the program initially focused on establishing a detailed schedule for implementation of the remaining items that the previous Government had targeted for liberalization by end-June 1987. According to this new schedule, the liberalization will be completed in April 1988. As of February 1987, 76 percent of the list of 1,232 items had been freed from restrictions, and the trade liberalization program remained on track. Tariffs continue to be limited to a maximum rate of 50 percent, and the Government has indicated, in the context of negotiations with the World Bank for an Economic Recovery Loan, that another review of the tariff structure would be undertaken with the objective of further reducing the maximum rate and achieving a more even structure of nominal protection of around 20-30 percent.

d. Tunisia

During the 1970s and early 1980s, Tunisia experienced relatively rapid economic growth, domestic financial stability, and a generally strong balance of payments position, associated with buoyant petroleum export receipts. Although the rate of economic growth remained satisfactory, there was a marked deterioration in the financial situation during 1983-85, attributable both to domestic financial policies and a sharp decline in the external terms of trade. A slackening of tourist activity, lower workers' remittances, and unfavorable weather conditions contributed to the financial imbalances, that were characterized by a rising level of external debt, a pronounced increase in the debt service ratio, and near exhaustion of a once comfortable level of foreign reserves. In the face of pressures stemming from the resource imbalances, the Tunisian authorities placed continued reliance on price and investment controls. Import controls were also tightened, with prior authorization required for most goods, including capital goods imports for approved projects.

Against this background, the Government decided to implement a comprehensive adjustment program in late 1986 that was supported by a stand-by arrangement from the Fund. The Tunisian authorities adopted measures to contain overall demand, improve the competitiveness of the export sector, and move toward a more market-oriented economy, thereby enhancing the efficiency of the productive system.

The authorities recognized that Tunisia's restrictive trade system had contributed to the economy's financial imbalances by distorting relative prices, which in turn led to a misallocation of resources, a decline in external competitiveness, and slower growth. Trade liberalization was therefore viewed as an essential element of the adjustment program. As set out in the Tunisian authorities' Economic and Financial Policy Memorandum, the import liberalization program established a timetable for the gradual reduction of quantitative restrictions and rationalization of the tariff structure. As a medium-term objective (by 1988), the Government intends to liberalize all imports of raw materials, semifinished products, spare parts, and capital goods, with the exception of specifically identified products used by weakly integrated industries (mainly assembly plants with low domestic value added). Beginning in 1989, a timetable will be established for the elimination of the remaining restrictions by 1991, with the exception of certain luxury goods. In accordance with this plan, a number of specific measures have already been taken. During the period August 1986-January 1987, restrictions were lifted on imports of virtually all spare parts and raw materials; imports of semifinished products for industries exporting at least 15 percent of their value added were also liberalized, as were imports of capital goods for all newly approved projects.

In tandem with the liberalization of quantitative restrictions, the authorities intend to reform the import tariff system by reducing the higher import tariffs and by narrowing the disparities in the tariff schedule. The aim is to achieve a reasonably uniform effective protection rate of about 25 percent by 1991. As a first step toward this goal, in the context of the 1987 budget, the Government reduced tariff rates to a maximum of 50 percent and introduced a universal minimum tariff of 15 percent. All tariffs previously between 25 and 31 percent were reduced to 25 percent, and those between 32 and 56 percent were reduced by six percentage points. Further tariff reductions are planned for 1988.

The import liberalization program is being supported by an active exchange rate policy, which resulted in a 20 percent depreciation in the real effective exchange rate of the dinar during the first eight months of 1986. During the remainder of the program period, the authorities intend to maintain the real effective exchange rate at least at the level reached in August 1986.