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To: Members of the Executive Board

From: The Acting Secretary

Subject: Trade Policy Issues and Developments - Annexes

The attached annexes on trade policy issues and developments provide additional information for the Executive Board discussion which is now scheduled for Friday, September 2, 1988.

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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# Trade Policy Issues and Developments: Annexes

Prepared by the Exchange and Trade Relations Department

(In consultation with other Departments)

Approved by H.B. Junz

August 5, 1988

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Note: It should be noted that the term "country" used in this report does not in all cases refer to a territorial entity that is a state as 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.

# Evolving Framework for International Trade 1/

## I. Introduction

This Annex reviews selected GATT activities and developments under the Uruguay Round. Reference is also made to the work of the OECD and of UNCTAD in selected areas. Section II describes recent multilateral trade initiatives, including an overview of progress thus far under the Uruguay Round, and the outcome in the trade area of the recent OECD ministerial meeting and the Economic Summit. Section III identifies the existing GATT mechanisms for multilateral surveillance in the trade area and discussions in the new Round to improve trade surveillance and other aspects of the functioning of the GATT system. Sections IV and V deal, respectively, with protection issues by type of instrument (tariffs, nontariff barriers, safeguards, subsidies, and dumping) and by sector (agriculture, textiles and clothing, tropical products, natural resource-based products, and services). Section VI looks at issues concerning developing countries, including the work of the Committee on Trade and Development, integration issues, and the utilization of GATT provisions on trade restrictions for balance of payments purposes. Section VII describes issues under the Uruguay Round related to dispute settlement and operation of selected GATT articles and Tokyo Round codes. Table 1 presents a list of selected issues considered by GATT bodies and under the Uruguay Round, and identifies the section in this Annex dealing with these issues.

## II. Overview of Multilateral Trade Initiatives

### 1. The Uruguay Round

The General Agreement on Tariffs and Trade (GATT) celebrated its fortieth anniversary in 1987. In its four decades of operation, the GATT has had many accomplishments. As a result of seven successive rounds of multilateral trade negotiations, average tariffs in industrial countries on industrial products have declined sharply, from over 40 percent in 1947 to around 5 percent today. World trade has expanded markedly, including a twentyfold increase in the volume of trade in manufactured goods. GATT's membership has quadrupled to cover 96 countries accounting for over 85 percent of world trade 2/ (Table 2).

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1/ This paper contains three annexes which provide background information for the main paper "Trade Policy Issues and Developments," SM/88/166 (8/3/88), and Supplement 1 "Trade Policy Issues and Developments: Industrial and Developing Countries." References are made in this paper to Annex Tables contained in Supplement 3, "Trade Policy Issues and Developments: Statistical Material."

2/ The most recent accessions to GATT include Mexico (1986), Botswana and Morocco (1987), and Lesotho (1988). A few other countries, including China, have applied for accession.

Table 1. Discussion Forums in GATT and the Uruguay Round

| Sector/Issue | Tokyo Round Code/GATT Committee or Overseeing Body 1/ | Uruguay Round Negotiating Group | Reference in Annex I (Section) |
|---|---|---|---|
| Agriculture | Committee on Trade in Agriculture | Agriculture | V.1. |
| Balance of payments restrictions | Committee on Balance of Payments Restrictions | GATT Articles | VI.2 |
| Bovine meat | Arrangement Regarding Bovine Meat/International Meat Council | MTN Agreements and Arrangements | VII.3 |
| Civil Aircraft | Agreement on Trade in Civil Aircraft/Committee on Civil Aircraft | MTN Agreements and Arrangements | VII.3 |
| Customs valuation | Agreement on Customs Valuation/Committee on Customs Valuation | MTN Agreement and Arrangements | VII.3 |
| Counterfeit goods | Expert Group on Trade in Counterfeit Goods | TRIPS | IV.5 |
| Dairy products | International Dairy Arrangement/International Dairy Products Council | MTN Agreements and Arrangements | VII.3 |
| Developing country matters, Part IV, Enabling Clause | Committee on Trade and Development | | VI |
| Developments in the trading system | GATT Council | FOGS | III |
| Dispute settlement | Relevant Committee, GATT Council | Dispute Settlement | VII.1 |
| Dumping | Agreement on Anti-dumping Practices/Committee on Anti-dumping Practices | MTN Agreements and Arrangements | IV.4b |
| Government procurement | Agreement on Government Procurement/Committee on Government Procurement | MTN Agreement and Arrangements | VII.3 |
| Import licensing | Agreement on Import Licensing/Committee on Import Licensing | MTN Agreements and Arrangements | VII.3 |
| Natural resource products | Working Party on Problems of Trade in Natural Resource Products | NRBP | V.4 |
| Nontariff Measures | Group on Quantitative Restrictions and Other Nontariff Measures | Nontariff Measures | IV.2 |
| Regional arrangements | Specific working parties | GATT Articles | VII.2 |
| Safeguards | | Safeguards | IV.3 |
| Services | | Services | V.5 |
| Subsidies and countervailing measures | Agreement on Interpretation and Application of Articles VI, XV and XXIII ("Subsidies Code")/Committee on Subsidies and Countervailing Measures | Subsidies and Countervailing Measures | IV.4a |
| Surveillance | GATT Council, relevant Committees | FOGS | III |
| Tariffs | Committee on Tariff Concessions | Tariffs | IV.1 |
| Technical barriers | Agreement on Technical Barriers to Trade ("Standards Code")/Committee on Technical Barriers to Trade | MTN Agreement and Arrangements | VII.3 |
| Textiles | Textiles Committee (also supervises Textiles Surveillance Body), Working Party on Textiles and Clothing (1983-86) | Textiles and Clothing | V.2 |
| Trade-related intellectual property rights | | TRIPS | IV.5 |
| Trade-related investment measures | | TRIMS | IV.6 |
| Tropical products | | Tropical Products | V.3 |

1/ The GATT Council of Representatives considers matters placed before it. Working parties may be established to investigate specific issues (e.g., accession, waivers, etc.)

Note: FOGS = Functioning of the GATT System; TRIPS = Trade-related Intellectual Property Rights; TRIMS = Trade-related Investment Measures; NRBP = Natural Resource-based Products.

Table 2. GATT Membership 1/

A. Contracting Parties to the GATT

| | | |
|---|---|---|
| Antigua and Barbuda | Germany | Nigeria |
| Argentina | Ghana | Norway |
| Australia | Greece | Pakistan |
| Austria | Guyana | Peru |
| Bangladesh | Haiti | Philippines |
| Barbados | Hong Kong | Poland |
| Belgium | Hungary | Portugal |
| Belize | Iceland | Romania |
| Benin | India | Rwanda |
| Botswana | Indonesia | Senegal |
| Brazil | Ireland | Sierra Leone |
| Burkina Faso | Israel | Singapore |
| Burma | Italy | South Africa |
| Burundi | Jamaica | Spain |
| Cameroon | Japan | Sri Lanka |
| Canada | Kenya | Suriname |
| Cent. African Republic | Korea, Republic of | Sweden |
| Chad | Kuwait | Switzerland |
| Chile | Lesotho | Tanzania |
| Colombia | Luxembourg | Thailand |
| Congo | Madagascar | Togo |
| Côte d'Ivoire | Malawi | Trinidad and Tobago |
| Cuba | Malysia | Turkey |
| Cyprus | Maldives | Uganda |
| Czechoslovakia | Malta | United Kingdom |
| Denmark | Mauritania | United States |
| Dominican Republic | Mauritius | Uruguay |
| Egypt | Mexico | Yugoslavia |
| EEC | Morocco | Zaire |
| Finland | Netherlands | Zambia |
| France | New Zealand | Zimbabwe |
| Gabon | Nicaragua | |
| Gambia, The | Niger | |

B. Acceded Provisionally

Tunisia

C. De Facto Application 2/

| | | |
|---|---|---|
| Algeria | Guinea Bissau | Solomon Islands |
| Angola | Kampuchea, Democratic | Swaziland |
| Bahamas, The | Kiribati | Tonga |
| Bahrain | Mali | Tuvalu |
| Brunei Darussalam | Mozambique | United Arab Emirates |
| Cape Verde | Papua New Guinea | Yemen, Democratic |
| Dominica | Qatar | |
| Equatorial Guinea | St. Christopher and Nevis | |
| Fiji | St. Lucia | |
| Grenada | St. Vincent | |
| | Sao Tomé and Principe | |
| | Seychelles | |

Source: GATT

1/ As of June 30, 1988.

2/ Countries to whose territories the GATT has been applied and which now, as independent states, maintain a de facto application of the GATT pending final decisions as to their future commercial policy.

Notwithstanding these successes, the multilateral trading system stands at a crossroads today, as developments over the past decade have challenged its credibility and relevance. Protectionist pressures have intensified, nurtured by macroeconomic imbalances and inadequate structural adjustment; a large number of discriminatory nontariff measures have been imposed, bypassing the GATT; trade tensions have escalated among GATT members, both among industrial countries and among industrial and developing countries; and new areas, such as services and intellectual property rights, demand attention in a manner unforeseen at the time GATT was established. The shifts in the balance of world economic power since the late forties have been accompanied by an erosion of leadership in the trade area, together with an increasing tendency toward regionalism and bilateralism at the expense of multilateralism.

Against this background, the launching of the Uruguay Round of Multilateral Trade Negotiations (MTN) at Punta del Este, Uruguay, in September 1986 was of major importance. The new Round is viewed by many as essential to keep domestic protectionist demands at bay, and to restore the relevance and credibility of the multilateral trading system. This Round is the most ambitious of its kind as it goes beyond the traditional concerns (such as tariffs) of past MTNs, gives greater recognition to the linkages between trade and other economic policies, covers areas which in the past were largely neglected (such as agriculture), new areas (such as services), and sectors that have been relegated to special regimes through multilateral action (textiles and clothing). In addition, systemic issues, such as, examination of the functioning of the GATT are an integral part of the negotiations.

The Ministerial Declaration launching the new Round spells out the overall and specific objectives of the MTN and establishes a time frame of four years for its completion (Attachment I). The Round aims, inter alia, to further liberalize trade, to strengthen the role of the GATT, to increase GATT's responsiveness to the evolving international economic environment, and to foster cooperative action to strengthen the interrelationship between trade and other economic policies affecting growth and development. To conduct the negotiations, a Trade Negotiations Committee (TNC) was established with two subsidiary bodies, the Group of Negotiations in Goods (GNG) and the Group of Negotiations in Services (GNS). 1/ GATT members also committed themselves to observing a "standstill" and "rollback" of trade restrictive measures that are inconsistent with GATT.

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1/ The GNG was further divided into fourteen negotiating subgroups covering tariffs, nontariff measures, tropical products, natural resource-based products (NRBP), textiles and clothing, agriculture, safeguards, GATT articles, MTN agreements and arrangements, subsidies and countervailing measures, dispute settlement, trade-related intellectual property rights (TRIPS), trade-related investment measures (TRIMS), and the functioning of the GATT system (FOGS).

The Uruguay Round participants spent 1987 in "the initial phase" of the negotiations, preparing the ground for the future exchange of concessions. Much of the discussion in the various negotiating groups was devoted to clarification of the content and modalities of the negotiations, submission of proposals, and other steps necessary to move the negotiations forward. At the end of the initial phase, there was broad "formal" agreement among the participants that satisfactory progress had been made, though many of them stressed that there was no room for complacency. A mid-term ministerial review of progress in the negotiations was agreed for December 1988 in Montreal.

Developments under the Uruguay Round may be summarized as follows: 1/

(i) Since the Uruguay Round pledge on the "standstill," recourse to new trade restrictions has increased.

(ii) Thus far, one conditional rollback offer has been tabled (by the EC). Many countries expect the rollback to be achieved toward the end of the negotiations rather than ahead of them.

(iii) In view of the persistence of protectionist pressures and large macroeconomic imbalances, some countries have urged that the Round do more to create a climate of confidence and to send a positive signal to governments, the business community, and the financial markets concerning the direction of the negotiations. They recommend an "early harvest" of agreements, at least in selected areas by the time of the mid-term review, which would also help sustain the momentum of the negotiations. Others doubt the feasibility of achieving selected agreements, and look more toward "globality" in the outcome of the negotiations, with balanced progress in the majority of negotiating areas.

(iv) Progress in the individual negotiating groups has been uneven, as wide divergences of views continue to prevail. For example, on agriculture, which is crucial to the negotiations for a number of countries, views diverge on whether the ultimate objective of the negotiations should be a total or partial elimination of subsidies, and on the role of short-term measures. Although far from agreement, the discussion on services has been more substantive and proceeded faster than initially expected by many countries. Discussions in other new areas (TRIPS and TRIMS) are in a preliminary stage. Substantive discussions have taken place on trade policy surveillance in the group on functioning of the GATT system.

(v) Negotiations in many of the groups appear to be inevitably linked. For instance, progress on nontariff measures appears to be

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1/ This summary is based on GATT Press Releases, GATT six-monthly reports on "Developments in the Trading System," and staff discussions with country officials.

linked to progress on safeguards, and that on subsidies to progress in agriculture. Progress in the area of textiles is linked with the issues of safeguards, subsidies, and reciprocity. Although these linkages may create deadlocks, they can also permit progress through quid pro quos. In delinked areas, such as, the functioning of the GATT system and dispute settlement procedures, the negotiations are moving forward.

(vi) Developing countries are taking an active part in all the negotiating groups. In their view, insufficient attention has been given in the discussions to the principle of differential and more favorable treatment which was reiterated in the Uruguay Round Declaration. Many developing countries are also concerned about increasing calls for them to become more fully integrated into the obligations of GATT, and to reduce reliance on GATT provisions on trade restrictions for balance of payments purposes. While developing countries are resisting changes in these provisions, it is fairly clear that many industrial countries feel strongly that implementation of the provisions needs tightening. These views have been expressed in various forums, including in meetings of the GATT Committee on Balance of Payments Restrictions.

## 2. Other initiatives

The OECD has conducted substantive research on trade issues including the costs of protection and the inter-relationships between trade and structural adjustment. In particular, the OECD's analytical and quantitative work on agricultural trade has provided an impetus for reform. The OECD is also an important forum for its members to coordinate positions on trade policy issues.

At their latest meeting in May 1988, OECD ministers called for resolute efforts by OECD countries to fight protectionist pressures; resolve trade frictions on a nondiscriminatory basis; observe the standstill and rollback commitments of the new Round; and work toward a better functioning of the GATT. The OECD communiqué endorsed, inter alia, the need for greater integration of developing countries into GATT, and for liberalization of trade in services. It called for efforts to reach tangible progress in the new Round before the end of 1988; toward this end, member countries were encouraged to agree on a "framework approach" (i.e., formulation of general principles guiding the specific points of negotiations). It urged a strengthening of policy reform efforts in agriculture, calling on members to agree on a framework approach including short- as well as long-term elements which would promote the reform process.

The need to improve the trade environment has been featured in the annual economic summits of major industrial countries. In the most recent Economic Summit held in June 1988 in Toronto, the leaders of Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States, and the president of the European Commission welcomed the proposed U.S.-Canada Free Trade Agreement, as well as progress toward a single market in the EC by 1992. They agreed that it was vital for the GATT to become a more dynamic and effective organization, particularly in regard to the surveillance of trade policies and dispute settlement procedures. They called for greater ministerial involvement in GATT discussions and strengthened linkages with other international organizations. They emphasized the need to make agriculture more responsive to market signals.

Trade policy issues are discussed also in a number of other international organizations including the Fund, the Bank, and UNCTAD. The Bank and the Fund have increasingly emphasized trade policy issues in their consultations with members and in the design of adjustment programs supported by these institutions. 1/ The Bank has prepared a handbook on the Uruguay Round to assist, in particular, the developing countries in their deliberations. The UNCTAD has done considerable research on trade issues of relevance to the new Round, and is extending technical assistance to developing countries. It has also prepared an extensive inventory of nontariff measures maintained by its members. 2/

## III. Surveillance

### 1. Existing GATT mechanisms

Broadly defined, almost all GATT bodies have surveillance functions and regularly review particular aspects of trade policies and measures. Existing GATT bodies concerned with surveillance include the following: (1) The special meetings of the Council, held twice a year, perform regular and systematic reviews of developments in the trading system, based on a six-monthly survey prepared by the GATT secretariat. 3/ (2) The Committee on Trade and Development reviews matters of interest to developing countries (see Section VI.1). (3) The Committee on Balance of Payments Restrictions is responsible for multilateral surveillance of trade restrictions taken for balance of payments purposes (see Section VI.3). (4) The Textile Committee oversees the Multifibre Arrangement (MFA), and the Textile Surveillance Body reviews bilateral agreements of MFA members. (5) The committees associated with

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1/ See Section IV on the role of the Fund in the main paper, SM/88/166 (8/3/88).

2/ See section dealing with developing countries in SM/88/166 (8/3/88) Supplement 1, and the companion paper on "Industrial Policies of Industrial Countries and Their Effects on Developing Countries," SM/88/167 (8/4/88).

3/ These surveys are issued for the information of the Fund's Executive Directors.

the various MTN codes review members' policies and measures at intervals between four times a year and once every two years. 1/

Notwithstanding the above mechanisms, the need for more effective trade policy surveillance has been increasingly recognized, both within and outside GATT. Accordingly, the Uruguay Round is devoting much attention to surveillance issues (Section III.3).

2. Standstill and rollback

The function of the Uruguay Round's Surveillance Body, established in early 1987 to oversee compliance of the new Round's "standstill" and "rollback" commitments, is more a political than a legal form of surveillance. Several countries have alleged contraventions of the standstill. For example, Chile has complained about GSP treatment in the United States and the EC's import licensing of apples; the EC is concerned about new manifestations of the "Buy America" program in the United States; the United States has raised the issues of import curbs on certain dairy products and new subsidies for white peabeans by Canada and new soybean subsidies by Switzerland; and Canada has complained about the EC's ban on imports of meat from animals given artificial hormones.

Regarding the rollback, thus far only the EC has put forward a proposal (in March 1988), which envisages rolling back some of its residual restrictions (over 100 quantitative restrictions covering a variety of products) excluding those on Eastern Europe and Japan. The offer is conditional on similar offers from other participants. As the first rollback offer, the EC announcement was generally welcomed by other participants, but some countries have expressed concern about its discriminatory nature (vis-a-vis Eastern Europe and Japan) and limited significance in terms of the amount of trade it would liberalize.

The absence of significant rollback offers is viewed by many countries as an indication that any major rollback would probably be at the end rather than at the beginning of the negotiations, because many countries insist on a "balance of benefits approach," and are unwilling to give anything away unilaterally. Rollback issues are also complicated by the views of some countries that "gray area" 2/ measures are

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1/ The Consultative Group of 18 (CG 18), established in 1975, has a mandate to follow international trade developments, and forestall sudden disturbances in the trading system and the international adjustment process. The CG 18 is not a decision-making body, as its function is essentially consultative; it may, however, make recommendations to the GATT Council. It has not met since 1987.

2/ "Gray area" measures are those taken outside GATT surveillance and whose conformity with GATT is not determined.

not subject to the rollback but are subject to negotiation; their reduction would depend on progress on safeguards and in reducing subsidies.

## 3. Functioning of the GATT System

Dissatisfaction with the adequacy of existing surveillance mechanisms has led GATT members to consider possible improvements. Furthermore, many countries are no longer concerned only with obtaining direct trade advantages or clarifying GATT rules, but wish also to strengthen GATT's ability to adapt to present and future developments in the international financial and economic environment, and to strengthen GATT's institutional powers. Hence, the negotiations in the Uruguay Round's Group on Functioning of the GATT System (FOGS) are centered on three aspects: first, to enhance GATT surveillance of trade policies and practices and their impact; second, to improve the effectiveness and decision making of GATT as an institution; and third, to enable GATT to play a more active part in global economic policy-making.

### a. Trade policy reviews

A consensus appears to be developing that the objective of a trade policy review mechanism should be to enhance transparency and understanding of the trade policies of all members, and to allow for an evaluation of individual trade policies and trends, rather than examination of the legal compatibility of any particular measure with GATT rules. Many countries believe that the trade review mechanism would facilitate, inter alia, assessment of individual trade practices within the wider context of the external trade and financial environment. There is preference for a mechanism requiring more frequent reviews for countries with the largest share of world trade compared with others. However, disagreements persist on the content of surveillance and on how direct an effect on trade any given policy measure should have in order to be covered by the surveillance discussion.

### b. GATT effectiveness

The discussions so far on improving GATT's effectiveness have focused primarily on greater ministerial involvement in GATT's work. In the past three decades, ten ministerial level GATT meetings have been held. There is consensus that more frequent participation by trade ministers could provide political guidance and initiative, reinforce governments' commitments, give GATT greater prominence and credibility in domestic political arenas, and enable better monitoring of trade trends against the background of a wider political and economic context.

Broad support exists for periodic ministerial sessions of all GATT members, with full decision-making powers. Views are more divided about the size and composition of a possible smaller group of ministers who would meet more frequently, in an advisory role, to examine trade developments and policies before they were submitted for full deliberation in GATT. The concept of regular meetings with ministers representing certain constituencies, similar to the Fund's Executive Board, has not had much support among GATT members because the GATT is viewed as a contract, as opposed to an organization. 1/

c. Cooperation with other organizations

The Punta del Este Declaration states that negotiations should aim to increase GATT's contribution to economic policy-making through strengthening its relations with other international organizations responsible for monetary and financial matters.

The fact that exchange controls and trade measures can be used as substitutes has resulted in a special status, from the outset, to the links between GATT and the Fund. GATT Articles XIV and XV give determinant effect to this cooperation. For example, when a country adopts trade measures to deal with balance of payments difficulties, the Contracting Parties consult with the Fund, in the context of that country's consultations with the GATT Balance of Payments Committee. Other examples of institutional cooperation include the study prepared by Fund staff, at GATT's request, on the effects of exchange rate fluctuations on world trade. Furthermore, well developed channels of cooperation exist between the two staffs, including the operations of the Fund's Geneva Office. Relations between GATT and the Bank are less clearly institutionalized. The GATT's Director-General is invited to attend as an observer in the ministerial level meetings of the Fund and the Bank. In turn, the Fund is represented as observer at sessions of GATT Contracting Parties, the GATT Council of Representatives, and most standing GATT committees. The Uruguay Round's Trade Negotiations Committee (TNC) has invited the Managing Director of the Fund to be represented at the meetings of the TNC, the groups on negotiations of goods and services, and the groups on GATT Articles, functioning of the GATT system, trade-related investment measures, and natural resource-based products.

Many GATT members believe that some of the substantive questions relating to trade, finance, and monetary issues need to be addressed in the Round to reach meaningful conclusions on institutional relationships. Some have noted that while trade liberalization alone cannot solve problems of indebtedness and financing, protectionism aggravates these problems and makes it more difficult for indebted countries to fulfill their responsibilities to the Bank and the Fund. The impact of macro- and financial policies on trade is not always clearly perceived by national policy makers. The question, therefore, is the manner in which the GATT could make a greater contribution to the multilateral

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1/ Plans drawn up in the mid-forties to establish the International Trade Organization (ITO), on similar lines as the Bank and the Fund, did not materialize.

system in a way which takes full account of the interrelationships between trade and other policies.

The discussions on strengthening cooperation with other organizations are still in a preliminary stage, and views vary. Some favor strengthening cooperation only at the technical level between the secretariats of these institutions, while others take a more ambitious approach, seeking to broaden the area of present cooperation, and deal with actual policy-making and coordination. Some fear that the latter approach may lead to an overlapping and confusion of the roles of the organizations. Some developing countries are concerned that a strengthening of GATT/Fund/Bank relationships may result in cross conditionality and in stronger pressures on them to pursue open trade policies without similar pressures being applied to industrial countries.

## IV. Instruments of Protection

### 1. Tariffs

Tariff levels in industrial countries have been reduced in successive GATT negotiations and a high proportion of industrial tariffs are "bound" in the GATT against increases (Supplement 1). Tariff reductions have been less pronounced in some product sectors, such as, agriculture and textiles, and individual high tariffs remain. Tariff escalation (successively higher tariffs for products at a higher stage of processing) in industrial countries often makes effective protection higher than nominal protection.

Tariff reductions and supervision of GATT tariff schedules are overseen by the GATT Committee on Tariff Concessions established in 1980. Much of the committee's work in recent years has been related to preparations for implementation (which began in 1988) of the new Harmonized Commodity Description and Coding System, developed by the Customs Cooperation Council in Brussels. The new system, which serves as a single standard for the classification of traded goods, has presented some GATT members with the need for negotiations under Article XXVIII where the change from current nomenclatures disturbs the fine balance of concessions already negotiated in past negotiations. 1/

The Uruguay Round Group on Tariffs is discussing a number of proposals for tariff reductions. Some favor elimination of all tariffs on industrial products by industrial countries, while others support more modest reductions. Industrial countries' tariff peaks and escalation are of concern to developing countries. The group is searching for an agreement on a common negotiation basis which would cover a tariff-cutting approach, the elimination of high tariffs and

1/ GATT, GATT Activities, 1985 (Geneva, June 1986).

tariff escalation, as well as the expansion of the degree of bindings by all participants.

While not the most important issue in the Uruguay Round, tariff negotiations are a significant part of the debate on developing country integration. Developing countries have not generally reduced or bound tariffs in previous MTNs. Mexico and Chile are the only GATT members that have bound 100 percent of their tariffs (Mexico at 50 percent and Chile at 35 percent). The degree of tariff bindings varies widely in other developing countries but is generally low. Industrial countries are urging developing countries to bind most of their tariffs to ensure security of access to their markets. The issue of tariff bindings is also being discussed in a number of other negotiating groups, including tropical products, textiles, and natural-resource based products.

2. Nontariff measures

The proliferation of nontariff measures (NTMs) in the past two decades has led GATT members to search for better GATT disciplines in the use of such measures. Many NTMs are in the form of voluntary export restraints (VERs) and other "gray-area" measures outside GATT surveillance. The Uruguay Round Group on Nontariff Measures is considering proposals on the modalities of the negotiations, such as, the establishment of multilateral rules, and the choice of a formula approach or a request-and-offer approach to liberalization. 1/ In view of problems of measurement of the equivalence of future concessions of NTMs, the group is also considering possible measurement yardsticks. 2/ Issues under discussion include the NTMs to be covered in the negotiations, and their trade distorting effects. For example, some industrial countries are concerned about delays and additional costs to exporters associated with preshipment inspection requirements, whereas developing countries consider that such inspection helps save foreign exchange and deters unethical business practices. Progress in the group, particularly concerning "gray area" measures, is linked to progress on safeguards (see below).

Certain nontariff measures including technical barriers to trade, import licensing, and government procurement are governed by codes agreed in the Tokyo Round (Table I.1). These are discussed in Section VII.3.

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1/ The background documentation for use by the group includes an extensive compilation of nontariff measures by the GATT Group on Quantitative Restrictions and Other Non-Tariff Measures established in 1983.

2/ One suggestion is the use of the concept of Effective Rate of Assistance (ERA) which measures support to industry provided through both border and nonborder assistance.

3. Safeguards

The GATT's main safeguard provision is Article XIX which allows temporary restrictions on imports where domestic producers are seriously injured, and provides for compensation to affected trading partners. In practice, however, these provisions have been ineffective. Recourse to Article XIX has declined at the same time as an increasing number of discriminatory "gray area" measures are taken outside GATT. With one exception, since 1978 Article XIX has been invoked only by industrial countries (Table I.2). (Developing countries have tended to utilize GATT's balance of payments provisions to justify their trade restrictions.) Of 134 Article XIX actions taken since 1950, 23 had a duration of more than 5 years, and 32 had a duration of 3-5 years. As of mid-1987, 26 Article XIX measures were still in force. This compares to 135 known export restraint arrangements outside GATT in September 1987 and 253 in May 1988.

The 1982 GATT Ministerial Meeting called for a comprehensive safeguards agreement. However, such agreement was not reached because of differences in views between proponents of nondiscriminatory safeguards and those who favor selective action against imports from particular supplying countries. These differences in view also influence discussions in the Uruguay Round Group on Safeguards. In addition to the principle of nondiscrimination, the group is discussing other features of a possible new safeguards code including: transparency (clarity in rules and application of restrictions); degressivity (phased reduction during period of maintenance of restrictions); temporariness (limit on duration of measures); and compensation (redress for countries adversely affected by the restrictions). Other issues relate to appropriate definitions of "injury," "domestic industry," and "like or directly competitive products." Some countries favor the establishment of a surveillance body or safeguards committee which would ensure that Article XIX measures are taken solely to deal with emergency, short-term imbalances.

The discussion on safeguards is linked to a number of other areas, for both substantive and tactical reasons. Developing countries support a solution on safeguards based on nondiscrimination, as they are vulnerable to discriminatory restrictions; they also call for elimination of the Multifibre Arrangement (MFA) which is a major derogation from normal GATT rules on nondiscriminatory application of temporary restrictions. Some developing countries have also linked their cooperation on services and other "new" areas to progress on safeguards. A number of industrial countries appear inclined to link progress on safeguards with progress on developing countries' acceptance of greater discipline on balance of payments restrictions under GATT Article XVIII:B, and progress on subsidies.

## 4. Subsidies and dumping

### a. Subsidies

An agreement on the Interpretation and Application of Articles VI, XVI, and XXII of the GATT, more commonly referred to as the Subsidies Code, was negotiated in the Tokyo Round. The code aims to bring greater discipline to the use of subsidies. Export subsidies on manufactures are prohibited. For primary products, the code enjoins signatories to refrain from export subsidies which result in a "more than equitable share" of world export trade in such products. Signatories recognize that domestic subsidies may serve important social and economic policy objectives; hence, domestic subsidies are not prohibited, but signatories are enjoined to avoid their use where they have adverse trade effects for others. The code permits countervailing duties to be imposed to offset the injurious effects on domestic producers arising from imports of like products which benefit from subsidies abroad (export or domestic). As of March 1988, 21 countries had accepted the Subsidies Code (with the EC counted as one) (Table I.1).

The Subsidies Code has many interpretative difficulties. Differences of views exist among GATT members regarding the definition, scope, and measurement of subsidies and the application of countervailing duties. These differences include, for example, treatment of financial versus other subsidies, input versus final product subsidies, specific versus general subsidies; definitions of "primary" and "manufactured products," "domestic industry," "like products," etc. These differences have led to many trade disputes related to the conditions of use of subsidies and of measures to counter their effects.

The Committee on Subsidies and Countervailing Measures is responsible for overseeing the code. It acts as the forum under which signatories consult on matters related to the code, including clarification of definitions and resolution of disputes. The use of subsidies has to be notified by signatories to the committee. However, actual notifications are inadequate, partly because of insufficient data on subsidies, and to some extent because countries do not want to publicize their subsidies so as to avoid countervailing duties. All the above factors have made it very difficult to enforce the Subsidies Code, and trade frictions on subsidies have increased in the past several years.

GATT members are in basic disagreement as to whether or not the existence of a subsidy requires a financial contribution by governments. The committee issued (in 1985) a draft recommendation on the principle of specificity which held that a subsidy exists only if the government provides assistance to a particular industry as opposed to all industries. This recommendation, in principle acceptable to most signatories to the code, was not adopted because the United States opposed a concept that would exclude the provision of energy-related inputs to industry at prices below world market levels. 1/

Differences of interpretation have made it difficult for the committee to reach clear conclusions in some dispute cases. For example, progress was not made in the committee on disputes over EC subsidies on exports of wheat flour and pasta products, 2/ which required clarification of definitions of primary and manufactured products. Disagreements regarding the definition of "domestic industry" became evident, for example, in a dispute involving EC subsidies to the wine industry; the EC argued, and a GATT panel found (in a report not yet adopted by the GATT Council), that U.S. grape growers could not file a countervailing duty (CVD) petition against wine imports. 3/ Similar cases involving the practice of broadening the definition of domestic industry have arisen with respect to countervailing duty petitions by U.S. orange growers against Brazil's exporters of orange juice, and by Canadian cattle growers against EC beef exporters. (With respect to the latter, a GATT panel found in October 1987 that cattle growers were not part of the domestic industry, but the panel's report has not yet been adopted.) More recently, a GATT panel has been established to investigate U.S. charges that EC oilseeds subsidies nullify zero tariff bindings on soybeans.

Another source of disagreement relates to the application of the "injury test" in determining the need for countervailing duties. Some

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1/ In 1983, the U.S. Commerce Department argued that subsidies for the Mexican petroleum processing industry and the Canadian lumber industry were not countervailable due to the absence of specificity. In response, the U.S. Administration introduced legislation to make subsidies on natural-resource products countervailable. The Commerce Department, in turn, introduced the concept of de facto specificity, referring to a situation in which a few dominant users benefited from such subsidies, although they were in principle available to all users. Following this, the Commerce Department invited new countervailing duty petitions in 1986 which resulted in positive findings of subsidies in both Mexico and Canada, reversing the previous negative findings.

2/ A bilateral agreement reached in 1987 on pasta between the EC and the United States, involving a reduction in export restitution by the former, did not address the underlying issues which the two parties agreed to address in the Uruguay Round. See GATT, GATT Activities, 1985 (Geneva, 1986).

3/ This was related to certain provisions of the U.S. Trade and Tariff Act of 1984 concerning countervailing action on imported wine; the effect of the provision was to stretch the definition of the word "industry" sufficiently to allow grape growers, as well as wine producers, to initiate actions against wine imports. The EC contended that any request for a countervailing investigation could, under the code, only be introduced by producers of the like product, in this case wine, and not grape producers.

countries (e.g., the EC) apply the injury test to all countries, while others (e.g., the United States) apply it only to signatories of the Subsidies Code or to nonsignatories that have entered into bilateral agreements to exercise discipline over subsidies. Another issue is whether cumulation of imports is valid for the purpose of determining injury. Legislation expanding the scope of countervailing duties in some industrial countries has also been a source of concern to other countries.

Against this background, negotiations in the Uruguay Round Group on Subsidies and Countervailing Measures are both complex and difficult. For some countries the main objective is to achieve international discipline in the use of subsidies; others emphasize discipline in the use of countervailing duties on the basis of specificity, for the most part narrowly defined to include financial contributions by governments. Various approaches to subsidies are under discussion. One issue is whether to proceed by a classification of subsidies (prohibited, actionable, or nonactionable) or to to bring all kinds of government assistance, including for agriculture, under GATT's wing. Another issue is whether agreement on a definition of subsidies is a prerequisite to consensus on an effective dispute settlement system. The negotiations are further complicated by the linkage between subsidies and agriculture, and the widespread use of subsidies in the steel sector. Developing countries have emphasized the need to take fully into account, in drawing any new rules, the principle of differential and more favorable treatment for them.

b. Dumping

The Tokyo Round Agreement on Antidumping Practices, which replaced that negotiated during the Kennedy Round, came into effect in 1980. The agreement interprets the provisions of GATT Article VI which lays down the conditions under which antidumping duties (ADs) may be imposed as a defense against dumped imports. 1/ Antidumping investigations are reported to the GATT's Antidumping Committee. An ad hoc group on the Implementation of the Antidumping Code studies technical issues referred to it by the committee.

Recourse to antidumping measures, as well as disputes over their application, have increased considerably in recent years. The Antidumping code has involved controversy over definitions and measurement of dumping, injury, and the application of antidumping duties. The problem areas include (some are similar to those in the Subsidies Code) the appropriate definition or use of domestic industry, like products, constructed values, threat of injury, cumulative injury assessment, input or component versus final product dumping, the application of dumping in third markets, the use of price undertakings in antidumping

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1/ Dumped imports are defined as those which are sold at prices below those charged by the producer in his domestic market.

proceedings, and revision and termination of undertakings. Legislation by some industrial countries to widen the coverage of antidumping duties has been a source of concern to other countries.

An important recent controversy pertains to the extension of antidumping measures to components of products in so-called screwdriver operations. On June 22, 1987 the EC adopted a new regulation which stipulates that for the purpose of preventing circumvention of ADs on finished products, ADs may also be applied under certain conditions 1/ to products assembled or produced in the Community, using imported parts or materials. Under this regulation, the EC initiated investigations during 1987-88 on electronic typewriters, electronic scales, excavators, and photocopiers, all of which were assembled or produced by Japanese-related companies in the EC. In April 1988 the European Council decided to impose ADs on five companies.

Japan argued in the GATT Committee on Antidumping Practices that the EC's anticircumvention regulation was inconsistent with the GATT and the Antidumping Code because of: (i) the absence of investigations to determine dumping and injury for the imported components; (ii) the provision that stipulated that duties may be imposed provided that the value of components originating in the country subject to the initial antidumping duty exceeded the value of all other parts by a specified proportion; in Japan's view, this provision was intended to operate like a local content requirement and was inconsistent with GATT; (iii) the imposition of duties only on manufacturers associated with foreign companies already subject to antidumping duties, and not on domestic manufacturers even if they used the same imported components; Japan considered that this amounted to a discriminatory internal tax in violation of GATT; and (iv) Japan did not accept the EC's contention that the new regulation had legal cover under GATT Article XX:D. 2/ The EC contended that the legislation had been adopted after experience had shown that the opening of the antidumping investigation (on the final product) was often followed by the establishment of an assembly operation in the EC designed to circumvent eventual antidumping duties. The EC also argued that the legislation had been drafted with great care to define pre-

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1/ The conditions are that the "screwdriver" operation must be closely related to the firm on which ADs have been imposed and must have been established, or substantially increased its operations, following imposition of ADs on the finished product. In addition, the imported components from the country against which the initial duty was applied have to amount to at least 60 percent of the price of the finished product, i.e., the local content (or content from third countries) of the finished product must be under 40 percent.

2/ GATT Article XX:D states that nothing in the GATT shall prevent any contracting party from adopting measures necessary to secure compliance with laws or regulations that are not inconsistent with the GATT provisions.

cisely the conditions under which the circumvention of antidumping duties was most obvious.

Other recent issues regarding application of antidumping provisions include the following:

(i) Determination of the threat of material injury. In 1985, the committee adopted recommendations by the ad hoc group, which stressed that the totality of factors must be considered in such a determination. 1/

(ii) Difficulties in determination of constructed values or estimated production costs. 2/

(iii) Prevention of dumping in third markets. A GATT panel set up at the request of the EC to investigate the Japan-U.S. agreement on semiconductors did not address the issue of the validity of prevention of dumping in third markets, but it did rule that the type of measures taken by Japan to prevent dumping of semiconductors in third markets was contrary to the prohibition on quantitative restrictions on exports under the GATT (see Annex III).

(iv) The U.S. Court of International Trade made two new rulings which have the potential to encourage further aggressive use of

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1/ Article VI of the GATT recognizes that there are certain limited circumstances in which antidumping action is justified even before injury has materialized. Obviously, there is also a danger that that provision can be abused, especially if an authority accepts only a simple assertion of "threat." The Antidumping Committee has accepted that any administering authority should consider, among other things, a number of specific factors relating, for instance, to the rate of increase of dumped imports, the ability of the producer to increase his volume of dumped imports, the effect of dumped goods on domestic prices, and the state of inventories in the importing country. See GATT Activities, 1985.

2/ GATT rules permit the use of constructed values based on cost estimates as a basis for dumping charges in case domestic prices in the exporting country are not representative of costs, for example, because of the existence of monopoly power. A technical difficulty that often arises is that costs in the start-up period of the product or process are very high; from the producer's viewpoint not all costs are allocated to pricing in the start-up period in the expectation that costs would decline as sales volume increased. This consideration is important, for instance, in electronic products. Very few producers, if any, have the financial ability to dump long enough to eliminate all competition. Another technical difficulty arises in connection with indirect taxes that have to be netted out of domestic prices in assessing whether dumping is occurring; in practice, it is difficult to assess the incidence of taxation.

antidumping petitions by U.S. producers--one ruling makes it more difficult for the U.S. Commerce Department to suspend an antidumping order; the other ruling says that the use of the concept of cumulation of imports for different countries does not violate GATT antidumping provisions.

(v) Under a new regulation, the EC has initiated, for the first time, an unfair practices investigation in a service industry (Korean shipping).

Issues related to the Antidumping Code are being discussed in the Uruguay Round Group on MTN Agreements and Arrangements. These discussions have generally revolved around the need to clarify definitions and conditions under which antidumping actions are taken, and avoid abuse of the antidumping instrument as a disguised form of protection and harassment of foreign exporters. Some question the relevance of the code in today's business world, while others believe that varied interpretation of the code has given rise to arbitrary applications and unjustifiable impediments to trade. Considerable interest has been expressed in clarification of the application of the code to imported components, definition of "like products," and determination of constructed values (used when no sales of "like products" exist). Some countries are concerned that "recidivist dumping" (deliberate, repeated dumping) and "diversionary practices" (practices to evade an antidumping order) are being employed with increased frequency in a manner which defeats the intent of the code.

5. Trade-related aspects of intellectual property rights

The negotiations in the Uruguay Round Group on Trade-Related Aspects of Intellectual Property Rights (TRIPS) aim to identify GATT provisions which might apply to TRIPS, elaborate new disciplines, as appropriate, and develop a multilateral framework in counterfeit goods, building on the work already done in the GATT. 1/ Industrial countries argue that inadequate or ineffective protection of intellectual property rights (IPRS) have trade-distortive or trade-restrictive effects, hence new rules are needed to protect such rights. They suggest the adoption of norms that could serve as a basis for the enforcement of such key GATT principles as nondiscrimination, transparency, and national treatment, and the establishment of adequate enforcement mechanisms in these areas, especially for the protection of copyrights, machinery trademarks, patents, semiconductor layout, trade secrets, and designs.

Many developing countries are concerned about the danger of going beyond the mandate of the group. They emphasize that the group's work should be confined to trade-distorting or trade-restrictive aspects of IPRS, and not to the establishment of new regulatory regimes for intel-

1/ An Expert Group was established by GATT in early 1985 to look into questions relating to trade in counterfeit goods.

lectual property rights, per se, as these are matters in the competence of the World Intellectual Property Organization (WIPO). Some of these countries also believe that it would be wrong to design an intellectual property system based only on trade considerations; intellectual property owners have not only rights but also obligations to society, and dealing only with rights would entail a weakening of measures to protect the public interest.

6. Trade-related investment measures

The Uruguay Round Group on Trade-Related Investment Measures (TRIMS) is in the process of identifying relevant TRIMS, such as, local content and export requirements. It is also examining various GATT articles to assess their relevance for trade-distorting or trade-restrictive effects of investment measures. 1/ Views diverge on whether there is a need for further rules and regulations in this area; some countries believe that existing GATT Articles are already relevant for many TRIMS. A key issue is whether the group should deal with all TRIMS or only those with direct effects on trade. Another issue is whether it is more appropriate to deal with TRIMS on a case-by-case basis, or to seek to apply GATT disciplines to them across the board. Also being addressed are measurement questions including the difficulties of determining the trade effects of combinations of investment measures and of investment measures used in conjunction with trade measures. Some developing countries have emphasized that the group's mandate focuses only on the trade effects, and that no attempt should be made to put in place a new system of international investment regulations.

## V. Sectoral Issues

1. Agriculture

Agriculture has historically been considered special for socio-economic and strategic reasons. As a result, agriculture has remained largely outside GATT's normal disciplinary framework. GATT provisions on export subsidies for agriculture are vague (Section IV.4a). Growing budgetary and economic costs of high levels of protection and subsidization of agriculture, particularly in major industrial countries, have led to a widespread realization of the need for multilateral disciplines in this sector.

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1/ Some 18 GATT articles are being examined including Article I (on nondiscrimination); Article II (schedules of concessions); Article X (transparency); Articles XII, XIV, XV, XVIII:B (balance of payments provisions); Articles XXII and XXIII (consultation and dispute settlement); Article XXIV:12 (subnational entities); Article XXIX (Havana Charter); Article III (national treatment); Article XI (quantitative restrictions).

A breakthrough was achieved when the 1982 GATT Ministerial Meeting established the GATT Committee on Trade in Agriculture with a mandate to look into possible reform of agriculture. This committee agreed in November 1984 on a series of recommendations aimed at achieving greater liberalization of trade in agriculture. 1/ The committee also did extensive work on the compilation of information on nontariff measures maintained in agriculture by GATT members.

The work of the committee proved to be a valuable input for the subsequent discussions in the negotiating Group on Agriculture under the Uruguay Round. This group has a mandate to bring all measures affecting import access and export competition in agriculture under strengthened and more operationally effective GATT rules and disciplines. Discussions in the group have revolved around the scope of liberalization, various approaches to it, and the means of monitoring agriculture protection. An increasing number of countries are prepared to accept the use of production subsidy equivalents (PSEs) (Annex II), after suitable modification, for monitoring protection to agriculture.

The basic differences in approach to agriculture are reflected in the proposals that have been presented in the group, which vary in the recommended pace and extent of reform. Below are examples of three types of proposals.

The U.S. proposal calls for the complete phase-out over a ten-year period of all subsidies which directly or indirectly affect trade in agriculture and of all agricultural import barriers, as well as harmonization of health and sanitary regulations. Support to farmers need not be abolished, but it should not be linked to the type or amount of commodity produced; nor should such support distort trade, provide undue incentive to production, or shield farmers from market signals.

The EC views complete elimination of protection and subsidies for agriculture as unrealistic and politically unfeasible. It has proposed a two-stage approach. The first stage involves short-term measures to reduce agricultural imbalances by control of production and by emergency measures. The latter consist of (i) agreement on minimum export prices

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1/ The committee's recommendations called for the elaboration of conditions "under which substantially all measures affecting trade in agriculture would be brought under more operationally effective GATT rules and disciplines, with particular reference to improving terms of access to markets, to bringing export competition under greater discipline, to reinforcing the linkages under Article XI (quantitative restrictions) and Article XVI (subsidies) between national policies and trade measures in a manner which more clearly defines the limits to the impact of domestic agricultural policies on trade, and to more effectively implementing in relation to trade in agriculture the GATT provisions providing for differential and more favorable treatment for developing countries."

for cereals--these would be linked to the stabilization of imports of cereal substitutes (used for animal feed) in the EC; (ii) compliance by all OECD countries to the minimum prices set under the International Dairy Agreement; (iii) agreement on sugar by all OECD countries involving maintenance of the level of imports in a base year (1984). Other short-term measures include a commitment by all OECD countries to freeze their level of support relative to a base year (1984), as measured by some aggregate measure (perhaps the PSE with adjustments), particularly in sensitive areas such as cereals, beef, sugar, barley, and oilseeds. Basic reform involving a substantive reduction in support and protection is to be negotiated in the second stage over the long term.

The Cairns Group 1/ proposes a short-term reform program, to take ten years or less, at the conclusion of which a long-term framework to govern world trade would apply fully. The long-term framework envisages removal of all agricultural trade restrictions and subsidies, and for integration of agricultural trade fully into GATT's surveillance and dispute settlement mechanism. The short-term reform program envisages a phase-down of government support for agriculture, as measured by a PSE-type measure to be developed for this purpose. While the precise pattern of phase-down would vary from country to country, priorities will be given to phasing out export subsidies and reductions in tariff and nontariff measures. Given the urgent need to reduce agricultural trade distortions, early relief measures would be implemented by end-1988, and would involve (i) a freeze on subsidies, no reduction in market access, no new sanitary or phytosanitary measures, and nondisruptive release of stocks; and (ii) a cutback across the board of all subsidies and a commitment to increase access.

The merits of short-term measures versus long-term reform are under debate. The United States is concerned that adoption of short-term measures, including price fixing and market-sharing arrangements, may erode long-term discipline. Some countries have observed, however, that the pressures for compromise are considerable, partly because it may prove difficult to contain protectionist pressures if early progress in the Uruguay Round negotiations on agriculture is not achieved.

Although some developing countries are concerned about the impact of possible liberalization on their food import bill, most developing countries support comprehensive agriculture reform. Developing countries have indicated that they would expect to receive differential, and more favorable treatment under any agreed reform.

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1/ The Cairns Group comprises Argentina, Australia, Brazil, Canada, Chile, Colombia, Fiji, Hungary, Indonesia, Malaysia, New Zealand, the Philippines, Thailand, and Uruguay.

2. Textiles and clothing

Overall management of the Multifibre Arrangement (MFA) is undertaken by the Textiles Committee. The committee has established the Textiles Surveillance Body (TSB) to supervise the detailed implementation of the MFA. The Textiles Committee also established a Sub-Committee on Adjustment with responsibility for periodically reviewing developments in autonomous adjustment processes within the textiles and clothing industries, as well as the role of government policies and measures to facilitate industrial adjustment.

In discussions in the Uruguay Round Group on Textiles and Clothing, many developing countries are emphasizing the need to return to normal GATT rules for this sector, while most industrial countries consider it inopportune to do so in the near future as they fear the repercussions on their domestic producers. Indonesia has proposed, on behalf of developing country exporters of textiles and clothing, a multiple process consisting of a reversal of restrictive measures under the MFA; elimination of concepts and practices under the MFA that are incompatible with GATT; effective application of GATT principles relating to developing countries' trade in textiles and clothing; and termination of the MFA and all associated bilateral agreements. Industrial countries stress that while the position of their textile industry may have improved, they continue to face certain problems in their markets. Some industrial countries are more willing to consider trade liberalization of their textiles if developing countries also liberalize trade, especially their textiles import regimes. Other industrial countries have linked the discussions of the group with progress in other areas in the Round.

3. Tropical products

The Punta del Este Declaration recognizes that special attention should be given to liberalization in tropical products, as a number of developing countries largely depend on tropical products for their export earnings. In keeping with this understanding, the Uruguay Round Group on Tropical Products aims to seek the fullest possible liberalization of world trade in tropical products, with a view to achieving concrete results by the mid-term review of the Round in December 1988. The group is examining detailed information on trade flows and trade barriers on selected tropical products. 1/ Liberalization in these areas is expected to provide benefits to a number of developing countries although some may face erosion of their preferences in certain markets. A number of developing countries have presented initial lists

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1/ Products covered in the initial negotiations include: tropical beverages (coffee, tea, and cocoa); species, 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.

of specific tropical products of export interest to them. Some countries have enunciated general principles they would like to see operate in trade in tropical products, while others have submitted concrete proposals.

Some developing countries are concerned that linkages and prior conditions may slow down the negotiations. For example, some industrial countries have linked liberalization of trade in tropical products to overall reform in the agricultural sector. Given existing obstacles to an early comprehensive agricultural reform, this might considerably delay progress in liberalizing trade in tropical products. Furthermore, reciprocity by developing countries, particularly on the part of the more advanced ones, has also been raised as an issue in the discussions.

## 4. Natural resource-based products

Market access for natural resource-based products (NRBP) (viz., nonferrous metals and minerals, forestry products, and fish and fisheries products) is affected by subsidies and other nontariff support programs, which are often interlinked. The lack of transparency serves to obscure a full appreciation of the costs to both implementing countries and their trading partners. In 1984, the GATT Council set up a Working Party on Problems of Trade in Certain NRBP, and in 1985 Contracting Parties agreed to tackle the problems in this sector multilaterally.

Outstanding issues currently being discussed in the Uruguay Round Group on NRBP, on which wide differences of opinion exist, include: (i) whether coverage of the negotiations should be limited to nonferrous metals and minerals, forestry products, and fishing products, or should extend to other products (iron ore, construction material, phosphates, salts, and energy and energy-based products); (ii) whether the negotiations should aim at liberalization of import trade barriers or should also deal with subsidies and export restrictions; and (iii) whether the group should limit itself to monitoring the impact on NRBPs of progress made in other groups of the Uruguay Round, or should negotiate on these products.

## 5. Services

The importance of services in the domestic economy and in foreign trade has increased considerably for major industrial countries, and is also rising for some developing countries. Even so, there are as yet no multilaterally agreed definitions of services and trade in services, as these comprise a variety of activities affected by different conditions. Partly as a result, measurement of services is also beset with difficulties. Furthermore, issues related to services are made more complex by the fact that trade in services affects other domestic policies in often sensitive areas such as immigration, investment priorities, foreign ownership, rights of establishment, nationalized banking, etc.

The inclusion of services in the Uruguay Round was subject to controversy, as many developing countries were initially opposed to such inclusion. Some countries believed that they had little or no comparative advantage in the services sector, while others were concerned that inclusion of services could direct attention away from much needed reform in trade in goods. Some feared they would be forced to open their markets in certain key and sensitive segments, such as, banking and insurance, as a quid pro quo for preserving access to industrial country markets. Developing countries eventually agreed to the inclusion because of the legal separation of the entities negotiating goods and services, and acceptance by all GATT members that inclusion of services in the Round did not imply recognition of services as part of GATT.

The Uruguay Round Group on Negotiations on Services (GNS) aims to establish a multilateral framework of principles and rules for trade in services, with a view to a progressive liberalization, and respecting the policy objectives of national laws and regulations applying to services (see Attachment I). Discussion in the GNS has covered a variety of issues related to services, including appropriate definitions, measurement, coverage in the negotiations, and the merits of broad-based approaches on general principles versus sectoral approaches.

Thus far, there is no consensus in the group on a definition of trade in services, and whether an agreed definition is necessary for the group's work to progress. Some countries require agreed definitions to determine the scope of rules and disciplines in the negotiations; others feel that definitions can be dealt with in parallel with the ongoing negotiating process. Approaches on definitions vary from generic approaches identifying the essential attributes of a transaction in order that it might be considered as trade in services, to one based on an understanding as to which services are to be covered in the negotiations.

Another issue relates to the coverage of the negotiations and whether it should be limited only to cross-border sales of services, possibly including labor services, or should be broadened. The limited coverage is favored by those who wish to avoid bringing investment or rights of establishment into the negotiations. The proponents of the broader approach point out that firms are frequently required to establish themselves in a host country before they are permitted to sell certain services, and in some cases physical presence is required to provide the service (e.g., consultancy).

The approaches to negotiations on services fall broadly in two categories: (i) development first of a multilateral framework of principles for all sectors, which could then be used for sectoral negotiations; (ii) the alternative is to place greater emphasis on sectoral discussions and less on the multilateral framework, because of the perceived difficulties of achieving consensus on comprehensive rules and principles. Features under discussion of a possible framework for trade in services include most-favored-nation (MFN) application, national treatment (i.e., same treatment to both domestic and foreign service producers), and transparency. Some industrial countries consider it opportune for the group to begin pulling together broadly agreed views on principles and negotiating mechanisms to move the discussions forward. Others feel that before this can be done, the group would need to pay greater attention to ensuring respect for national policy objectives, as many existing obstacles to market access in services are motivated by nontrade considerations.

Developing countries are concerned that the negotiations are not addressing the need to promote economic development. Many of them are interested in inclusion of labor services in the discussions, whereas industrial countries wish to avoid bringing immigration into the negotiations. Some developing countries are important service producers with a stake in the multilateral negotiations, but others feel that there is little to be gained by opening the services sector, while still others simply want to protect their own services sectors. Some developing countries have expressed concern about the trade-restricting practices of transnational corporations in the service area.

A few developing countries have presented proposals to the group. These call for a framework agreement with relatively modest disciplines, and negotiation of trade liberalization mainly in the context of sectoral agreements. The proposals emphasized the need to respect national policy objectives and suggested particular areas for special treatment of developing countries.

## VI. Trade Issues Affecting Developing Countries

### 1. Issues of interest to developing countries

Issues of trade interest to developing countries are the responsibility of the Committee on Trade and Development, one of the principal standing committees of the GATT. In particular, the committee examines how member countries put into practice the provisions of Part IV of the General Agreement which provides for differential and more favorable treatment for developing countries, and includes an undertaking by industrial countries to reduce trade barriers affecting developing countries and not to impose new ones. The committee also has primary responsibility for overseeing implementation of the Enabling Clause which was agreed in the Tokyo Round and which also provides more favorable treatment to developing countries. The committee has two subcommittees: one dealing with the least-developed countries, and the other with the examination of protective actions taken by industrial countries affecting imports from developing countries.

Developing countries are concerned about a number of issues pertaining to the international trading system, some of which were raised in the latest (63rd) session of the committee in April 1988. First, high priority was assigned to dismantling protectionist trade barriers by industrial countries which reduced market access for developing countries; tariff escalation was also a matter of concern. Second, the need to strengthen multilateralism in the face of trends toward bilateralism was emphasized. Third, the importance of tighter disciplines on recourse to safeguard measures by industrial countries was highlighted. Fourth, some developing countries felt that the Uruguay Round discussions had so far concentrated on the areas of interest to industrial countries, such as services and TRIPS, and not sufficiently on areas of interest to developing countries. Finally, the principle of differential and more favorable treatment for developing countries was defended as essential for their growth, and concern was expressed about suggestions in some negotiating groups of the new Round about the possible erosion of such special treatment.

The issue of increased discrimination in the application of the Generalized System of Preferences (GSP) was raised in the committee. Developing countries were concerned that industrial countries appeared to be moving away from the basic principles, set out in decisions of the Contracting Parties of June 25, 1971 and of November 28, 1979, whereby industrial countries acting individually had been authorized to grant preferential treatment to developing countries, provided that the preferential schemes were of a generalized, nondiscriminatory, and nonreciprocal nature.

Subsequently, the Group of 77 at the 15th Session of the UNCTAD Special Committee on Preferences in May 1988 charged that the GSP was not working as well as it should. 1/ It argued that the principle of nonreciprocity was compromised by the insistence of industrial countries on concessions in areas such as services and intellectual property in the Uruguay Round negotiations, in return for continued GSP benefits. It also complained about the exclusion of certain developing countries from the benefits of GSP schemes on the basis of graduation. These views, however, were sharply criticized by most industrial countries. They referred to the sharp rise in GSP imports in recent years, and argued that the loss of preference for some beneficiary country suppliers was inevitable as these suppliers increased their competitiveness in the markets of the preference-giving countries.

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1/ An UNCTAD secretariat report on the worldwide GSP situation in 1987 indicated that the GSP helps no more than one fourth of developing countries' exports of dutiable goods products on average, and that enormous scope remains for liberalizing and harmonizing rules of origin. The report stated that denial of preferences to major beneficiaries had hurt their export performance, while failing to help the exports of smaller beneficiaries; it had, however, been of advantage to nonbeneficiary industrial countries. The conclusions of the report were sharply criticized by industrial countries.

## 2. Integration issues

The Enabling Clause establishes the principle of integration of developing countries, but does not lay down the criteria for doing so. It was a compromise in the face of pressure by industrial countries for institutionalized graduation and integration, and resistance by developing countries to these concepts. Unable to incorporate graduation criteria officially into the GATT itself, some industrial countries have unilaterally incorporated aspects of graduation into their own trade laws, using varying criteria. These attempts have met with criticism from developing countries.

For the Uruguay Round, integration and graduation have not been explicitly included in the agenda of negotiations, but they undoubtedly form part of the discussions, and cut across many groups. Many industrial countries view integration by developing countries into greater GATT disciplines as one of the Round's most important objectives, in part because they consider it as the best possible means of encouraging trade liberalization by developing countries. Some industrial countries clearly expect greater reciprocity by the more advanced developing countries, particularly in areas of the latter's comparative advantage and where they have made substantive inroads in export markets.

Many developing countries, however, view integration with concern, and more generally are skeptical about the benefits they can gain from the new Round. Some developing countries have noted that a dismantling of the MFA does not seem imminent; agreement on tropical products is important for some of them, though not in terms of their share in developing country exports; agreement on an MFN-based safeguard code is also important for them but progress thus far is slow. Liberalization of trade in agriculture may be the most important concrete outcome of the Round for developing countries in the Cairns Group. Developing countries have generally adopted very defensive positions in the discussions in the "new" areas (services, TRIPS, TRIMS) but a number of developing countries also have an interest in these areas as potential exporters. Some developing countries with open trade regimes, or that have recently undertaken trade liberalization, are of the view that they should get credit for this in the negotiations.

With respect to the least developed countries, their share in world trade has declined; some rely mainly on exports of a few primary commodities; and they already receive preferential treatment in most industrial country markets. The export problems of many of them are related primarily to domestic policy and production conditions. The Sub-Committee for Least Developed Countries has indicated willingness to review problems of these countries, and is accepting proposals from them for presentation to the appropriate negotiating groups under the Uruguay Round. Bangladesh requested such a review which indicated that Bangladesh's difficulties were primarily related to internal transportation and marketing problems, production bottlenecks, and insufficient export diversification.

3. Balance of payments provisions

The GATT Committee on Balance of Payments Restrictions exercises surveillance over the use of trade restrictions for balance of payments reasons by industrial countries (under Article XII) and by developing countries (under Article XVIII). Systematic recourse by industrial countries to Article XII has declined steadily, and now only ad hoc, temporary use is made of this Article (Table I.3). In contrast, Article XVIII:B has been very frequently used and represents the single, most widely applied exception to the prohibition contained in GATT Article XI on the application of quantitative restrictions (QRs). Some 85 percent of all QRs notified to GATT by developing countries are justified under Article XVIII:B. For many individual developing countries, restrictions on over 300 import items (and over 700 in the case of Argentina and Colombia) are currently justified on balance of payments grounds. A number of developing countries which appear to be applying restrictions for balance of payments purposes have not notified these to GATT and thus have remained outside GATT surveillance. 1/ During the period 1974-87, 112 consultations were held with 19 developing countries by the GATT Balance of Payments Committee; of these, more than two thirds took the form of "simplified" consultations, and the remainder were "full" consultations. 2/

Recourse by developing countries to GATT Article XVIII:C, which allows them to maintain QRs for developmental or "infant industry" purposes, has been very infrequent. Since 1970, Indonesia (in 1983) and Malaysia (in 1984) are the only two developing contracting parties to have notified certain import measures taken under Article XVIII:C. 3/ This Article requires prior notification and non-disagreement by the Contracting Parties, involving a time delay before imposition of the restrictive measure. Also, it allows trading partners which are adversely affected by the measure to seek compensation. In comparison

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1/ See 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).

2/ Full consultations involve discussion of the consulting country's trade measures and balance of payments situation, and conclusions and recommendations by the committee. The Fund provides background documentation as well as a statement on the consulting country, which generally includes an assessment of economic and financial trends and prospects, the balance of payments situation, and measures to deal with external imbalances. Simplified consultations involve no discussion on the consulting country; the committee determines only whether there is a need for a full consultation. The Fund provides background documentation for simplified consultations, but no Fund statement.

3/ Releases from GATT obligations under Article XVIII:C have been granted to Cuba (1949, 1955, 1960), Haiti (1950), India (1949), and Sri Lanka (1949, 1952, 1955, 1956, 1958, 1959, 1960, 1964).

with Article XVIII:B, which excludes the possibility of retaliation by countries adversely affected by the balance of payments measures, Article XVIII:C has a built-in safeguard against its excessive use.

The discussions on GATT's balance of payments provisions in the Uruguay Round are being held in the Group on GATT Articles. Many industrial countries strongly argue for a review of GATT's balance of payments provisions with a view to strengthening surveillance over trade restrictions for balance of payments purposes. More fundamentally, they question the economic rationale for these provisions in view of flexible exchange rates and other changes in the international monetary system in the past two decades. Furthermore, they view reduced reliance by developing countries on GATT's balance of payments provisions as essential to the process of meaningful integration of developing countries into the GATT. While their views differ on the need to modify Article XVIII:B, they wish to ensure that balance of payments restrictions are temporary and that they are used in a form that minimizes disruptive effects on trade. Industrial countries also believe that changes in procedures in the GATT balance of payments consultations are warranted to tighten the surveillance process. They suggest, for example, that consultations under the "simplified procedures" of Article XVIII:B may need to be reviewed.

Developing countries oppose any revision of the balance of payments provisions under Article XVIII:B, on the grounds that there have not been fundamental changes in the international financing system since these provisions were last reviewed in 1979. They maintain that the provisions contain explicit and detailed rules to ensure that restrictions are not invoked arbitrarily. While recognizing that trade restrictions are not a remedy for balance of payments problems, these countries believe they are often a necessary response to an adverse external environment.

## VII. Disputes, Articles, and Codes

### 1. Dispute settlement

The prompt resolution of trade disputes under multilateral surveillance is of vital importance to the smooth functioning of the GATT. GATT members have been concerned about the less than effective working of the GATT's dispute settlement mechanism. While this may be due in part to inadequate procedures, many countries consider that the difficulties arise elsewhere, including in the existence of vague GATT provisions, differences in their interpretation, and nonobservance or abuse of the proceedings.

A marked increase has occurred in disputes brought for arbitration by GATT panels (Table I.4). Thus far in 1988, the GATT Council established eight panels, more than in the whole of 1987. Also, delays in establishing the composition and terms of reference of the panels have become more serious. Some countries believe that the Uruguay Round negotiations should not be soured by excessive recourse to dispute settlement proceedings. Others view the increased recourse as a sign of growing confidence in the GATT.

Recent dispute settlement cases reflect several characteristics. First, they have focused considerably, but not totally, on agricultural issues, partly reflecting intensifying problems facing world trade in agriculture. Recent disputes relate, for example, to quantitative restrictions on imports in the EC (apples and almonds), Japan (beef and citrus), Korea (beef), Norway and Sweden (apples and pears), and the Indian licensing system (almonds), and to payments and subsidies to producers in the EC (oilseeds and related animal feed protein), certain EC directives (third country meat directives and growth hormone ban), and Argentina's differential export tariffs (soybeans and soybean products). Second, a number of disputes relate to newly emergent sectors such as electronics/high technology (e.g., Japan's semi-conductors). Finally, the increase in the number of GATT panels might also represent attempts to use the dispute settlement mechanism to review and debate GATT regulations, with a view to clarifying these rules or establishing the need to revise them.

The Uruguay Round Group on Dispute Settlement is considering the strengthening of existing dispute settlement procedures. Discussions revolve around issues such as arbitration and consensus, time limits for establishing panels, use of standard terms of reference, and improved surveillance of the implementation of panel reports.

## 2. GATT Articles

The Uruguay Round Group on GATT Articles is examining a number of Articles with a view to reviewing their applicability and relevance. In addition to the discussion (mentioned above) on GATT's balance of payments provisions under Articles XII, XIV, XV, and XVIII, the group has before it requests for examination of Article XXIV on customs unions and free trade areas. Some countries consider that Article XXIV is eroding the MFN principle of the GATT and that appropriate means should be found to enable nonparticipating countries to enjoy some of the benefits of regional integration on an MFN basis.

Many trading nations (both industrial and developing countries) continue to call for revisions in Article XXVIII (on the renegotiation of tariff schedules) on the grounds that the present distribution of negotiating rights favors large suppliers and creates disincentives for small suppliers to enter into tariff binding negotiations. Some countries wish to review the applicability of Article XVII on state trading, with a view to stricter disciplines and greater transparency in operations of state trading. In this context, it has also been suggested that the use of countertrade, particularly government-mandated countertrade, must be addressed to clarify how Article XVII might contribute to creating an effective discipline on countertrade activities which could distort trade and infringe on GATT principles. Other Articles under discussion include those dealing with subsidies, and with national security exemptions.

3. MTN agreements and arrangements

The Tokyo Round of MTN resulted in a number of codes and agreements. These covered subsidies, dumping, technical barriers to trade, import licensing, government procurement, and customs valuation, as well as sectoral agreements related to bovine meat, dairy products, and civil aircraft. The Uruguay Round Group on MTN Agreements and Arrangements is examining these codes and agreements to determine whether changes are warranted in any of them. Section IV.4 discussed the codes on subsidies and dumping, and Annex II discusses dairy products and bovine meat; this subsection focuses on the remaining codes and agreements.

The Tokyo Round Agreement on Technical Barriers to Trade, more commonly known as the "Standards Code," which entered into force on January 1, 1980, has now been signed or accepted by more countries than any other Tokyo Round code (Table I.1). The code is designed to ensure that procedures related to standards, testing and certification of products do not operate as unnecessary barriers to trade. The overseeing Committee on Technical Barriers to Trade has made available a list of products covered by notifications under the agreement for the use of national standards bodies. 1/ It has examined the work of international and regional bodies in the fields of testing and inspection, and possibilities of improving understandings under the agreement. In this regard, difficulties arise in keeping up with standards in certain high technology areas where technology changes rapidly, and in the differences among countries in decentralization with respect to standards. The standards related to "process and production methods" (PPM) are not covered under the code; disputes on PPM standards have increased, for example, EC standards on the use of hormones in beef.

In the Uruguay Round Group on MTN Agreements and Arrangements, further improvements have been suggested in the Standards Code, including better information and transparency on standards activities, clarification on processes and production methods, and possible expansion of the agreement to areas such as testing, inspection, and certification systems.

The Tokyo Round Agreement on Import Licensing is intended to ensure that licensing procedures do not in themselves act to restrict imports. The Committee on Import Licensing, to which notifications on national procedures are made, is examining possible improvements in notification procedures, clarification of definitions, and strengthened disciplines. These issues are also being discussed in the Uruguay Round

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1/ GATT, GATT Activities, 1985, Geneva, 1986.

Group on MTN Agreements and Arrangements. Some view the code to be too limited in scope, and that it needs clarification of definitions, discipline on the duration and trade coverage of licensing schemes, and discipline on the use of nonautomatic licensing, including increased transparency and institutionalized review proceedings.

The Government Procurement Code calls for open international bidding on government contracts exceeding a specified amount (SDR 130,000 from 1988). Negotiations on the coverage of government entities included in the code are being carried out in an informal working group. Some countries would like to include in the code the postal and telephone services, water supply, and transportation. Another issue is how to deal with privatization: some participants insist that countries which have privatized state enterprises should include other government entities under the code to restore the balance among countries on the share of government procurement open to international bidding. Some countries have also questioned whether the U.S. "Buy American" Act is in conformity with the obligations under the code. The United States has indicated that the provisions of the "Buy American" Act do not cover the entities included in its commitments under the code. Only a few developing countries are signatories to the code, partly because it does not provide for differential and more favorable treatment for developing countries. Discussions about the Government Procurement Code in the Uruguay Round cover the need for better information and review, wider coverage, improvement in tendering procedures, and procedures for accession to the code.

The Agreement on Trade in Civil Aircraft was the only sectoral agreement covering manufactures negotiated during the Tokyo Round. The agreement eliminated import duties on civil aircraft and the bulk of aircraft parts. It also introduced disciplines on nontariff barriers to trade. The Committee on Civil Aircraft supervises the agreement. Signatories to the agreement account for all of the world's large civil aircraft production outside of the Soviet Union. In 1986, the committee heard two complaints against the United States. The first was the U.S. Federal Aviation Adminstration's decision for a stricter interpretation of certain regulations. The United States said the move was for safety reasons, while the EC and other members expressed concern about possible harmful effects to trade and the servicing of civil aircraft. The second was the proposed transitional provision for certain aircraft contained in the U.S. Tax Reform Bill. The committee has also considered the U.S.-EC dispute on Airbus subsidies (Annex III).

Also under discussion in the Uruguay Round is the Customs Valuation Code which aims at more uniform and transparent practices on valuation of imported goods for customs among different countries.

## Agricultural Trade Policies

### I. Introduction and Summary

The agricultural support policies of major industrial countries have resulted in large imbalances and excess production. These policies have reduced market access for efficient agricultural exporters many of which are developing countries, and the disposal of surplus production on world markets has had a depressing effect on world food prices. In the latter respect, between 1980 and 1987 the IMF food commodities price index has fallen by one third in nominal terms and is almost half the 1980 level in real terms. Agricultural trade policies have led to an escalation of friction in the international trade of agricultural products during the 1980s. These policies have imposed a high cost on taxpayers and consumers in these countries and have adversely affected their macroeconomic performance. These factors underlie the prominence given to agricultural trade policy reform in the OECD and in the Uruguay Round negotiations. This Annex surveys recent policy actions that have given rise to these problems, efforts to reform these policies, and the costs of these support policies. Proposals for multilateral agricultural reform in the Uruguay Round are summarized in Annex I.

Section II reviews the policies of selected countries and country groups. It notes that the burden of agricultural support policies to taxpayers and consumers in major industrial countries is high, averaging US$185 billion per year in 1984-86, a substantial increase from the early 1980s. This amount was about six times more than annual official development assistance by OECD countries in 1984-86. Although these support policies were originally undertaken for domestic reasons they have been accompanied by trade restrictions and export subsidies that have adversely affected efficient agricultural exporters. Despite attempts to reform support policies in some industrial countries, significant action to reduce the adverse effects on international trade has not yet materialized.

Many of the policies in the United States Food Security Act of 1985 substantially increased the taxpayer costs of agricultural support, particularly for grains. Using a broad measure of public spending, agricultural support increased from US$24 billion in 1980 to US$54 billion in 1986. 1/ Most of this was used to increase income payments to farmers, while part was used to subsidize exports. Efficient exporters and U.S. consumers have also been adversely affected by the intensification of import restrictions, particularly for sugar.

The costs for the European Community (EC) have also increased as a result of surplus production and the increased subsidies by the United

1/ Based on data in OECD Monitoring and Outlook of Agricultural Polices, Markets and Trade, Paris (1988), and including federal and state spending.

States. The intervention policies of the EC have led to very large stockpiles of dairy products and beef, with stocks of butter peaking in 1986 at 92 percent of annual EC consumption. Spending on the Common Agricultural Policy (CAP) and by governments of EC members have increased by about 50 percent to US$25 billion between 1979-81 and 1984-86; and spending on the CAP will amount to 71 percent of the EC budget in 1988. Measures have been introduced during the 1980s in an attempt to slow the increase in costs of the CAP but their success to date has been limited. A package of measures was approved in February 1988 that could potentially reduce the rate of cost increases; however, these measures do not address the basic issue of high domestic prices nor do they include measures to improve market access for traditional exporters or reduce the extent of subsidized exports.

While budgetary spending on agriculture in Japan has remained fairly flat, the use of quantitative import restrictions has meant that the burden to the consumer has more than doubled between the early 1980s and 1984-86 and the impact of the appreciation of the yen has been to increase quota rents (received by importers) rather than lower consumer prices. The domestic prices of a number of basic farm products, including rice, are about 10 times the level of world prices. Despite recent modest reductions across-the-board in producer prices and plans to liberalize the import of beef and citrus products, market access for the other major agricultural commodities is still an issue.

Other major agricultural exporters among industrial countries have responded in different ways to the crisis in agriculture. Canada has continued to provide substantial support for its agricultural sector and has introduced a special income support scheme for grain and oilseed producers to offset the impact of increased subsidies by the United States and the EC. Australia and New Zealand have reduced support for all sectors of the economy, including agriculture, as part of their structural reforms in an effort to improve their overall macroeconomic performance.

The situation in developing countries is substantially different from that in industrial countries. Despite recent policy reforms whereby an increasing number of developing countries now pay producers prices roughly equivalent to world prices, many developing countries continue to burden their agricultural sectors with net taxation, either explicitly or through price controls. Moreover a large number of countries, support the consumption of imported cereals (e.g., wheat) by providing additional consumer subsidies.

Section III reviews developments in the major internationally traded food commodities and shows similar patterns of extensive support and increased trade friction. For example, the industrial countries provide the dairy sector with the highest level of support; in 1986 total support for the dairy industry in the United States amounted to US$1,400 per cow (the EC was not far behind) which was greater than the GDP per capita of 64 countries accounting for half the world's population. The disposal of surplus stocks has necessitated sales at prices well below those set in the International Dairy Arrangement.

Section IV examines the costs of these support policies both to the countries themselves and to other countries, and conversely the gains from liberalization, and shows that these can be substantial. The costs for an individual country are analyzed in terms of the direct impact on producers, consumers, and taxpayers as well as the broader implications for structural adjustment and macroeconomic performance. Liberalization of support policies is likely to generate direct gains to consumers and taxpayers that substantially exceed losses to producers. These losses to producers will not be completely at the expense of needy groups of farmers as most of the producer supports in the United States and the EC benefit large-scale farms. Since producer losses would be less under multilateral than unilateral liberalization, great importance is attached to the opportunity provided by the Uruguay Round for the former. Nevertheless the evidence suggests that unilateral liberalization by the major trading countries implies no lower (and possibly greater) benefits to the liberalizing country as a whole than multilateral liberalization because of the much larger welfare gains to consumers.

Agricultural support policies also contribute to macroeconomic imbalances and structural rigidities. The cost of agricultural supports forms a significant part of the budget deficit of the United States. Structural rigidities resulting from support for agriculture that would otherwise have experienced a decline relative to other sectors also imposes costs on the economy because tax and consumer-financed support reduces the competitiveness of the unsupported sectors. Studies on the EC suggest that liberalization would result in substantial gains in overall employment, income and exports of manufactured goods and services. Japan and Korea would also obtain similar benefits although the final impact would depend on the extent of liberalization, in other sectors in their economies, and by other countries for Japanese and Korean exports.

Overall, developing countries are likely to gain both in terms of net welfare and net earnings of foreign exchange from the liberalization by industrial countries for all agricultural products, including tropical products. However these gains are likely to be very unequally distributed unless substantial changes are made in the policies of many countries that currently have sizable cereal imports. Almost all countries in Asia and Latin America, many of which are highly indebted, are likely to obtain substantial benefits from industrial country liberalization. However, evidence suggests that in the absence of changes in their own policies, many countries in Africa, including North Africa, will suffer substantial foreign exchange and net welfare losses, primarily because of the higher cost of wheat and rice imports. Many of these countries hold producer and/or consumer prices well below world levels, discouraging production and increasing the consumption of imported food. Much of these losses could possibly be offset by the expansion of production of other cereals that are more suited to agronomic conditions in the region with more appropriate price and structural policies, although the long-run result has not been analyzed in comprehensive studies.

## II. Developments in Individual Countries

This section reviews developments in agricultural support policies, with particular emphasis on their impact on trade, in selected countries and country groups. Table 3 sets out the main types of support policies classified in terms of their method of operation and summarizes their direct costs. Table 4 summarizes the main policies used in selected countries and includes explanations of the main instruments. The proliferation of institutional arrangements of support policies that have common features in their operation, while often reflecting the influence of a special political constituency, also tends to reduce the transparency of the type and overall level of agricultural support.

Cross-country comparisons of support policies are difficult because many of these policies are not transparent. Producer subsidy equivalents (PSEs) can be used to overcome this problem as they provide a comprehensive measure of the gross value of the support policies. In essence, a PSE converts the full range of support policies to the equivalent subsidy that would be needed to provide the producer with the same income if the support policy was removed. This is particularly important for comparing nontariff measures, and output restrictions which are less transparent, with budgetary measures. A PSE is expressed as a monetary amount (Table II.2) or as a percentage of the gross value of agricultural production to producers (Table II.3). 1/ Industrial countries make the heaviest use of market price support policies and direct income support (Table II.2). In percentage terms, in 1984-86 PSEs ranged from 69 percent in the case of Japan to 40 percent for the EC and 28 percent for the United States (Table II.3). The interpretation of PSEs is more difficult for developing countries because the agricultural sector in many of these economies is subject to inflated input costs as a result of protection for other sectors, which can offset some or all of the agricultural support. A few of the developing countries shown in Table II.3 have net taxes on their agricultural sector, while some are neutral, and others provide substantial support (e.g., Korea has a PSE of 59 percent).

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1/ The gross value of production to producers includes not only the price received for sales of produce but also direct payments from the government as a result of farming, e.g., disaster and diversion payments. See OECD, National Policies and Agricultural Trade, Paris, 1987, for a full discussion of PSEs.

Table 3. A Summary of Common Agricultural Support Policies

| Operation and Direct Costs | Instruments |
|---|---|
| **1. Market Price Support** | |
| Restricts quantities or increases price of commodities entering domestic market through domestic or border measures, or reduces price of exports to world levels.<br><br>Domestic market measures raise domestic prices and discourages consumption. Cost is mainly borne by consumer, although a budgetary cost is incurred in set-asides etc. and stockpiling.<br>Border measures reduce market access for efficient exporters. Export subsidies have a budgetary cost and reduce prices received by other exporters. | Domestic market<br>Domestic measures: production quotas, including limits on purchases by domestic marketing board monopolies. Set-asides, land diversion programs, dairy herd reductions.<br>Price discrimination systems, price premiums on fluid milk.<br>Domestic stockpiling, CCC inventory and loan operations.<br>Marketing board price stabilization policies at cost to government. Price control at below market level (negative support).<br>Border measures: tariffs, import levies.<br>Quantitative restrictions, import quotas, variable levies, restrictive state trading operations.<br>Restrictive sanitary requirements.<br><br>World market<br>Export subsidies, including restitutions and Export Enhancement Program.<br>Export taxes (negative support) |
| **2. Direct Income Support** | |
| Raises the price and/or income received by producer leaving domestic price inaffected. Less distorting than market price support because consumption not reduced but can still lead to excess production. Cost is borne mainly by budget and some domestic supply control measures (see above) may also be used to limit budgetary exposure. | Deficiency payments (e.g., difference between a target or guide price and market price).<br>Payments under income stabilization schemes.<br>Payments under headage and acreage diversion schemes.<br>Product levies (e.g., co-responsibility levies) (negative support). |
| **3. Indirect Income Support** | |
| Subsidies for inputs and related services. Reduce marginal cost of production to increase producer income.<br>Generally these have a budgetary cost. May lead to excessive use of inputs and administrative rationing to limit use of subsidized inputs may also lead to inefficiencies. | Programs affecting variable costs of production<br><br>Fertilizer subsidies<br>Fuel tax exemptions<br>Concessional domestic credit for production loans<br>Irrigation subsidies<br>Subsidized crop insurance<br>Income tax concessions<br><br>Programs affecting marketing of commodities<br>Transportation subsidies<br>Marketing and promotion programs<br>Inspection services |
| **4. Long-Term Policies** | |
| Government spending on physical infrastructure and research and development. The extent to which this spending diverts such resources away from competitive industries may cause long-term problems.<br>Resultant productivity increases have increased the costs of other forms of agricultural support policies. | Product specific development and extension services.<br>Conservation and environmental programs<br>Structural programs.<br>Rural roads and other public works. |
| **5. Misaligned Exchange Rates** | |
| Exchange rates that do not produce a sustainable balance of payments outcome. Undervalued exchange rate reduces domestic price of competing imported food and price of exported commodities. | Undervalued or overvalued exchange rates. Multiple exchange rates. |

Table 4. Main Agricultural Producer Support Policies for Selected Countries and Major Commodities, 1982-87

| Commodity | United States | European Community | Japan | Canada | Australia |
|---|---|---|---|---|---|
| Grains | CCC inventory operations and commodity loans; Deficiency payments; PIK entitlements; average reduction (set asides) Export Enhancement Program | Price supports maintained by intervention purchases subject to guarantee threshold; variable levy; export refunds; co-responsibility levies (negative support); land set-aside (all products) | State trading; including the restriction of imports; deficiency payments | Tariff (corn); income stabilization, (WGSP); deficiency payment (SCGP); CWB pool deficit; transport subsidies; crop insurance. | AWB pool deficit; domestic price discrimination |
| Oilseeds | CCC inventory operations and commodity loans; Export Enhancement Program | Deficiency payments | Deficiency payments | As above | ... |
| Dairy | Price supports maintained by tariffs, quotas, and government purchases; Dairy Herd Termination Program | Price supports maintained by intervention purchases; production quotas, variable import levies; export refunds; offset by co-responsibility levies | Price supports through government stockholding, production quotas and trade barriers; some deficiency payments | Production and import quotas, deficiency payments, fluid milk premium | Production quotas import restrictions |
| Livestock | Beef: Tariff; quota; voluntary restraint agreements; Export Enhancement Program; other: general (research and development, inspection, etc.) | Price supports maintained by intervention purchases; variable import levies; export refunds | Beef: State trading by LIPC; quotas; tariff; domestic price stabilization. Pork: variable levy. Poultry: tariff | Beef: Tariff Pork: Tariff Poultry: Production and import quotas | ... |
| Sugar | Price supports; import quotas | Price supports maintained by intervention purchases; variable import levies; export refunds; production quotas; offset by co-responsibility levy | State trading by JRSSPSC; price stabilization; variable import levy; controls on HFCS; deficiency payments. | Deficiency payments | Domestic price discrimination |

Notes:

This table includes main support mechanisms only and excludes support provided at the state or provincial level for all countries and at the national level for EC countries.

An overview of U.S., EC, and Japanese support policies is contained in G. Miller the Political Economy of International Agricultural Policy Reform, Australian Government Publishing Service, Canberra, 1986. Details are contained in OECD National Policies and Agricultural Trade: Country studies on the United States, European Community, Japan, Canada, and Australia, Paris, 1987.

United States

Commodity Credit Corporation (CCC) inventory operations and commodity loans for grains and oilseeds involve a program under which farmers are offered loans for their crops at a specified price, this price is termed the loan rate. The crops serve as collateral and farmers may either repay their loans and redeem their crops or not pay their loan and surrender or forfeit their crops to the CCC. The latter option is attractive when the market price is below the loan rate. The interest rate is also below the market rate. CCC support purchases are made for dairy products and, until 1985, sugar.

A deficiency payment is used to raise the effective price a producer receives up to the target price by making up the difference between the target price and the higher of the market price or loan rate.

Beef is supported by the U.S. Meat Import Law which provides for quotas on meat imports when annual imports are estimated to exceed a certain trigger level defined as 110 percent of an adjusted base quota. Quotas have not been applied since 1979 and typically voluntary export restraint agreements are used.

Table 4. Main Agricultural Producer Support Policies for Selected Countries and Major Commodities, 1982-87 (Concluded)

European Community

A variable levy is a levy that is used to raise import prices of grains and dairy products to a threshold price, and of beef to a guide price, both of which tend to be above the domestic market price for the same commodity, thus effectively excluding imports. Legally the European Community has argued that this is not a quantitative import restriction but a frequently adjusted tariff.

Guarantee thresholds differ from production quotas in that the former implies a subsequent price reduction if a level of output is exceeded does not directly limit production in the current year, and is applied on a Community-wide basis. Production quotas are applied to individual producers for the current year.

The current sugar regime has remained effectively the same since 1981. Domestic prices are maintained by production quotas and variable levies that effectively exclude all imports except special imports from African, Caribbean, and Pacific (ACP) countries. The production quotas, which include high fructose corn syrup (HFCS), are divided into three categories. Production for domestic consumption ("A" quota) receives full price guarantees. Production for export ("B" quota), set at a proportion of "A" quota, receives an export restitution. The remainder of sugar production, "C" sugar, is carried over into "A" quota for the next year. Co-responsibility levies are used to finance the sugar regime. A levy of 2 percent of the intervention price is made on all sugar produced under quota. In addition, a levy of up to 37.5 percent can be made on sugar produced under the B quota. However, revenue generated by these levies has been insufficient to cover the heavy cost of export refunds and so an elimination levy was introduced in 1985 and a supplementary levy was approved in February 1988.

Japan

State trading in grains is by the Food Agency of the Ministry of Agriculture, Forestry and Fisheries; in beef by the Livestock Industry Promotion Corporation (LIPC); and in sugar by a the Japan Raw Silk and Sugar Price Stabilization Corporation (JRSSPSC).

The LIPC acts to both stabilize the domestic price of beef and to manage the supply of imported beef by quotas. The domestic price stabilization operation is based on calculating the median price of the band using a formula that includes production costs and the average market price in the past seven years. During the year, the LIPC intervenes to keep the price of beef within the stabilization band.

The institutional framework for intervention in the sugar market has not changed greatly since 1982 when the Sugar Price Stabilization Law was amended. The operations of the JRSSPSC to stabilize the price of imported sugar entail setting a stabilization price ceiling band and a target price with it. When the import price of sugar is below the target price, as has been the case during the 1980s, the JRSSPSC imposes surcharges and variable levies based on this difference. Part of these receipts is kept for rebates should the import price exceed the stabilization ceiling. To encourage domestic production, the Government fixes minimum producer prices. The JRSSPSC is obliged to buy sugar from refiners who have paid growers the minimum producer prices; the JRSSPSC resells the sugar to the same refiners (in a book transaction) at a lower price which is comparable to the price of sugar made from imported raw sugar. The loss on this operation may be regarded as a deficiency payment and is financed from JRSSPC levies and from the Government's budget. The production of high fructose corn syrup (HFCS) is also regulated by production quotas, variable levies and surcharges.

Canada

The programs are Western Grain Stabilization Program (WGSP) and the Special Canadian Grains Program (SCGP). The Canadian Wheat Board (CWB) runs a pool deficit if market prices fall below initial guaranteed prices and this is made up by the federal government (these deficits have been infrequent).

Australia

The Australian Wheat Board (AWB) runs a pool deficit if the market price falls below the guaranteed minimum price and this is made up by the federal government. (A deficit has only occurred in 1986/87.) Domestic price discrimination entails charging a stable price on the domestic market that is generally, but not always, above world prices and profits from this may assist the export industry. A price equalization levy was applied to domestic consumption to equalize returns of exported products. This policy was terminated in July 1986.

## 1. United States

During the 1980s there has been a major shift in U.S. farm policy. Prior to the 1985 Food Security Act the policy effectively supported the world price of grains at considerable budgetary cost. From 1985 this policy was changed while domestic farm incomes were supported from direct budgetary payments, and the subsidization of exports was introduced. Both policies have resulted in a much greater level of budgetary spending than before. Import restrictions have been tightened, particularly for sugar. The United States has also made frequent use of GATT dispute settlement procedures and bilateral trade agreements. The United States has stated its willingness to completely liberalize its agricultural sector as part of its proposal in the Uruguay Round which calls for the elimination of all distorting support programs by all major countries.

A characteristic of the U.S. agricultural policy is that the major policy variables are mandated in the Food Security Acts (commonly known as Farm Bills) which cover 4-5 crop years. The 1981 Farm Bill, reflecting the optimistic outlook for prices at that time, fixed support prices (i.e., loan rates) at historically high levels and resulted in the large accumulation of surplus stocks by the Commodity Credit Corporation (CCC), particularly in grains and dairy products. This stock accumulation by the CCC had the effect of a market price support policy which, by virtue of the position of the United States in world trade in grains, bolstered their world price (at the expense of the U.S. budget) and permitted other countries with surplus production to expand their exports.

The Food Security Act of 1985 sought to redress the problems created by the previous Farm Bill, by reducing the incentives for further CCC stock accumulation and providing subsidies for exports through the Export Enhancement Program (EEP) and the Targeted Export Assistance (TEA) program. 1/ The incentives for CCC stock accumulation were reduced by making support prices of grains and dairy products closer to market prices and stipulating that programs for some other commodities were to be run without CCC acquisitions. Farmers' incomes were maintained by large deficiency payments. The EEP provided US$2 billion to subsidize exports over the three-year period to September 1988 through a subsidy payable in cash or commodities, the latter entitling the exporter to additional commodities from CCC surplus stocks. In July 1987 authorization was made for additional funding for the EEP which was to come out of other programs and the 1988 Trade Bill has a provision to extend the EEP until 1990 and to raise the limit of funding to US$2.5 billion. As of end-June 1988, export sales of US$5 billion have been assisted under the EEP with the subsidy provided having a market value of US$2.1 billion. The EEP was defended by the

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1/ A more detailed discussion is contained in O. Evans "U.S. Agricultural Support Policies," IMF mimeo (1988), WP/88/1.

United States as a means to counter unfair practices--including subsidies--by competitors and to encourage subsidizing exporters to negotiate reform. However, the homogeneous nature of agricultural products means that the prices received by "fair" agricultural exporters are also affected. The inclusion of the TEA in the 1985 Farm Bill aimed to counter the effects on U.S. agricultural exports of practices by foreign governments deemed to be unfair by the United States. However, the program has been administered as a market promotion fund rather than a price support policy. This combination of policies has contributed greatly to the decline in world prices for grains in 1985-87, and increased U.S. budgetary costs. Budgetary spending on agricultural support rose from 0.3 percent of GDP in 1980 to 0.6 percent in 1987 (Table II.4). The firming of world grain prices in late 1987 and 1988 has started to reduce the budgetary costs of these policies.

The United States has also continued to use and intensify a number of quantitative import restrictions. Under the 1955 GATT waiver for the products included in Section 22 of the 1933 Agricultural Adjustment Act, the United States maintains quantitative import restrictions on dairy products, peanuts, and cotton. This waiver was justified on the grounds that the United States needed time to adjust its agricultural policies although no specific time limit for doing so was included. The EC has announced its intention to seek a review of this waiver by a GATT panel. The quota on sugar is imposed under a "headnote" to the U.S. Tariff Schedule. Following successive reductions in the U.S. sugar import quotas, Australia has requested that this be reviewed by a GATT panel. Quotas and VERs are also used for beef and have not been approved by GATT. These restrictions are summarized in Table II.5.

The long-running dispute in GATT over EC treatment of U.S. citrus exports and EC subsidies of pasta exports was settled in 1986 with a bilateral agreement for improved market access for U.S. citrus products and a limit on subsidies of EC pasta exported to the United States. Disputes and threats of retaliation have also arisen over U.S. access to the EC market for oilseeds and vegetable oils, over compensation for U.S. export markets for feed grains to Spain and Portugal arising from the expansion of the EC, and issues affecting U.S. beef exports. The United States has also brought Japan's restrictions of certain agricultural products before the GATT dispute settlement, which found them to be inconsistent with GATT. Japanese restrictions on beef and citrus products have been the subject of very intensive negotiations resulting in new bilateral agreements for the liberalization of the markets. Complaints about Korea's restrictions of beef imports have been lodged under GATT Article XXIII separately by the United States and Australia.

## 2. European Community

In the European Community the Common Agricultural Policy (CAP) provides the main framework for agricultural support, although national spending is still important. The CAP aims to maintain a fair standard of living for farmers, reasonable prices for consumers, and to stabilize markets. The combination of market price support mechanisms and increases in productivity have led to increases in production that have boosted self-sufficiency in all major agricultural commodities to well beyond 100 percent. Surplus production, together with imports permitted under special arrangements, has necessitated the export of surpluses, with substantial restitutions (subsidies), and the stockpiling of large amounts of certain products, notably butter and beef. The use of these subsidies has enabled the European Community to change from a net importer of food in the 1970s to the largest exporter of food products in the 1980s. The European Community has also increasingly used dispute settlement procedures to improve its market access. 1/

In the period 1984-86 taxpayers in the EC are estimated to have paid an average of US$18 billion per year for agricultural support through the European Agricultural Guarantee and Guidance Fund (EAGGF) (two thirds of the EC budget), and national and provincial expenditures are estimated to have provided an additional US$8 billion (see Tables II.1 and II.10). In 1988, EAGGF expenditures alone are estimated to be US$24 billion, 71 percent of the EC budget.

Proposals for the reform of the CAP have been made during much of its history. The most recent efforts came in the mid-1980s, reflecting high costs of the CAP, and the emergence of constraints on exporting surpluses because of their effect on both other industrial countries (particularly the United States) and developing countries. The reform measures have taken the form of price restraint (including the use of guarantee thresholds), limits on the entitlement to support, and limits on the overall expenditures on price support from the EC budget. Some of these measures, including those agreed upon in February 1988 represent a step to restrain the growth in the budgetary cost of the CAP and represent a first step on the path of reform. However, the measures do not include steps to increase market access for other exporters and thereby reduce the cost of the CAP to consumers, or to reduce subsidized exports.

Price restraint has involved a freeze (and in some cases a slight reduction) in intervention prices in ECU since 1983/84 and the use of guarantee thresholds. However, these measures by themselves have not been effective in restraining production because of the high initial level of prices and productivity increases that have compensated for real reductions in prices. The effectiveness of guarantee thresholds depends on a realistic setting of the threshold level and the magnitude of price reductions. In July 1987, guarantee thresholds were introduced

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1/ A more detailed discussion of the CAP, including its history, operational details and impact on the European Community is contained in L. Lipschitz, J. Rosenblatt, T. Mayer, et al. The Common Agricultural Policy of the European Community - Principles and Consequences, IMF mimeo, DM/88/1, 1988.

for soybeans and olive oil and renewed for oilseeds. Measures decided on in February 1988 set guarantee thresholds for cereals, oilseeds, tobacco, and sheep meat.

Limits on the entitlements to support have come from restricting the period of intervention purchases during a marketing year, and production quotas. Production quotas have been in place on sugar since 1981 and on milk since 1984. The February 1988 measures also included a land set-aside program. Participation for farmers is voluntary but each member country must have a program. In return for setting aside at least 20 percent of his arable area for at least five years, a farmer receives certain payments and exemptions from levies on the remaining production.

Expenditure limits were introduced as part of the February 1988 measures. These limit the increase in spending on agricultural support to no more than 74 percent of the increase in Community GNP. Total EC expenditure would be limited to 1.2 percent of Community GNP. The limit on agricultural spending is to be achieved by the use of stabilizers, such as, guarantee thresholds, production quotas, and intervention limits, applicable on most CAP products. Despite these measures, the EC Commission is to be provided a source of revenue in addition to agricultural import levies, customs duties, and the 1.4 percent of the base on which the value added tax is levied.

Monetary Compensation Amounts (MCAs) were originally introduced to postpone (generally to the beginning of the next crop year) some of the effect on agricultural prices of exchange rate changes among EC members. Because of a decision in 1984 to link ECU prices to the strongest currency in the EMS, MCAs have since contributed to the upward pressure on support prices in the Community. Prices for farm products are set in ECUs at the beginning of each crop year and translated into domestic prices. Positive MCAs serve as import taxes and export subsidies for countries that revalue their currencies, and negative MCAs serve as import subsidies and export taxes for countries that devalue. MCAs give rise to green currency rates that differ from actual exchange rates within the crop year. 1/

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1/ In principle, MCAs are eliminated at the beginning of each crop year in order to equalize green currency rates and actual exchange rates. In the past, however, not all MCAs have been eliminated so that differences between actual and green currency rates have continued across crop years. Countries with positive MCAs are reluctant to have a reduction in domestic farm prices and countries with negative MCAs want to reduce the inflationary impact of a devaluation. Lipschitz et. al. (1988) op. cit. contains a fuller discussion of MCAs, including numerical examples of their calculation and proposals for reform.

From 1984 price increases in ECU terms became so small that strong currency countries in need of dismantling positive MCAs at the beginning of each crop year faced the prospect of reducing agricultural prices in domestic currency terms. To avoid this, the system was changed by effectively linking prices in ECUs to the strongest currency in the EMS. This system effectively put a floor under agricultural prices in domestic currency terms, and placed upward pressure on support prices in the Community (Table II.12). At the end of June 1987 the Commission adopted a scheme for the phasing out of MCAs, including the use of Community-wide reductions in price levels expressed in ECUs. Member states where prices would have to decline as a result of these measures are entitled to grant farmers aid financed from their own budgets, provided it is not linked to output. While the negative MCAs could be phased out more rapidly by green rate depreciations, countries with strong currencies, which face price freezes or reductions, have resisted this to prevent devaluing countries from improving their competitive position. In addition, the raising of national currency prices would increase the cost of the CAP.

## 3. Japan

The institutional framework through which Japan's agricultural policies are implemented has remained much the same since the 1970s. Although its factor endowments would appear to favor other industries Japan supports significant agricultural production. Despite recent reductions in the administered prices of all major products, import restrictions have raised the domestic prices of agricultural products to up to ten times world prices. Although there seems to be a growing awareness of the high costs of Japan's agricultural policies to consumers, this is tempered by an official stress on food security for basic farm products, 1/ as well as the influence of farm groups on the political process, characteristic of many industrial countries. As a result significant pressure for reform has come from major agricultural exporting countries. These pressures, together with the Government's efforts to reduce food prices, have brought about some liberalization of several items, most recently beef and citrus products, and small reductions in producer prices over a range of products. However, access to the Japanese market remains a major issue.

Although Japan is the largest single net food importer, about 70 percent of food consumed in Japan is produced domestically (Table II.13.). Reflecting the special position of rice in Japanese agriculture, self-sufficiency for rice is over 100 percent. Since no rice is exported on commercial terms (some is exported as food aid) the disposal of excess production of rice has been a problem. Feed grains have been the main source of import growth as the livestock industry has

1/ Ministry of Agriculture, Forestry and Fisheries "Agriculture: International Debate and Japan's Position," Japan's Agricultural Review, Vol. 16, October 1987 quoting the Maekawa Report.

grown rapidly. With the inclusion of imported feed grains in the measure of self-sufficiency (i.e., on a calorie basis), the rate is roughly 50 percent, which is lower than other industrial countries but about the same as the United Kingdom before its entry into the EC.

Producer prices are shown in Table II.14. Generally producer prices are set to encourage a certain level of production and, based on an estimate of input costs, to ensure income from farming will be comparable to that of nonfarm jobs. In 1987 producer prices were reduced across the board; this reflected the lower costs of imported inputs as well as the need to improve the efficiency of the farm sector and increase reliance on market prices. The 6 percent reduction in the price of rice was the first decrease in 30 years. In 1988, the producer price of rice is to be reduced by 4.6 percent. Despite these price reductions, the quantitative import restrictions coupled with the depressed world prices for agricultural commodities set in U.S. dollars and the appreciation of the yen against the U.S. dollar has meant that the ratios of the domestic producer prices to world prices (nominal protection coefficients) have risen to up to ten times the world price (Table II.15). 1/ This support is substantially financed by consumers (Table II.1) and was equivalent to a subsidy of 57 percent of the value of producers' income (the PSE ratio) in 1979-81 and 69 percent in 1984-86, the highest ratio among OECD countries (Table II.3).

Table II.16 shows that most of the budgetary spending on agriculture is for long-term assistance, such as, structural policies and the development of rural infrastructure. Budgetary spending on price support policies, estimated at ¥ 353 billion for 1988, has been declining steadily over the past decade from ¥ 767 billion in 1980. State trading entities use some of the proceeds from profits on imports (quota rents) for price support policies. The total of budgetary and extrabudgetary price support spending which was about ¥ 858 billion in 1980, increased during the early 1980s but declined to ¥ 760 billion in 1987; this decline is much smaller than for budgetary spending only.

In October 1986, the United States lodged a complaint with the GATT over Japanese import restrictions on 12 agricultural products (which account for a relatively small proportion of trade). A dispute panel found that restrictions on 10 of the products were not justified under Article XI:2(c). In February 1988 Japan accepted the report; it undertook to liberalize restrictions on 8 of the products and initiated bilateral discussions on compensation for the remaining 2 products, starches and processed dairy products. These discussions have not been concluded. In June 1988, at the expiration of bilateral agreements on citrus (with the United States) and beef (with the United States and

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1/ The comparison of domestic and world prices is subject to a number of qualifications about transport costs and quality of product; see note to Table II.15.

Australia), Japan reached new bilateral agreements with these countries for the phased liberalization of these markets.

## 4. Other countries

### a. Canada

Canada's agricultural sector is largely export-oriented and, despite its extensive land resources, has in recent years provided increased subsidies and support to agricultural producers, as evidenced by the increase in its PSEs from 24 percent in 1979-81 to 39 percent in 1984-86. Subsidies have increased substantially both as a result of the rapid decline in world prices and attempts by the Government to counter the impact of competitive export subsidization by the United States and the EC. Canada has also used countervailing duties to protect its producers from the subsidized exports of other countries; these included duties on beef imports from the EC and on corn imports from the United States. In 1986 a GATT panel found the former to be inconsistent with the GATT code (see Annex I for details).

### b. Australia

Agriculture in Australia receives relatively little support from government programs. The average PSE for this sector was at 15 percent in 1984-86 (Table II.3). Relatively high assistance is given to the dairy industry and minor products, such as, dried vine fruits and tobacco. In accordance with the general government policy of economy-wide reductions in assistance, all these schemes are under review. In particular, the dairy industry, which has by far the largest level of support in the Australian agricultural sector, is subject to the agreement on Closer Economic Relations with New Zealand; under this agreement the Australian dairy industry is to be made competitive with the New Zealand industry by 1992. It was announced in May 1988 that assistance to the sugar, dried vine fruits, tobacco, and citrus industries would be reduced in line with tariffs on manufactured goods. The Government also undertook to eliminate the monopoly position of the Australian Wheat Board (AWB) in the marketing of wheat.

### c. New Zealand

The Government of New Zealand has embarked on an economy-wide program of reductions in industry assistance, including agriculture. While New Zealand agriculture had a PSE of 23 percent in 1984-86, the elimination of subsidized credit, direct price supports, and some tax concession will eventually bring the PSE to closer to zero. During the period 1985-87 assistance to agriculture remained high due to the write-off of certain types of loans made under previous policies. Although New Zealand is one of the most efficient producers of pastoral products, its rural incomes are very low. This has resulted from low world prices, relatively higher interest rates on large loans made during the period of subsidized credit, a relatively strong New Zealand dollar, and the reduced but still high assistance to the manufacturing sector. These factors led to a contraction of sheep flocks and lamb production, although this has been offset in part by a diversification into more profitable nontraditional products and recent increases in wool prices. While parts of the farm sector have faced problems in the adjustment to the changed international circumstances, New Zealand has experienced an improved macroeconomic and structural performance.

d. European Free Trade Association

All members of the European Free Trade Association (EFTA) provide extensive support for their agricultural sectors mainly through quotas and variable levies on imports and domestic production quotas. The dairy industry is an important sector in these countries. Typically, these countries have a fairly high level of self-sufficiency as well as surpluses in dairy products, some of which is exported. Meat production is also important in the Scandinavian countries. In the case of Austria, where high levels of support for grains and dairy products have led to excess production, the upward trend in PSEs has been dampened by the requirement that producers pay an increasing share of the high cost of surplus disposal, resulting in a slight decline in PSEs, from 36 percent in 1979-81 to 35 percent in 1984-85. Switzerland was granted a waiver for its agricultural policies at the time of its accession to the GATT. The Swiss constitution contains the basis for its policies of agricultural support policies; the two basic objectives are the preservation of farms and the provision of secure food supplies. The OECD is currently updating PSE estimates for EFTA countries other than Austria.

e. Developing countries

The agricultural policies of developing countries are much more diverse than those of the industrial countries and have been undergoing significant changes in recent years. A major review of their policies was presented in the 1986 World Development Report 1/ which highlighted the bias against agriculture in many developing countries, particularly low-income countries, in the late 1970s and early 1980s. This is particularly significant because the agricultural sector tends to be the most important sector in these economies in terms of employment and output. Also, household incomes are lower in this sector. Higher income developing countries, including Korea, were found to have more neutral policies or policies which favor agriculture.

The 1986 World Development Report study noted several sources of the bias against agriculture: (1) Industrial protection resulting from inward-looking strategies both raise the cost of inputs in the farm

1/ International Bank for Reconstruction and Development, World Development Report 1986, (1986), Oxford University Press and World Bank, Washington D.C.

sector and result in a less depreciated exchange rate, which reduces the price of traded goods, primarily agricultural commodities; (2) The control of domestic food prices reduces the prices received by farmers; (3) An overvalued exchange rate may also be used to hold down the cost of food imports which reduces demand for domestic production and the profitability of exports; (4) Export taxes often fall on agricultural exports; and (5) Statutory marketing boards often have a monopoly on farm output for export or for domestic use, or on the supply of farm inputs. Inefficiencies resulting from these arrangements as well as implicit price control may also introduce a bias against agriculture.

The ratio of producer or consumer prices to world prices provides some indication of the overall bias for or against agriculture, particularly if adjusted for overvalued exchange rates. In the case of wheat (Table II.17), while some developing countries promote agriculture and maintain producer prices at around world levels, many countries hold these prices and especially consumer prices at very low levels (with Egypt showing the greatest bias), discouraging domestic production and strongly encouraging consumption of wheat, which is often imported.

During the 1980s, and particularly in recent years, there has been increased recognition of the problems that result from such policies, including the development of severe food shortages. This has led to the reversal of policies that discriminate against agriculture in some developing countries. Large exchange rate changes in many African countries, e.g., the Gambia, Ghana, and Nigeria have led to improved producer prices for agricultural products and have stimulated production. The relaxation of price controls and on grain marketing arrangements have occurred in other countries (e.g., Tanzania). In the face of low world prices for their exports, Argentina and Thailand have reduced their export taxes.

Some developing countries, particularly in Asia, have placed emphasis on achieving self-sufficiency in food, particularly cereals, for a number of years. Subsidized inputs for agricultural production are a common form of assistance to agriculture in developing countries (Table II.2). Input subsidies typically relate to credit, irrigation, and fertilizer. However, the extent of these benefits is not clear. India subsidizes fertilizer for farmers, but much of the subsidy goes to high-cost domestic producers of fertilizer, rather than farmers. Subsidized credit has been one of the main forms of assistance to farmers in Brazil but the subsidy element, arising from interest rate controls and high and variable inflation, and access to credit, has varied greatly in recent years.

Information is also available on the tariffs and trade restrictions imposed by developing countries. 1/ A study of 50 developing countries

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1/ In this section, tariffs are taken to also include other government charges on imports.

found that, with the exception of manufactured goods, other than chemicals and machinery and equipment, food has the highest level of average tariffs and this occurred across all levels of per capita income except the highest group. Similarly, food has the largest number of nontariff measures (NTMs), including the largest number of multiple NTBs applying to the same tariff item. 1/ 2/ In addition, countries in lower-income groups tend to have higher average tariffs and frequency of NTMs than those in higher-income groups (Supplement 1, Tables 16 and 17).

The apparent contradiction between the above finding which indicates a greater incidence of border measures in low-income developing countries and the previous observation of a greater bias against agriculture in low-income developing countries compared with higher-income countries appears to be due to the heterogeneous nature of food items. A disaggregated analysis for Asian countries indicates that cereals typically having the lowest tariff rate, whereas meats and dairy products, and beverages and spices typically having higher tariff rates. 3/ This suggests that nonessential foods may be considered luxury goods and are more heavily taxed.

The presence of import licensing and state trading monopolies is not necessarily associated with domestic prices consistently above world levels. Many developing countries use licensing to gain more control over import flows rather than the use of more general macroeconomic instruments. In addition, imports may be controlled to limit the higher demand for imported subsidized cereals.

## III. Developments in Trade in Individual Commodities

Tables II.18 through II.23 show data on agricultural production, trade, and stocks for a number of products. They show that, particularly in the case of dairy products and grains, high levels of support have been associated with large stock accumulation. For sugar, the growth in exports by temperate zone industrial countries has reduced the share of exports by developing countries.

### 1. Dairy products

Within the agricultural sector, the dairy industry receives the highest level of assistance across OECD countries and within individual

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1/ R. Erzan, H. Kuwahara, S. Marchese, and R. Vossenaar, The Profile of Protection in Developing Countries, UNCTAD, Discussion Paper No. 21.

2/ This duplication is termed stacking, and may reflect the incidence of inspections and standards on top of other import control measures.

3/ Dean A. DeRosa, Agricultural Trade and Protection in Asia, IMF mimeo, WP/88/63 (1988), countries. 1/ In 1986 this support is estimated to have amounted to US$1,139 and US$833 per cow in the United States and EC, respectively. For comparison, in 1986 about 64 countries accounting for about half the world's population had per capita GDP below this level. 2/ The incentives for production provided by this assistance have led to surplus production, necessitating large expenditures to accumulate and store stockpiles, particularly in the EC but also in the United States. In 1985-86 stocks were at record levels and have had to be disposed of at very low prices; the latter partly reflected the deteriorated state of stocks due to extended storage.

The problems in the dairy industry have been recognized for some time. After protracted discussions during the Tokyo Round, the International Dairy Arrangement (IDA) was established under the auspices of GATT in 1980. The IDA set minimum export prices for various types of dairy products which have been periodically changed in light of market conditions. Despite the general observance of the IDA, very high stock levels have forced some producers to enter into sales at very low prices: in categories excluded from the IDA (e.g., stock feed); in new categories created outside of the IDA (e.g., 18-month old butter); or by obtaining a derogation from some parts of the IDA.

In 1984 the EC announced sales to the U.S.S.R. of 200 thousand tons of old and deteriorated butter stocks at about 40 percent below the IDA minimum price. The United States and Austria left the IDA in October 1985 in protest. At the same time, it was agreed that butter at least 18 months old was not subject to the IDA minimum prices. In 1986 the EC sold an additional 475 thousand tons of old butter and butter oil to the U.S.S.R., also at very low prices. In 1987, it was determined that sales of fresh butter to the U.S.S.R. could not be made at the IDA minimum prices and a derogation from the IDA was obtained to permit traditional suppliers to that market to sell at prices below the minimum during 1987. In 1987, New Zealand sold 50 thousand tons of butter oil to Brazil at about half the minimum export price under a separate derogation of the IDA. Sales of cheese below export quality have also been below the IDA minimum price and milk powder for stock feed, which is excluded from the IDA protocols, has generally been sold at about half the minimum price as that for human consumption. 3/

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1/ OECD (1987), op. cit.

2/ Total support defined as PSE from OECD (1988), op. cit., GDP per capita from International Bank for Reconstruction and Development, World Development Report 1988, Oxford University Press and World Bank, Washington, D.C. (1988).

3/ Information in this section is based on GATT, The World Market for Dairy Products 1987, Geneva, 1987.

a. United States

The United States restricts imports of dairy products by quotas, permitted under the 1955 waiver for Section 22 of the 1933 Agricultural Adjustment Act. The quantities of imports permitted are shown in Table II.5.

The dairy industry also benefits from support purchases by the CCC. Up to 1985 this entailed the accumulation of large stocks of dairy products, mainly cheese and powdered milk (Table II.8). The Food Security Act of 1985 contained a number of provisions for the dairy industry. First, support prices were reduced. Second, the Dairy Herd Termination Program was introduced to reduce production by buying whole herds of dairy cattle for slaughter costing US$1.3 billion over 1986-88. However, improved productivity has offset most of the effect of fewer stock on milk production. Third, to permit the CCC to reduce its butter stocks, exports of 100 thousand tons of surplus butter were provided for in each of the fiscal years 1986-88. However, only three thousand tons of butter oil were exported under this program in 1986.

A new Dairy Export Incentive Program was adopted in February 1987 in which some 140 thousand tons of fresh butter were offered for sale to a large number of countries. No significant export sales have been reported under this program. The low level of stocks means that the United States is unlikely to be a significant exporter in the near future.

b. European Community

The EC's stocks of surplus dairy products continued to accumulate until 1987, a tendency characteristic of the dairy sector since the earliest days of the CAP. EC stocks of butter exceeded 1,500 thousand tons at the end of 1986, about 92 percent of EC consumption in that year; of this approximately 600 thousand tons was older than 18 months and much of this was in a very poor condition. There has been a long history of unsuccessful attempts to deal with this problem. In the early 1980s, guarantee thresholds were applied whereby the increase in the intervention price would be reduced by a few percentage points if certain production levels were exceeded. However, in the absence of a mechanism to prevent intervention prices being increased to offset this reduction in the next marketing year, this policy was abandoned.

Steps have been taken since 1984 to reduce the entitlement to support through production quotas and by measures to reduce the incentive for intervention sales. In 1984, quotas on milk production were established, but in order to give the system some flexibility the overall Community quota had an allowance for 10 percent additional production. These additional quotas were quickly utilized and excess production continued. In December 1986, further steps were taken to eliminate surplus production. Milk quotas over the period 1987-89 were to be reduced in two steps by a total of 8.5 percent with 3 percent coming from the voluntary abandonment of milk production (with compensation), and a uniform 5.5 percent reduction in quotas. In December 1986, in order to make intervention purchases less attractive, the delay in the payment for the purchase of such stocks was increased and the seller was made responsible for the first 240 days of storage. Intervention purchases of skimmed milk and butter were also limited to certain months of the year if intervention purchases exceeded specified quantities.

In February 1987 it was also decided to dispose of 1 million tons of old butter in 1987/88. These measures included special exports of 400-500 thousand tons in 1987 (to the U.S.S.R.) at very low prices and sales of 300 thousand tons for animal feed and industrial uses. The overall cost of the measures was around ECU 3.2 billion.

Despite having large surpluses of butter, the EC continues to provide access for New Zealand butter to the United Kingdom at intervention prices which are well above world prices. The quota has been reduced gradually, from 81,000 tons in 1985 to 74,000 tons in 1988. While this access was only intended as a transitional measure, New Zealand argues that it faces difficulties expanding its dairy export markets, e.g., to the U.S.S.R., as these have become highly competitive with large subsidized sales by the EC at well below IDA prices.

c. Japan

Support for dairy producers in Japan has enabled self-sufficiency to be maintained at about 85 percent during the 1980s. The guarantee price for manufacturing milk, the basic price received by producers, remained relatively constant prior to 1986 but was subsequently reduced to reflect lower input costs (Table II.14). Despite this small decline in real prices, increases in productivity have led to increased production and surpluses in some products, necessitating the introduction of some supply control measures. The supply of milk has been controlled by quotas on raw milk production which are allocated to individual producers. After increasing steadily up to 1985, the quotas were reduced in 1986. Production in excess of this quota results in a significant penalty.

Import quotas are used to maintain the domestic price (standard transaction price) of dairy products, above world prices. However, as this price would still not provide typical producers with the desired level of income, the difference between the standard transaction price and the guarantee price to producers is made up by a deficiency payment from the Livestock Industry Promotion Corporation (LIPC). The payment is funded partly from the budget and partly from the LIPC's own revenue from the quota rents on beef imports.

Japanese import restrictions on processed dairy products were included among the agricultural products which were the subject of investigation by a GATT panel requested by the United States.

Article XI:2(c)(i) of GATT permits import restrictions on agricultural products that are necessary to support measures to restrict the production of a "like" domestic product. However, the panel report found that as the domestic production restrictions were on raw milk and the import restrictions were on processed dairy products, the latter were not consistent with Article XI because they did not meet the likeness condition with raw milk. Although Japan accepted the GATT panel report in February 1988, it noted the fact that there was a domestic scheme to limit raw milk production and that, if this was not sufficient to justify import restrictions on processed dairy products, it would call into question the GATT legality of similar restrictions in other countries. 1/

## 2. Grains

World production of grains for export (except rice) is concentrated in the temperate industrial countries. Developing countries, including China which is the world's largest producer of wheat, grow large quantities of grain mainly for domestic consumption. Production of grain has grown strongly during the 1980s because of increases in yields and a number of favorable seasons. Trade volumes of grain declined during the 1980s as former large importers, such as, China, India, and Indonesia, have achieved a high degree of self sufficiency. Stocks of grain, particularly those held in the United States, reached a peak in 1986/87 but have subsequently declined due to conscious stock disposal policies. Reflecting changed intervention practices and the export subsidies of the United States and EC, prices fell to very low levels in 1985/86 but appear to have bottomed out during 1986/87 due to poor seasons in a number of countries and cut-backs in production.

### a. United States

As the largest exporter of grains, the policies of the United States have a heavy influence on international markets. Under the 1981 Farm Bill, both target prices and support prices (i.e., loan rates) were set at levels that turned out to be excessively high relative to market prices. 2/ Loan rates at well above market prices provided incentives for significant amounts of production to be surrendered to the CCC (i.e., the crop was forfeited). This policy increased CCC stocks of grain to very high levels and, at the same time, reduced the quantities available for export. In effect, this policy supported

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1/ Relatively little raw milk is traded internationally and almost all industrial countries, including the United States and European countries, have import restrictions on processed dairy products without specifically limiting the production of processed dairy products. The restrictions of the United States on imports of processed dairy products are covered in its 1955 GATT waiver.

2/ See Table 4 for a brief explanation of institutional features of the U.S. support system.

world prices for grain and at the same time permitted other countries with surplus production, particularly the EC, to expand their exports. U.S. stocks of wheat and coarse grains peaked in 1986/87 at about 202 million tons, equal to 94 percent U.S. consumption in that year.

The Food Security Act of 1985 sought to redress a number of problems created by the previous Farm Bill. To reduce the incentive to forfeit the crops to the CCC, loan rates were substantially reduced and based on a formula related to market prices. In the case of wheat the loan rate was reduced from US$3.30 per bushel in 1985/86 to US$2.40 per bushel in 1986/87 (US$121 and US$88 per ton, respectively). This sharply reduced CCC stock accumulation after 1986/87. However, target prices for wheat were frozen at US$4.38 per bushel, the level since 1984/85, for two years and were to decline thereafter to US$3.94 per bushel in 1990 (Table II.7). This large gap between target prices and loan rate or market prices, which is made up by a deficiency payment, meant that there was a continued incentive for overproduction, as well as a substantial budgetary cost of the program. To limit budgetary exposure, land set-aside programs continued to be mandatory for receiving deficiency payments. However, the set-aside program has only been moderately effective at limiting production. Typically the least productive land is set aside first and the high target prices give a strong incentive for more intensive cultivation of the remainder. In 1987, 27.5 percent of the base acreage was set aside, and only at this level was there a significant impact on production. The set aside was reduced to 10 percent in 1988. As a result of these measures, budgetary expenditures on wheat and coarse grains rose sharply and accounted for most of the increase in budgetary spending on agriculture from US$18 billion in 1985 to US$26 billion in 1986. Grain exports have been the main beneficiary of the Export Enhancement Program (EEP) included in the 1985 Farm Bill and subsequently extended. Significant sales assisted by the EEP were made to the U.S.S.R. (13 million tons), China (7 million tons), and Egypt (6 million tons).

The support program for rice had an additional subsidy element. Since the loan rates for rice were not reduced to world market prices, the 1985 Farm Bill specified that the CCC loan could be repaid at the higher of the world market price or 50 percent of the loan rate. This preferential rate was needed to allow U.S. export prices to match world market prices more closely and to minimize forfeitures. In addition, rice exporters were entitled to negotiable certificates for CCC commodity stocks equivalent to the difference between the world market price and the loan repayment rate, should the latter exceed the former.

Changes in U.S. grain policy contained in the 1985 Farm Bill have had a major impact on the international grain market. The removal of market price support in the form of CCC stock accumulation, the subsidization of exports through the disposal of CCC stocks under the EEP, together with the depreciation of the U.S. dollar vis-à-vis other major currencies since 1985, have meant that other exporters, particularly the EC, faced very strong competition. Between 1984 and 1987, wheat prices fell by 25 percent in U.S. dollars but by almost 50 percent in terms of ECUs. The United States regained much of its share of world grain exports; in the case of wheat, this had fallen from 47 percent in 1980/81 to 29 percent in 1985/86 but increased to 41 percent in 1987/88. The EC has had to greatly increase its export restitutions (subsidies). At a substantial budgetary cost, Canada introduced an additional deficiency payment to offset the effect of increases in subsidies by the United States and the EC. In the case of Australia the stabilization scheme required Government payouts in 1986/87, but as producer prices follow market prices fairly closely, there was a large shift out of wheat production. Substantial subsidization of rice exports enabled the United States to increase its share of world exports but has also reduced world prices. This has had a detrimental effect on other rice exporters including Thailand, the largest rice exporter, and other Asian countries.

While the stated aim of the EEP was to intensify competition with subsidizing exporters, the resultant decline in world prices affected all exporters. Australia has protested on a number of occasions against the EEP and considered its extention and change in funding arrangement in June 1987 a breach of the standstill agreement in the Punta del Este Declaration. The United States considered the changes in funding to be a routine renewal of an established program.

b. European Community

As with many of the commodities supported by the CAP the high level of support has enabled the EC to change from a net importer of cereals in the 1970s to a net exporter in the 1980s. As noted earlier, the EC's share of world wheat exports increased during the early 1980s, but declined in the face of strong competition. Intensified competition from the United States has greatly increased the cost of the support for the cereal sector. Export restitutions have increased from ECU 945 million in 1984 to an estimated ECU 3,615 million in 1988.

The budgetary cost of restitutions for surplus disposal and the resultant trade tensions has prompted continued efforts to restrain production. Guarantee thresholds were introduced in 1982/83 and, although these have produced slight price reductions, productivity increases have maintained the incentive for increased production. In February 1988 the guarantee threshold for 1988/89 was set at 160 million tons, compared with actual production in 1987/88 of 155 million tons. In addition, a co-responsibility levy of, at most, 3 percent was imposed (supplementing the basic levy of 3 percent), payable at the beginning of each marketing year 1988/89-1991/92. If production in the year exceeds the guarantee threshold by less than 3 percent, the supplementary levy is to be partially refunded. If production exceeds the guarantee threshold by more than 3 percent, the levy is not returned and intervention prices are reduced by 3 percent in the next marketing year.

The use of grains as animal feed is an alternative use of surplus production. Competition has been provided by the use of noncereal animal feeds (e.g., cassava (manioc), corn gluten feed, molasses, brans) which enter the EC levy free and are subject to zero or very low tariffs; and with the exception of brans and molasses, all are bound in GATT. As a result, the EC has negotiated VERs with Thailand on imports of cassava. Proposals have also been made for the increased subsidization of domestic grains for this purpose; however, these have not been adopted.

c. Japan

Rice is the main agricultural product in Japan, and is considered a basic food product in which a high degree of self-sufficiency is desired for food security, as well as for social-political-cultural reasons. Support to production of rice and other grains in Japan is provided mainly through quantitative restrictions on imports implemented through state trading by the Food Agency of the Ministry of Agriculture, Forestry and Fisheries (MAFF). Rice is not imported except for very small amounts of special types of rice. As a result of the restriction of supply and the sharp appreciation of the yen since 1985, domestic producers are able to receive ten times world prices for grains, up from three times in 1980.

In addition to import restrictions, the producer prices of grains are supplemented by deficiency payments funded from the budget and by profits from state trading in wheat imports. Importers are paid world prices for wheat and the Food Agency sells this to millers at a higher price, approximating the wholesale price of domestic wheat. The budgetary component of support has declined from ¥ 652 billion in 1980 to ¥ 262 billion in 1988 while the extrabudgetary component increased from ¥ 59 billion in 1980 to ¥ 183 billion in 1987 (Table II.16).

The high producer price of rice has led to the excess production of rice despite the high cost of production on small farms. In 1986, self-sufficiency in rice was 110 percent (Table II.17). To reduce excess production, diversion schemes for rice have been in operation for a number of years. These schemes divert paddy fields away from rice cultivation to other crops, mainly cereals and citrus products. In late *1986, a new six-year program of the Paddy Field Use Reorientation* Program was adopted with an increase in the target acreage for diversion from 600,000 hectares to 770,000 hectares.

d. Canada

The Canadian Wheat Board has the monopoly on the export of western-grown wheat, barley and oats. It regulates producer deliveries through quotas, sets producer prices, and controls access to the grain handling system. The main support programs for grains and oilseeds are the Western Grain Stabilization Program (WGSP), transportation subsidies, and the Special Canadian Grains Program (SCGP). The WGSP is a voluntary program that provides support for the income of western grain and oilseed producers. Producers and the Federal Government pay into a fund and payments from the fund are made when either net cash-flow or net cash-flow per ton, whichever is larger, falls below the average of the previous five years. As such it is intended to reduce the impact of large declines in grain and oilseed prices on farm incomes but, through the use of the moving average, force producers to eventually adjust to world prices. While payments from the fund were infrequent prior to 1984, they have been substantial in subsequent years due to low world prices, reaching Can$1,364 million in 1986/87. Grains and oilseed producers in western provinces also benefit from subsidies under the Western Grain Transportation Act and despite attempts to have producers pay a larger share, subsidy payments by the Government have risen from Can$324 million in 1980/81 to Can$1,090 million in 1986/87. The SCGP, first announced in December 1986, provides deficiency payments to grain and oilseed producers based on the seeded area and at rates proportional to the price decline attributed to the impact of increased subsidies by the United States and EC. Expenditure for the 1986/87 crop was Can$923 million, and Can$1,100 million has been provided for the 1987/88 crop.

e. Australia

The Australian Wheat Board is the sole domestic seller of most domestic and all export wheat. It operates a price stabilization scheme underwritten by the Australian Government. This price stabilization scheme provides protection to producers against rapid price declines but quickly incorporates export prices into producer prices. The guaranteed minimum price (GMP) is set at 95 percent of a three-year moving average (including the current season) of net grower returns, which is related to the export price. Due to the rapid and substantial price decline in 1986/87 the GMP was above the export returns, and government funding of about $A 230 million was required to support the scheme, the first such support since its introduction in 1979. With increases in export prices in 1987/88 and the inclusion of the past low prices in the moving average, government funding is unlikely to be required in 1987/88. As a result of the low prices, wheat production in Australia declined from 16.2 million tons in 1986/87 to 12.1 million tons in 1987/88.

3. Meat

Most meat is consumed in the country of production. Beef and veal form the main components of the international trade in meat and exports account for less than 10 percent of total consumption. Since 1970 major changes have occurred in the pattern of trade. The relative and absolute importance of Latin American exporters (Argentina, Brazil, and Uruguay), where production is not subsidized, has declined, especially with Argentina facing reduced markets in Europe as Spain and Portugal entered the EC. In 1984, the EC emerged as the largest exporter of beef through the use of export subsidies. The EC exports mainly processed beef products and its markets are primarily in Egypt, Saudi Arabia, and the U.S.S.R. Recently the market for beef has been affected by dairy herd liquidations in the United States and the EC.

As a result of the Tokyo Round, in 1980 producers and consumers of meat agreed to an arrangement regarding bovine meat and the establishment of the International Meat Council. The Council aims to liberalize and expand trade and operates primarily to gather data and make market assessments.

a. United States

In the period since 1985, U.S. trade in beef has been affected by two policies: the continued operation of the United States Meat Import Law and the impact of the Dairy Herd Termination Program.

Meat prices in the United States are maintained above world prices by the operation of the U.S. Meat Import Law which provides for quotas (Tables 4 and II.5), although these have not been applied since 1979. In order to avoid the imposition of quotas, which are not included under the 1955 waiver by GATT, the United States enters into negotiations with exporters, generally Australia and New Zealand, for voluntary export restraint (VER) agreements if meat imports are expected to exceed the trigger level (110 percent of the quota). As a result VERs were negotiated in 1982, 1983, and 1987. Quotas are only imposed if it is determined that the trigger level will be exceeded too late in the year to enter into negotiations. Exporters have an incentive to enter into a VER because the quantity under this arrangement will be 10 percent above the quota level.

The 1985 Food Security Act included the Dairy Termination Program, whereby the CCC bought whole herds of dairy cattle slaughter. In order to avoid disruption of the domestic market, more than half was exported at very low prices and the remainder used for domestic food aid and for the U.S. military in Europe. Of the 180,000 tons of meat purchased, half was exported to Brazil, which was experiencing a temporary meat shortage (see below), at around US$0.33 per pound (about one third of the price of beef imported into the United States). Argentina, Australia, and New Zealand registered complaints at this sale.

U.S. exports are relatively small and are mainly of high-quality beef to Japan. 1/ U.S. exports of beef are assisted by two programs included in the 1985 Farm Bill, the Targeted Export Assistance Program (TEA) and the Export Enhancement Program (EEP). The amounts involved in both programs are relatively small, with allocations of US$7 million and US$5 million, respectively, as a subsidy element.

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1/ Further details are available in the section on the Japanese market for meat.

b. European Community

As with a number of other products, the operation of the CAP has changed the EC from a net importer to the largest exporter of beef. The EC continues to import beef largely as a result of international agreements, including some undertakings on market access made during the Tokyo Round when the EC was a net beef importer. These undertakings remain in place despite the change in the EC's trading position. In addition, as a result of the EC enlargement in 1986, Argentina's quotas for "high-quality" beef and frozen boneless beef were raised by 7,500 tons to a total of 87,000 tons. Beef stocks in the EC reached a peak of 885,000 tons in 1985 (12 percent of EC consumption and 115 percent of exports in that year) but declined substantially in 1986 as a result of the special sale of 200,000 tons of beef to Brazil in that year.

In December 1985, the EC farm ministers prohibited the use of all hormone and growth promoters used for beef cattle fattening as of January 1, 1988 with a subsequent postponement to January 1989. While supported by some consumer and health groups, the directive has been opposed both internally and from foreign beef exporters. In February 1988, the European Court of Justice overturned the directive on technical and procedural grounds, but as national legislation is already in place the directive was reissued and this is expected to delay the January 1989 introduction. The United States has strongly objected to the hormone ban as this would exclude its beef exports to Europe, worth more than US$100 million annually, and has prepared a set of retaliatory measures.

The EC operates a Third Country Meat Directive under which only specified meat packing plants are able to export to the EC in order to ensure compliance to certain health and safety regulations. Although this has been applied to other non-EC countries for a number of years, it had not been applied to the United States and it was announced that a list of plants in the United States would be publicized in January 1988. The U.S. meat industry considered this a protective device and filed a complaint under Section 301 of the 1974 Trade Act. As a result of bilateral discussions, the EC published a list of approved U.S. plants that covers the current trade flows.

c. Japan

Producer prices for Japanese beef are primarily supported by import quotas operated by the Livestock Industry Promotion Corporation (LIPC). Japan has remained about 70 percent self-sufficient in beef during the 1980s. The quotas for beef imports are divided into approximately 80 percent operated by the LIPC, 10 percent operated by private traders, and the remaining 10 percent for special categories (e.g., hotels, Okinawa, and meat processing). 1/ The quantity and pattern of beef imports are influenced by separate bilateral agreements with the United States and Australia, most recently covering the four-year period from March 1984 to 1988. The agreement with the United States was for high-quality beef while the agreement with Australia was for total imports of beef; the growth rate in the former quota was set at a much higher rate than the global quota. 2/ In addition, because quota rents on high-quality grain-fed beef were much higher than on the lower quality grass-fed beef, the share of the former imported by private traders also increased dramatically. Both factors contributed to a substantial increase in the share of beef imports from the United States at the expense of Australia and New Zealand. A study by the Australian Bureau of Agricultural and Research Economics of the demand for beef in Japan suggested that in the absence of quotas, the lower cost grades of beef would have a much larger share of the market. The study also noted the very large quota rents and estimated that in 1986 the quota rents on beef imports by the LIPC and private traders alone were about ¥ 108 billion (US$640 million) and ¥ 50 billion (US$300 million), respectively, totaling 169 percent of the value of beef imports in that year. 3/

In June 1988 Japan entered into new bilateral agreements with the United States and Australia on the liberalization of beef imports. The agreements called for annual increases in the beef quota of 60,000 tons for each of the three years to 1990/91, giving a quota level of 394,000 tons, almost twice the level in 1987/88. During this period the role of the LIPC will be reduced and the proportion of beef imports handled by private traders will increase. From 1990/91, quotas will be eliminated and the tariff increased to 70 percent, declining to 50 percent in 1992/93. The agreement with Australia has a special provision that guarantees the growth of imports of chilled and aged beef which currently is almost entirely supplied by Australia.

d. Brazil

Brazil has traditionally been a large exporter of beef. However, in 1986/87, after a period of high inflation, beef and other prices were frozen under the Cruzado Plan and beef producers withheld cattle from

1/ Imports of diaphragm beef are outside the quota and are mainly sourced from the United States; high-grade diaphragm beef can substitute for grass-fed beef, especially in hamburgers.

2/ The bilateral agreements with the United States and Australia allowed for increases in total beef imports from 134.8 thousand tons in 1980 to 168.0 thousand tons in 1986, and increases in high-quality beef imports from 20.8 thousand tons in 1980 to 51.5 thousand tons in 1986. The overall quota for 1987 was set at 214.0 thousand tons.

3/ F. Teal, et al., "Japanese Beef Policies: Implications for Trade, Prices and Market Share," Australian Bureau of Agricultural and Research Economics, Occasional Paper 102, 1987.

the market. Production dropped by about 400,000 tons or 17 percent, and in order to satisfy demand, Brazil imported beef under the above-mentioned special sales from the United States and the EC at very low prices.

4. Sugar

The international price of sugar remains extremely depressed at around a quarter of its peak level in 1980 despite having risen very slightly in 1988 due to the impact of weather conditions on some producers. Sugar provides an important example of the extent to which protection in temperate industrial countries has fostered large increases in domestic production at the expense of low cost producers in developing countries. Low cost sugarcane is grown in tropical and subtropical climates, while higher cost sugar beets are grown in temperate zones. The high cost of sugar in industrial countries has encouraged the production of nonsugar sweeteners in some countries. Brazil has large tax incentives and subsidies on the use of alcohol made from sugarcane as a petroleum substitute. The gains from a less protective environment are likely to be very great for developing countries even though the loss of special access to industrial country markets for some developing countries may offset some of this gain. The last International Sugar Agreement with provisions to affect market prices was effective from 1978, and market support operations were abandoned in 1984 as the free market price was well below the agreed price range. The EC refused to sign the last agreement on the grounds that its export quota was too low; earlier the EC had changed from a net importer to a major net exporter of sugar.

a. United States

The 1985 Farm Bill mandates that raw sugar prices be supported at no less than 18 cents a pound through 1990 and that import quotas be set to minimize loan forfeitures to the CCC. With the world price of sugar at less than 7 cents a pound in 1987, the relatively high price of domestic sugar has encouraged U.S. production, which increased from 5.5 million tons in 1981/82 to 6.5 million tons in 1987/88. The high domestic price has also encouraged the production of high fructose corn syrup (HFCS) for use in processed foods as it is not controlled as is the case in the EC and Japan. (The production of HFCS would not be profitable at the current free market price of sugar.) This and the use of noncaloric sweeteners has led to a decline in U.S. sugar consumption. In order to balance demand and supply, import quotas have been steadily reduced to one quarter of their original level, from 2.6 million tons in 1982/83 to 0.7 million tons in 1988, although shortfalls in U.S. production in 1988 have permitted a revision of the quota to

1.1 million tons. 1/ A continuation of the current sugar policy is highly likely to require zero quotas in a few years. The reduction in quotas has caused severe problems for sugar exporters, many of which are highly indebted developing countries, particularly in Latin America, the Caribbean, and the Philippines. For example, Caribbean basin countries, whose economies are highly dependent on sugar, lost over US$1 billion in foreign exchange earnings since 1984. 2/ Thus, compared with the U.S. support policies for grain, the market price support policy for sugar shifts the cost of the producer subsidy away from the budget and on to consumers and exporters.

b. European Community

The high levels of open-ended support encouraged domestic production and transformed the EC from a net sugar importer to one of the four largest sugar exporters in the late 1970s. The current EC sugar regime was introduced in 1981 in response to the high budgetary cost of support, and friction with traditional exporters to the EC. The latter was caused by restrictions on market access to the EC for traditional suppliers and the use of export restitutions (subsidies) by the EC for disposal of surplus production. Domestic prices are maintained by production quotas and variable levies that effectively exclude all imports, except those under special market access for African, Caribbean, and Pacific (ACP) countries which were former colonies of EC members. Sugar from ACP countries under quota allocations receives the guaranteed domestic price as a form of aid, either as sales in the EC market or as an export restitution (on their own exports). Although the sugar regime was intended to be financed from co-responsibility levies, the very low world prices have meant that these levies, despite several increases, have at times not been sufficient to cover the cost of the restitutions.

## IV. Costs of Agricultural Support Policies

### 1. Introduction

Agricultural support policies have a high cost, both for the country adopting these policies and for other countries. (i) The most apparent costs are the direct budgetary costs and costs to consumers in terms of higher prices and inefficiencies in agricultural production fostered by protection. (ii) However, these direct costs are only first-round effects, because the financing of the support and the inappropriate relative prices resulting from support policies have a detrimental impact on overall macroeconomic performance. In addition,

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1/ For details of country allocation see, "Primary Commodities Market Development and Outlook" (Commodities Division of the Research Department), World Economic and Financial Surveys IMF, May 1988.

2/ Estimates by the United States Department of Agriculture.

the insulation of one sector from the process of adjustment to changes in economic conditions, particularly exchange rate and relative price changes, increases the burden of adjustment on the other sectors. (iii) The cost of support policies is also transmitted into the international market by import restrictions and export subsidies which result in lower and more unstable international prices for agricultural products.

The studies reviewed in this section conclude that, while there can be major gains for the world economy from the complete liberalization of agriculture as proposed by some participants in the Uruguay Round, the benefits from unilateral liberalization are no less and might even be greater for the liberalizing country. 1/ Thus, it does not make economic sense to delay unilateral measures to obtain multilateral liberalization. Liberalization of agriculture by individual industrial countries is particularly important because this sector generally receives the highest levels of support, resulting in the net taxation of nonagricultural sectors. The gains for industrial countries will come from an expansion of their nonagricultural sectors which are able to absorb increased employment. Most developing countries will gain from higher prices for their agricultural exports. To make full use of this opportunity, however, developing countries would also need to address the burdens on their agricultural sectors, including the net taxation imposed on them through the protection of their manufacturing sectors, and to ensure that consumer prices reflect economic costs and are not biased in favor of imported foods.

## 2. Direct costs

The direct (or partial equilibrium) costs of agricultural support policies can be measured on a gross or a net basis. The gross costs to taxpayers and consumers have been used in the earlier part of the paper, with the estimates by the OECD (Table II.1) being among the most comprehensive. 2/ Some of these payments by taxpayers and consumers are reflected in producer incomes and hence represent transfer payments. In addition to this transfer, support policies also result in a net welfare "deadweight" loss which represents the difference between the cost to consumers plus net payments by the government, and the increase in producer income. 3/ Some studies have focused on the net welfare effects on the grounds that the simple transfer of income from one group to another does not have a welfare effect. While the results of these studies vary with the products covered and assumptions on price

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1/ Countries that liberalize will import more food, and since world price increases are less under unilateral than multilateral liberalization, consumers gain much more from the former (Subsection 4.b.).

2/ OECD (1988) op. cit.

3/ In a simple partial equilibrium framework, this represents part of the loss of consumer surplus and losses due to the stimulation of less efficient production.

elasticities, they show that these welfare losses are not insignificant. 1/ The results of Tyers and Anderson are of particular note because of their broad product coverage and use of recent estimates of elasticities and transmission of world prices into domestic prices. The net welfare losses of all industrial countries from protection in the early 1980s in this study are estimated at around US$20 billion (in 1985 U.S. dollars) (Table II.24). 2/

More attention has been given to the gross value of the transfer in this Annex because the net welfare losses do not take account of distributional issues and are likely to significantly underestimate the effect on the economy. Some of the reasons for this are: (i) The transfer to producers does not always reach the targeted group. The political decisions to support the agricultural sector are usually based on the goal of supporting small-scale farms. However, in the United States and the EC, the more efficient large farms have been able to capture most of the benefit enabling them to compete with, and take over, small farms. 3/ A farm sector based on very small farms, as in Japan, leads to very inefficient production. Moreover, the benefit originally intended for actual producers gets built into land or quota values; this restricts the new entrants and the continuation of support policies is required for the preservation of asset values.
(ii) Financing this producer support by consumers through higher food prices places a relatively greater burden on lower income groups.
(iii) The consumer transfers, taxes, and deficits used to finance the transfers create additional problems. Assistance to one sector needs to be paid for by other sectors with adverse effects on efficiency, competitiveness of the whole economy, and on overall macroeconomic performance.

### 3. Macroeconomic effects

Reflecting the above concerns, more recent studies of the costs of agricultural support policies have tended to focus on the macroeconomic effects. These studies, using general equilibrium models in which the agricultural sector is linked to the rest of the economy, show that the costs of the support policies greatly overshadow the partial equilibrium net welfare losses.

The effect of the CAP on the European Community has been the set of policies most widely studied in this field. A study by Stoeckel and Breckling of France, Germany, Italy, and the United Kingdom has divided

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1/ The World Development Report (1986) and Lipschitz et al. (1988) op. cit. survey these studies.
2/ R. Tyers and K. Anderson, Liberalizing OECD Agricultural Policies in the Uruguay Round: Effects on Trade and Welfare, Working Papers in Trade and Development No. 87/10, Australia National University (1987).
3/ OECD (1987) op. cit.

each economy into four sectors, including agriculture. 1/ The study focuses on the gains from liberalization which are taken as the reverse of costs of the CAP, and examines the differential effects on the four countries in the study. Important assumptions of the model are use of an explicit consumption tax to finance the agricultural policies and rigid real wages. Thus, support policies reduce competitiveness of manufacturing and service industries, and since the encouraged sector, agriculture, uses capital and land more intensively than labor, the unemployment resulting from the relative decline from manufacturing and service sectors will not be fully absorbed by the agricultural sector. With liberalization, although jobs would be lost in agriculture, other sectors would gain, resulting in a net increase in employment of about two million to three million depending on the actual flexibility of real wages. Liberalization is also likely to increase the share of agricultural output from small farms. Aggregate income increases by 1.6 percent on average; due to their lower share of value added from agriculture, Germany and the United Kingdom would benefit the most from liberalization.

A study by Donges, et al., for Germany reached similar conclusions about the employment and growth benefits from the liberalization of the CAP. 2/ While farmers lose, the main channel through which this loss would be reflected is a fall in farm values. To overcome this loss, the authors note that farmers might be issued special bonds to compensate farmers for this one-time loss. The general equilibrium approach was also applied by Lipschitz, et al., in measuring the effect of the CAP on Germany. 3/ They also assume rigid real wages and show that, while an increase in agricultural prices from the CAP will increase agricultural employment and exports (if subsidized), these gains are more than offset by losses in other sectors. The authors suggest that the complete liberalization of agriculture would reduce consumer prices in Germany by 5 percent, increase employment by 4 3/4 percent, and raise GDP by 3 percent.

Studies on the impact of liberalization on the U.S. economy are less complete. The prime channel through which the liberalization of agriculture would improve U.S. macroeconomic performance is through the reduction in the budget deficit. As noted earlier, U.S. budgetary spending on agricultural support increased rapidly during the 1980s, to US$27 billion in 1987/88 (Table II.4). According to Feltenstein, the improvement in the current account deficit would be slightly more than

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1/ A. Stoeckel and L. Breckling, "Some Economy-Wide Effects of Agricultural Policies in the European Community: A General Equilibrium Study," in the Centre for International Economics Agricultural Policies and the Non-Farm Economy, Canberra, 1988.

2/ J. Donges, H. Dicke, G. Kirkpatrick, and E. Gerber "Effects of Agricultural Trade Liberalization and West Germany's Economy," in Centre for International Economics (CIE) (1988) op. cit.

3/ Lipschitz et al. (1988) op. cit.

the reduction in the budget deficit, although the actual result could vary depending on the response of interest rates and net private savings. 1/ Hertel et al., look at the efficiency gains from a transfer of labor and capital from the farm to the nonfarm sectors. While farmers bear the brunt of unilateral liberalization, the output of the manufacturing sector and overall GNP are significantly increased. 2/

In a similar vein, two studies by Vincent show that support for agriculture is at the expense of manufactured exports and real wages in Japan and Korea. 3/ Liberalization would also bring about a very sharp drop in rural land prices, as the encouragement of agriculture places a large premium on land which is relatively scarce in both countries. It is important to note that, while the liberalization of agriculture could provide gains to these countries through the expansion of manufactured exports, this expansion is limited by quotas and VERs, or threats of such action, mainly by industrial countries.

Although Australia and New Zealand provide some support for their agricultural sector (currently this level is much lower than most OECD countries) this is offset to some extent by the higher protection for the manufacturing sector which increases input costs to agriculture. As Higgs (1988) notes, this is a disadvantage with the use of PSEs which do not take into account the cost of inputs. 4/ 5/ More importantly, he notes the potential problems for a country, such as, Australia (and by implication other countries, e.g., some developing countries) where agriculture is relatively lightly assisted compared with the manufacturing sector; in this case if agriculture is liberalized while the manufacturing sector remains heavily protected resource allocation is likely to worsen. This suggests that the focus on global liberalization of agriculture, in isolation from protection in other sectors, is misplaced. The removal of support for agriculture is important for many OECD countries because this is their most heavily protected sector. Countries with more heavily protected industrial sectors should place greater emphasis on removing these distortions.

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1/ A. Feltenstein, "Agricultural Policies and the U.S. Federal Budget and Trade Deficit," in CIE (1988) op. cit.

2/ T. Hertel, R. Thompson, and M. Tsigas, "Economy-Wide Efects of Unilateral Trade and Policy Liberalization in U.S. Agriculture," in CIE (1988) op. cit.

3/ D. Vincent, "Effects of Agricultural Protection in Japan: An Economy-Wide Analysis," and "Domestic Effects of Agricultural Policies in Asia Countries with Special Reference to Korea," both in CIE (1988) op. cit.

4/ A measure, such as, the effective rate of assistance, takes this into consideration and can more clearly show the extent to which support for one sector is a tax on another sector.

5/ P. Higgs, "The Taxation of Australian Agriculture Through Assistance to Australian Manufacturing," in CIE (1988) op. cit.

While all the countries studied are likely to obtain significant gains from the unilateral liberalization of their agricultural policies, it is a practical reality that the countries with poor economic performance have the greatest incentives to liberalize. The underlying economic performance of Australia and New Zealand was weaker than most other OECD countries in the early 1980s, and growth was sustained by substantial foreign borrowing. Although these countries are traditional and efficient agricultural exporters, they have chosen to remove most of their own agricultural support policies, at the same time as reducing industrial protection and regulation. This has occurred despite the continued use of subsidies by less efficient agricultural producers to expand their market share. While the agricultural sectors in Australia and New Zealand have sustained some loss of income, this has been partially offset by the incentives to produce nontraditional agricultural commodities. These policies have fostered structural adjustment and, particularly in New Zealand, have helped to improve its fiscal position and overall macroeconomic performance. Similarly, many developing countries, under programs supported by the Bank's SAL and the Fund's SAF and other facilities, have reduced the distortions faced by their agriculture sectors. Despite the great range of evidence supporting the view that the major trading countries can also gain from unilateral liberalization, they have not yet significantly reduced protection for agriculture.

## 4. International effects

### a. Impact on commodity prices

A variety of studies have shown the extent to which agricultural support policies in industrial countries have reduced world prices of the commodities, reduced trade volumes, and, by stabilizing domestic prices, increased the instability of world prices. Recent major studies on the effect of the liberalization on agricultural prices have tended to be in the context of multicommodity, multicountry models of the world agricultural production. While these models are partial equilibrium models and abstract from the effects of liberalization on nonagricultural sectors, they capture most of the salient effects of support policies on the market for agricultural products. In particular, these models take into account: (i) the linkages among agricultural products; (ii) the effects on support policies in one country of other countries' policies; and (iii) the impact of liberalization on a multilateral basis.

The use of these models is mainly to suggest the broad magnitude and direction of price changes resulting from liberalization because the interactions in commodity markets are so complex that the results are likely to have a significant margin of error. Table II.25 compares the results from the two versions of the Tyers and Anderson model and the

OECD Ministerial Trade Mandate model. 1/ The two Tyers and Anderson models are included to illustrate the sensitivity of these models to changes in their specifications. All models are based on the levels of assistance prevailing in the early 1980s, but while the Tyers and Anderson models examine the consequences of complete liberalization by individual countries, as well as by all industrial countries, the OECD study focuses on an across-the-board 10 percent reduction in PSEs for all OECD countries. 2/ Although there are significant differences in the actual values of the effect on the prices of agricultural products on world markets, the results show the general tendency for the support policies to depress world food prices (or liberalization to increase them). The fall in grain prices from the removal of support policies in the OECD model reflects the removal of production restrictions (set-asides) for wheat and coarse grains in the United States which is projected to increase grain output. However, Tyers and Anderson and other studies by the International Institute for Applied Systems Analysis and the Economic Research Service of the U.S. Department of Agriculture suggest that grain prices would increase. 3/ Also important is the fact that the increase in world prices resulting from liberalization is likely to be greater as a result of multilateral action than unilateral action.

b. Impact on industrial countries

The impact of liberalization by industrial countries on the volume of trade is shown in Table II.26. The direction of the results generally show a reduction in exports or an increase in imports by industrial countries across food products. As noted before, the exception is coarse grains, with increases in exports due to the removal of

1/ R. Tyers and K. Anderson, "Distortions in World Food Markets: A Quantitative Assessment Background Paper," World Development Report (1986). Tyers and Anderson (1987) op. cit, and OECD (1987) op. cit.

2/ A number of changes were made to the model in Tyers and Anderson (1987) compared with the earlier version. The main reason for the significant change in the results for the EC is that the more recent version assumes a much lower degree of transmission of world market price changes to domestic prices for the EC. A fuller discussion of these models is contained in Lipschitz, et al. (1988). Tyers and Anderson (1987) also attempt to adjust their model to include protection levels prevailing in the later 1980s by projecting 1980-82 levels of protection adjusted for major policy changes. The results of OECD (1987) reflect only a 10 percent cut in assistance instead of complete liberalization. Although the model is nonlinear in a number of respects, the results have been multiplied by ten to maintain comparability.

3/ J. Quizon, B. Gardner, and L. Quin, "Consequences of Agricultural Trade Liberalization for Developing Economies Assisted by AID," Wharton Econometrics (1988).

set-asides in the United States. The developing countries would respond by increasing their net exports, and centrally planned economies in Europe would respond by decreasing their imports.

The global welfare effects of liberalization can also be analyzed in these models in a partial equilibrium context as discussed in Section IV.2. The results (Table II.24) clearly show that the main beneficiaries of liberalization are the countries that liberalize themselves; in particular, the gains to the liberalizing industrial country are likely to be greater under unilateral liberalization than for multilateral liberalization. This is because under unilateral liberalization these countries will import more food and consumer welfare will increase substantially as the domestic price decline in this case will be greater than under multilateral liberalization. In the cases of both multilateral and unilateral liberalization, agricultural producers in the EC and Japan lose heavily, but this is more than offset by gains to other groups in their own countries. The studies also show an important reason why multilateral liberalization in the Uruguay Round has advantages to agricultural producers; it reduces the price adjustment faced by producers, hence, they would lose less than under unilateral liberalization. Of particular interest is the case of the U.S. producers who are heavily subsidized but would not lose from multilateral liberalization. This occurs because the United States is a low-cost producer of certain agricultural products, including grains, and could be expected to increase exports to currently protected markets under this scenario, particularly with the removal of the land set-aside scheme.

c. Impact on developing countries

The liberalization of agricultural support and trade restricting policies by industrial countries on all commodities, including tropical products, can potentially yield substantial benefits to developing countries. Their gains from increased agricultural exports are likely to outweigh both the increased foreign exchange cost of food imports and related welfare losses. The distribution of these gains, however, is likely to be quite uneven, with Asia and Latin America having overall net welfare gains but Africa (including North Africa) suffering a substantial loss because of their large cereal imports. 1/ The net welfare loss to developing countries shown in Table II.25 probably results from the exclusion of tropical products which are of great interest to developing countries. As noted in the World Development Report (1986), the gains to developing countries could be greater if

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1/ Quizon, et al. (1988) op. cit. The study covered USAID-supported countries only, and so excluded China and many middle-income (and above) developing countries, many of which are large agricultural exporters. A caveat to the study is that it was based on a study of individual commodities, and the supply and demand responses did not take into account any cross elasticities.

agricultural producers in developing countries could take full advantage of the increased world prices, through reductions in the net taxation placed on them. If developing countries liberalized their own agricultural policies at the same time, there could be a substantial welfare gain of around US$18 billion (in 1980 U.S. dollars). 1/

Despite the likelihood that developing countries overall will gain from liberalization in agricultural markets, as they are substantial exporters of cereals, beef, sugar, tropical products, and agricultural raw materials, there is need to focus on the special case of cereal-importing countries. Although these countries will receive higher prices for their agricultural exports, which may offset some of the higher prices of cereal imports, the price increases of the latter are likely to be greater than the price increases in tropical products and agricultural raw materials because industrial country support and protection is much less for these commodities than for cereals.

A study of cereal-importing countries suggests that the impact of liberalization by industrial countries on their foreign exchange position and overall cereal consumption depends on the extent to which domestic prices are adjusted to encourage domestic production, and the extent to which consumer prices are adjusted to reflect the relative cost of imported and domestically grown cereals, thereby redirecting demand to domestic cereals. Some evidence of this is provided in the study by Quizon, et al. (1988). 2/ They assumed that developing countries pass all of the changes in world prices on to producers and consumers but make no other policy changes. They found that, in the case of wheat, Asian countries gained substantially in terms of foreign exchange and were about neutral in terms of net welfare, while Latin American and African countries, the main losers, lost both in terms of foreign exchange and net welfare; Egypt was by far the largest loser, and large losses were also experienced by Peru and Sudan. The extent to which countries would actually incur losses depends on their policy responses. Many of the countries that incur the largest losses are those countries that hold producer and/or consumer prices well below world prices (Table II.17); adjusting these would reduce both foreign exchange and welfare losses. A similar pattern exists for rice where the main beneficiaries were Asian countries with Latin American countries showing smaller gains, but African countries showing large losses. The situation is very different for maize where there were no significant developing country losers, primarily because Latin American, and particularly African, countries are able to expand production. This is in contrast to wheat and rice that are not well suited to conditions in many of these countries, particularly in Africa. Thus, increases in world prices for cereals will not necessarily reduce the cereal intake of the current cereal-importing countries, but the extent to which

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1/ World Development Report (1986), citing Tyers and Anderson (1986), op. cit.

2/ Quizon, et al. (1988) op. cit.

reductions are avoided depends on changes in domestic prices to encourage domestic production and to shift consumption to cereals suited to domestic agricultural conditions. The full impact of industrial country liberalization has not been fully studied in multicountry, multicommodity models for developing countries.

d. Impact on price variability

Tyers and Anderson (1986, 1987) and a number of other studies cited in World Development Report (1986) also show that the liberalization in agriculture would significantly reduce the variability of international prices. One mechanism for this is support policies which insulate domestic producers and consumers from market price and exchange rate disturbances. Under the support policies of many countries, there is no incentive to reduce production or to increase consumption during times of increased supply, and vice versa for periods of reduced supply. This increases the burden of adjustment on unprotected markets. With liberalization, a larger number of producers and consumers would bear the adjustment for supply disturbance and, hence, overall price fluctuations would be less. An additional factor is important in the case of sugar, one of the most volatile commodity markets. Studies suggest that the asymmetric response of policy makers, who rapidly adjust producer prices upward in response to a surge in world prices from a short-term supply problem (often weather-related), and who are relatively slow to lower prices after the boom has passed, amplifies the sugar price cycle. Typically, because sugar cane production takes 2 to 3 years to respond to higher prices, most of the stimulated production will enter the market after the boom, amplifying the downturn in prices. 1/

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1/ R. Sturgiss, G. Wong, and B. Borrel, "Policy Intervention, Price Variability and the International Sugar Agreement," Bureau of Agricultural Economics, Discussion Paper 87.1 (1987). See also "Primary Commodities: Market Developments and Outlook," (Commodities Division of the Research Department) World Economic and Financial Surveys, IMF, May 1988.

# Industrial Sector Trade Policies

## I. Introduction and Summary

This Annex reviews recent trade policy developments in selected sectors (steel, textiles and clothing, automobiles, shipbuilding, electronics, footwear, and civil aircraft) with emphasis on selected major industrial countries. The review indicates that impediments to trade in most industrial sectors remain significant or have increased further. Considerable structural adjustment has taken place in the 1980s in traditional industrial sectors of industrial countries, including in steel, textiles, and shipbuilding, involving significant reductions in capacity and employment, and adoption of more efficient production processes. Nevertheless, traditional industries continue to depend on a variety of trade restrictions and/or subsidies. At the same time, nontariff measures for newly emerging industries in the high-tech area are also on the rise.

In the case of textiles and clothing, multilaterally agreed restrictions against developing countries have been in place for 27 years, and another extension of the Multifibre Arrangement (MFA) in July 1986 (MFA IV) further widened its product coverage. A large part of world trade in steel is managed by bilateral export restraint arrangements outside GATT surveillance. Substantial subsidies are extended to the steel industry, though efforts are being made to contain such subsidies and channel them toward modernization and restructuring of the industry. The shipbuilding sector is characterized by overcapacity and heavy reliance on subsidies. As in the case of steel, many industrial countries are undertaking programs to rationalize capacity and limit state aids in shipbuilding, against the background of depressed world market conditions and rising competition from developing countries. Protectionist pressures in the footwear sector remain strong; resort to restrictions has increased recently partly due to competitive pressures arising from the appreciation of major European currencies with respect to the currencies of the newly industrializing economies (NIEs). Protectionist pressures in the automobile sector, directed mainly at Japanese car exports, have also been influenced by the major shifts in exchange rates in the past several years. The electronics sector is also affected by increasing protection against Japan and the NIEs, national security concerns, and bilateral approaches to dispute settlement and liberalization. Disputes over the use of subsidies have been common in many sectors including civil aircraft.

Numerous studies have demonstrated the significant costs of protection in most industrial sectors, both in terms of higher prices and welfare losses. The number of jobs saved in the protected sector is usually limited, whereas the cost per job saved is often three or four times the average wage in the economy. Protection has also resulted in trade diversion and has encouraged direct investment which may not have occurred in the absence of trade restrictions.

## II. Steel

### 1. Recent trade trends

The world steel market has been under strain since the early 1970s due to the existence of overcapacity and sluggish demand in industrial countries, reflecting in part a substitution of plastics for steel in the production of many products. 1/ After a recovery in 1983-85, world consumption and production declined in 1986 (Table III.1). In 1987 and 1988, however, the world market recovered somewhat due to buoyant demand in the United States, Japan, and Canada.

In the face of sluggish demand and increased competition from emerging developing country suppliers (Brazil, Korea, Mexico), the steel industry in OECD countries has undergone considerable structural adjustment involving substantial reductions in both installed capacity and in employment (Tables III.1 and III.2). Nevertheless, capacity utilization has remained low: it fell markedly in 1982, but improved somewhat thereafter; in 1987, capacity utilization rates were 67 percent and 65 percent in the EC and Japan, respectively, and 80 percent in the United States.

In contrast to developments in the OECD, installed capacity has increased in the rest of the world, particularly in Korea, where it rose by 75 percent during 1979-85. Capacity utilization rates have also been higher outside the OECD area. The increasing importance of developing country producers and exporters has resulted in a decline in the share of OECD countries in world exports, from 74 percent in 1980 to 62 percent in 1987 (Table III.3). Korea's share has increased, and in 1985 Korea was ranked 15th and 7th, respectively, among world steel producers and exporters.

The volume of world steel exports increased significantly during 1983-85, but declined thereafter. Steel trade has become increasingly subject to quantitative restrictions, particularly voluntary export restraints (VERs); by May 1988 a total of 47 known VERs (or equivalent measures) affected steel trade (compared with 38 in September 1987). 2/ Most of these VERs protected the U.S. and EC markets, and restrained exports from developing countries (17), East European Countries (10), the EC (5), and other industrial countries (15). Trade flows are also influenced by subsidies and dumping and measures to counteract their effects by the use of countervailing and antidumping duties. Indeed, many VERs in the steel sector, particularly in the United States, were negotiated following countervailing and antidumping investigations.

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1/ OECD, "World Steel Trade Developments, 1960-1983: A Statistical Analysis," 1985.
2/ GATT, "Review of Developments in the Trading System," Geneva, various issues.

## 2. United States

Following the strong recovery in U.S. steel consumption during 1983-84, demand softened in 1985-86, as the declining trend in steel demand from the automotive and construction sectors was compounded by a drastic decline in tubular products caused by the curtailment of U.S. oil and drilling activity subsequent to the collapse of oil prices (Table III.4). Demand for steel recovered in 1987; consumption increased by more than 7 percent at a time when imports, which continued to be constrained by VERs, decreased by 2 percent. Production thus rose by almost 10 percent and import penetration (ratio of imports to apparent consumption) dropped to 21 percent. Capacity utilization exceeded 80 percent and steel prices surged, resulting in a price level 20 to 40 percent higher at the end of 1987 than a year earlier. Indications are that the same trends are at work in 1988, and some items are in short supply in North American markets.

Despite considerable structural adjustment, including a reduction in production capacity from 140 million tons in 1980 to 102 million tons in 1987, the U.S. steel industry has continued to rely on protective trade barriers; many of these were negotiated in lieu of countervailing measures to combat "unfair" competition from abroad. Under the President's steel program presented on September 18, 1984, U.S. steel imports are regulated by a series of bilateral arrangements aimed at reducing import penetration (to a working target of about 18.5 percent of domestic consumption) and allowing time for domestic producers to undertake further adjustment. 1/ By early 1987, the United States had VERs with many steel exporting countries, 2/ generally covering a period of five years ending September 1989, and restricting shares in the U.S. market to specified proportions. Sweden and Taiwan Province of China have resisted VERs; however, Taiwan Province of China imposed a unilateral restraint on steel exports to the United States effective September 1986, and the United States has a "consulting arrangement" with Sweden on the latter's exports of stainless steel to the United States. Quarterly consultations on steel trade developments have been held with Canada.

The new steel arrangements (1986-September 1989) agreed between the United States and the EC in December 1986 replaced the 1982-85 Carbon Steel Accord and the 1985-86 ad hoc Pipes and Tubes Accord. Under the new arrangements, overall limits on ten categories of products covered by the 1982 accord were expanded by 125,000 tons. Limits in place since August 1985 on the quantity of exports subject to "consultation" clauses

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1/ See IMF, "Trade Policy Issues and Developments," Occasional Paper No. 38, 1985, pp. 37-38, for the background of the program.

2/ The countries that are currently signatories to VERs on steel to the United States are Argentina, Australia, Austria, Brazil, Bulgaria, Czechoslovakia, the EC, Finland, Germany, Hungary, Japan, Korea, Mexico, Poland, Portugal, Romania, South Africa, Spain, and Venezuela.

were expanded by an extra 25,000 tons and some new products were added. Semifinished steel products were to be treated as "consultation products," i.e., while not subject to limitation, the United States reserved the right to review the situation should there be any surge in imports. The existing pipes and tubes arrangement continued as a separate accord, but its duration was extended to September 30, 1989 so that its termination would coincide with that of other steel accords. In addition, the United States imposed an annual quota of 400,000 tons on imports of semifinished steel from the EC in January 1986, following the Community's refusal to incorporate this limit in the VERs. The EC retaliated with curbs on trade worth US$43 million. A settlement of this dispute was reached in July 1986, whereby the United States agreed to raise the quota to 600,000 tons and the EC lifted its retaliatory measures.

Following agreements on VERs on steel imports into the United States, petitions for dumping and countervailing duty investigations (which were numerous before 1985) declined; however, a number of antidumping and/or countervailing duties remain in effect on imports from nonagreement countries (e.g., Saudi Arabia). As some products such as semifinished steel were in short supply at the beginning of 1988, requests for imports beyond specified limits were granted by the U.S. Department of Commerce.

On July 16, 1987, the President granted a 27-month extension of the specialty steel tariff and quota protection introduced four years earlier under GATT Article XIX safeguard provisions. For flat-rolled products--stainless steel sheet, strip, and plate--the tariff will be decreased from 3 percent ad valorem in the first year to 1 percent by September 30, 1989, pursuant to findings by the U.S. International Trade Commission (ITC) that this segment of the industry was becoming more competitive. The existing quota program was extended for stainless steel bar and wire rod and alloy tool steel, and by the end of October 1987 orderly marketing agreements on steel were negotiated with Canada, Japan, Korea, Poland, Spain, and Sweden; unilateral quotas were assigned to Mexico and Taiwan Province of China.

A number of studies have estimated the costs of protection for the U.S. steel industry and economy. In one such study, the impact of VERs on steel was estimated to lead to an increase in average prices of steel in the United States by 4.8 percent, and a reduction in steel imports by US$2.8 billion. 1/ However, in steel-consuming sectors, VERs were estimated to bring about higher import penetration and reduced exports, as U.S. firms forced to purchase steel at inflated prices became less competitive. Total imports of the economy were estimated to decline by US$1 billion to US$1.5 billion, while exports were estimated to fall by

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

US$0.5 billion to US$1 billion. In terms of employment, the jobs saved was estimated at 27,000 man-years, but this would be largely offset by a decline of 24,000 man-years in other sectors.

Another study 1/ estimated the costs to consumers of the restrictions on steel at US$1.1 billion a year (in 1983 dollars) and the annual overall cost for the U.S. economy as a whole at US$779 million; gains for domestic producers were estimated at US$428 million a year and quota rents extracted by foreign producers at US$557 million a year. Jobs protected in the steel industry were estimated at 9,000, with the cost to consumers of each job thus saved estimated at US$114,000 per year. For every dollar earned by workers who would have been displaced in the absence of protection, consumers and the U.S. economy were estimated to lose US$35 and US$25, respectively.

3. European Community

Since the late 1970s, the European steel industry has been in a generally depressed state and apparent consumption has declined (Table III.1). Partly reflecting restructuring efforts, installed capacity, production, and employment in the steel sector declined significantly in the 1980s. Even so, capacity utilization has remained below 70 percent. A limited improvement was observed recently, but problems associated with excess capacity are likely to re-emerge in 1989, especially when investments in developing countries (e.g., Korea) come on stream and competition becomes tougher even in high specialty steel segments.

Since 1980, the Community's steel industry has been declared in "manifest crisis." Internal and external measures are maintained to assist in an orderly reduction in production capacity. The internal measures consist of production quotas and target guide prices (supplemented by minimum prices) for a number of steel products, and regulations on state aids to the steel industry. The latter were strengthened in 1981 and aimed to eliminate operational subsidies by the end of 1984 and general aids by the end of 1985. Although the objective for capacity reduction (by 30-35 million tons) during 1980-85 was met and subsidies were cut, at the end of 1985 the Commission estimated that excess capacity still amounted to 25 million tons, or 17 percent of existing capacity.

Under a new regime for the steel industry for the two year period ended 1987, production quotas were lifted on steel products (coated sheet and reinforcing bar) accounting for 15 percent of output, and some flexibility provisions were built in the quotas to allow limited shifts

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1/ D.G. Tar and M.E. Morkre, "Aggregate Costs to the United States of Tariffs and Quotas on Imports," Bureau of Economics Staff Report to the U.S. Federal Trade Commission, December 1984.

between products; 1/ in addition, the Commission was authorized to allocate supplementary quotas to firms that could prove hardship under the quota system. 2/ Minimum prices were abolished, but the Commission continued to issue guide prices. State aids to companies that reduced capacity or closed plants 3/ continued to be permitted, in addition to aid for R and D and environmental protection.

At the end of 1987, the Commission estimated that some 30 million tons of capacity was in excess of the level justified by market prospects. Hence, production quotas were continued for the first six months of 1988, albeit for products covering only about half of production. 4/ Quotas for certain products were to be extended to the end of 1990 provided that undertakings were received by the Commission by June 1988 to close at least 75 percent of excess capacity. Social aid was increased for persons losing jobs as a result of the restructuring, mainly in the form of early retirement and assistance for new employment and retraining, and was to be financed out of levies on steel output. A program (RESIDER) to stimulate new economic activities and investment in regions adversely affected by restructuring of the steel industry was also introduced; the program cost amounted to ECUs 300 million for three years and was to be financed jointly by the European Regional Development Fund (i.e., the EC's common budget) and the member states.

Notwithstanding proposals to extend quotas, production quotas were discontinued for all categories of steel in June 1988. This was partly motivated by the belief that restructuring would occur more rapidly if left to market forces, and that quotas hindered competition (by

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1/ Production quotas did not apply to Spain and Portugal. The Spanish industry was also permitted to continue government aids for longer than the rest of the EC industry.

2/ As in the past, the Commission would only allocate 97 percent of output each quarter in proportion to pre-established reference quantities. Previously, the 3 percent margin was used primarily to encourage firms to close capacity rapidly, by allocating such firms a larger quota thereby allowing a more intensive use of existing capacity. Beginning 1986, this margin could be allocated to firms that had returned to competitiveness after a period in which they had lost market shares.

3/ Aid to companies was permitted in an amount equivalent to 50 percent of their payments to employees that are laid off or take early retirement.

4/ Steel makers with an output of less than 200,000 tons were excluded from the quota system. Products excluded from the quota regime were hot-rolled coil and coil-rolled sheet (categories la and lb), reversing mill plates (category II), and heavy sections (category III).

allocating quotas to efficient and inefficient producers alike) and discouraged rationalization by means of cross-border mergers. 1/ EC members with less efficient industries were in favor of continuing quotas while restructuring was underway; others were concerned that the elimination of quotas under conditions of continued subsidization by some members would distort trade within the EC. 2/

With regard to external measures, imports of steel from major suppliers have been regulated since 1978 through bilateral export restraint agreements. These agreements have been renewed annually with the majority of supplying countries, on the basis of expected domestic consumption and in reference to the 1980 import level. Under the arrangements, import volumes during 1981-85 were set 9 percent to 12.5 percent below the 1980 import level. In 1986, the arrangements aimed at limiting outside supplies to about 10 percent of internal consumption, while permitting a 3 percent increase in import volume over the previous year. 3/ The number of arrangements declined from 15 in 1984 to 12 at the end of April 1988 (including EFTA countries). 4/

Export restraint agreements have been complemented by a system of surveillance and import licenses, and the basic import price system that is applicable to nonagreement countries. The basic import price system sets floor prices which, if not observed, can trigger antidumping actions against the foreign supplier. (Antidumping duties have been applied against Mexico on this basis.) The EC announced in 1987 a revision of its official basic import prices: for most products the prices were lowered to reflect changes in production costs, stemming from cheaper raw materials and energy, and the depreciation of the U.S. dollar.

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1/ A joint company of Hoogovens, a Dutch producer, and Krupp, a German producer, had in fact split because of difficulties in dealing with the two governments and the EC quota administration.

2/ The Belgian, French, and Italian industries have made losses in recent years. In the United Kingdom, the industry is profitable but write-offs of large losses up to 1985 are considered by some observers as a continuing subsidy.

3/ Steel imports from certain EFTA countries (Austria, Finland, Norway, and Sweden) are covered by an exchange of letters of understanding (consulting arrangements), which are aligned with the EC's free trade agreements with EFTA and contain no ceilings for export volumes.

4/ Export restraint agreements were negotiated with Austria, Brazil, Bulgaria, Czechoslovakia, Finland, Hungary, Korea, Norway, Poland, Romania, Sweden, and Venezuela. Venezuela was included for the first time in 1987. Japanese exports to the EC were regulated by an exchange of letters in 1986. Among the countries which had been included in previous annual negotiations, Australia was dropped from the list because of the small size of its steel exports, and South Africa became, in any case, subject to economic sanctions by the EC.

Originally, it was intended to eliminate VERs and production quotas at the same time. Although production quotas have been eliminated, the VERs remain in place. The Commission has indicated that the EC is unlikely to dismantle VERs while world trade is essentially managed. In a market free of restrictions, the EC would likely encounter problems competing in the U.S. market with Argentina, Brazil, and Korea.

4. Canada

Canada's steel industry remains competitive in the world market as a result of major investments and modernization of plants in the last two decades. A substantial recovery in apparent consumption and crude steel production began in 1983; following a pause in 1985-86, the recovery continued in 1987. Exports began to recover in 1984 and the trend continued until 1987. In recent years, Canada has shipped 60 percent to 70 percent of its steel exports to the United States, while the latter supplies the major share of Canada's imports.

Canada has been concerned that some third-country suppliers have attempted to circumvent restrictions on steel exports to the United States by channelling shipments via Canada. In view of U.S. industry pressure for protection against increasing imports from Canada, the latter introduced rules of origin in October 1986 on all imports of iron and steel pipes and tubes. In order to prevent circumvention and to minimize the "diversion" of steel to Canada, following increased import restrictions in other markets, Canada progressively introduced an import/export monitoring system for carbon and specialty steel in 1986-87, under which import and/or export permits are required before any shipment can be cleared for delivery in or from Canada. Such permits, however, have been granted freely on request. In addition, the Canadian Import Tribunal began an investigation into the risks of diversion to Canada of foreign carbon steel and specialty steel products in 1986.

5. Australia

Faced with a sharp downturn in production, employment, and profitability in the domestic steel industry in the early 1980s, the Australian Government announced in August 1983 a five-year assistance package for the industry, commencing January 1, 1984. The main element was the introduction of sliding-scale bounties on four (later five) items produced and sold in the domestic market, representing about 26 percent of domestic production for this market. The ceiling on bounty payments was initially set at A$72 million a year, while those for individual bounties could be adjusted in line with domestic steel price movements. The bounties were complemented by a safety mechanism providing for a review of assistance needs if the local industry's share of the domestic market in eight specified product categories fell below 80 percent or rose above 90 percent. The assistance package also introduced general limits on imports of steel products from developing countries at preferential rates of duty; imports from these countries, exceeding the average volume of imports during the five years ended June 30, 1983, would attract general rates of duty. Finally, the package provided for the introduction of a "fast track" dumping mechanism for steel products.

The situation of the steel industry improved after 1983, but it is difficult to assess the extent to which this was related to the assistance package. It is probable that the main positive factor behind the industry's improved situation was the recovery of the Australian economy, combined with a sustained depreciation of the Australian dollar since the end of 1984. The bounties have contributed to the return to profitability of the industry, as they have helped create a more stable environment for producers and provided an additional 17 percent to 20 percent protection on high alloy and steel mill products (in a period when tariffs on high alloy and stainless steel were phased from 25 percent to 15 percent by April 1988). However, the only change in the scheme, owing to the triggering of the safety mechanism through deviation from target levels, has been the withdrawal of developing country preferential treatment for Brazil, Korea, and Taiwan Province of China for exports of hot-rolled steel strip and plates.

## III. Textiles and Clothing

### 1. Recent trade trends

World output of textiles and clothing has generally increased since 1982. In the industrial countries, production of textiles rose by 1/2 percent and 3 percent in 1985 and 1986, respectively; clothing production was stable in 1985 and increased by 2 percent in 1986. Employment in both the textile and clothing sectors declined steadily in all industrial countries (Table III.5). The decline was more pronounced in the textile sector which has adopted more capital-intensive production methods.

In the developing countries, output of textiles rose by 3 percent and an estimated 6 percent in 1985 and 1986, respectively, while that of clothing was stable in 1985 and increased by an estimated 8 percent in 1986. Buoyant consumer demand in the industrial countries, particularly in the EC, contributed to the expansion in 1986.

World exports of textiles (in U.S. dollars) expanded by 21 percent in 1986, in marked contrast to the stagnation of the previous year. 1/ In part, this reflected the depreciation of the dollar. The exports of both industrial and developing countries (including the centrally planned economies) grew roughly in line with world exports, resulting in unchanged market shares (65 percent for industrial countries).

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1/ Data in volume terms are not readily available.

World exports of clothing (in U.S. dollars) grew by about 4 percent in 1985 and 27 percent in 1986. Exports of industrial countries rose by 32 percent in 1986, with the result that their share in world exports increased to some 45 percent, compared with about 43 percent in 1985 (and about 56 percent in 1973). Their share in world imports of clothing rose in 1986 to about 85 percent. Clothing imports in 1986 rose strongly in the EC (45 percent), Japan (43 percent), EFTA (43 percent), Canada (19 percent), and the United States (15 percent) (Table III.6).

## 2. Multifibre Arrangement

Over the past 27 years, trade in textiles and clothing has been regulated under international agreements. Following the Short-Term Arrangement Regarding International Trade in Textiles (October 1961-September 1962), and the Long-Term Arrangement Regarding International Trade in Cotton Textiles (October 1962-73), the Multifibre Arrangement (MFA) came into existence as a "temporary" departure from normal GATT rules. The MFA's stated objectives are to achieve the expansion and progressive liberalization of world trade in textile products, while at the same time avoiding disruptive effects in individual markets and in individual lines of production in both importing and exporting countries. The original MFA (1974-78) was followed by MFA II (1978-81), extended by MFA III (1982-July 1986), and extended again in July 1986 by MFA IV (August 1986-July 1991). By early 1988, 39 participants had officially accepted the corresponding protocol of extension. 1/

The MFA envisages essentially two types of restrictions: (1) those under Article 3, which permit bilateral or unilateral restrictions as a result of market disruption, and (2) those under Article 4, which provide for bilateral agreements to eliminate the risks of market disruption. In effect, these Articles provide for a volume growth norm of at least 6 percent annually in export categories restricted under the MFA for more than one year. The MFA has "flexibility" provisions that permit switching between individual quota categories (swing), carryover of unutilized quota to the following year, or borrowing (carry forward) of next year's quota.

The 1986 protocol of extension of the MFA (commonly known as MFA IV) was originally opposed by most developing countries, which favored a return to GATT rules after the expiry of MFA III. These countries finally agreed to the extension as they became more sensitive to the risk that, in its absence, developed countries would resort both to safeguard actions under GATT Article XIX and probably to strong unilateral actions. Also, some suppliers became concerned that they might lose market shares if the MFA was terminated.

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1/ Including the 12 members of the EC as a single entity.

MFA IV widened the coverage of the Arrangement. Besides products from cotton, wool, and man-made fibers, it now includes those from other vegetable fibers, such as, ramie, sisal, and jute, and blends containing vegetable fibers and silk that are directly competitive with those that were already covered by the Arrangement. Further, under MFA IV, an importing country can prolong unilateral restrictions, which had been previously limited to a maximum duration of 12 months, for an additional 12 months without a new finding of market disruption. In contrast to these more restrictive provisions, MFA IV includes an understanding that bilateral agreements should provide for increased market access to imports in overall terms, and that exports from least developed countries, small suppliers, and new entrants should not be made subject to restraints. It also recognized that the existence of serious injury to domestic producers, or its threat, should not be based solely on the level or growth of imports but should be substantiated by relevant information on an identifiable segment of the domestic industry. However, as in MFA III, paragraph 10 of the protocol stipulates that any "mutually acceptable agreement" can be made between importers and their dominant suppliers. Finally, MFA IV also contains the objective of an eventual application of GATT rules to trade in textiles and clothing but does not specify a time limit for reaching it.

Restraints under the MFA have been applied almost exclusively to products from developing countries. Table III.7 lists the bilateral agreements in effect in early 1988 under Article 4 of the MFA; most of these were negotiated under the 1986 protocol of extension.

Although it is difficult to assess the overall impact that MFA IV might have on world trade in textiles and clothing, some indications in this regard are provided by recently concluded bilaterals. In most of the agreements signed by the United States, product coverage was expanded to include textiles and/or apparel of silk blends and other vegetable fibers; these represent a minor share of the U.S. imports of textiles, but a significant portion of imports of clothing (8.2 percent). Permissible import growth rates remained mostly unchanged with respect to previous agreements, but in the case of dominant suppliers, like Hong Kong and Korea, growth rates of less than 6 percent and more limited flexibility provisions as compared with other suppliers were negotiated under paragraph 10 of the 1986 protocol.

In the case of the European Community, product coverage in agreements concluded under MFA IV has remained unchanged and several restraints were terminated. Total EC restraints, including national subquotas, have been reduced by about 30 percent relative to those maintained under MFA III. 1/ Japan has continued its past practice of not imposing quantitative limitations under the MFA; however, the

1/ In the two-year period 1986-87, imports of textiles from MFA exporters rose by 54 percent in volume terms.

Japanese market is protected by a number of non-MFA export restraint arrangements, notably with China and Korea. 1/

Evidence suggests that the MFA has acted to reduce imports considerably below the level that would have occurred without it, but that it has nevertheless permitted additional inflows in response to economic factors, such as, exchange rate changes, domestic growth, or increased competitiveness of exporters. 2/ Thus, despite the MFA, developing countries have significantly increased their share of world exports of textiles and clothing over the last quarter of a century. A number of factors have contributed to this growth. First, numerous bilateral agreements under the aegis of the MFA have entailed monitoring rather than strict quota provisions; further, when quotas were in place, the "carryover" provisions have permitted temporary flexibility in response to changes in demand. Second, because the MFA tends to operate on the *volume rather than the value of imports, it introduces an incentive to* upgrade product quality; hence, the unit value of U.S. imports of textiles and apparel appears to have rapidly adjusted upward in the initial years of MFA II, as well as the beginning of MFA III. Third, quotas imposed on the major exporters have encouraged additional supplies from new entrants and nonrestrained producers.

Notwithstanding the above factors, the MFA has a restrictive effect. Two main methods have been used to quantify this impact. Under the first method, a number of studies have computed tariff equivalents of quotas. For the United States, the estimates range from 8.8 percent to 50 percent depending on product and country coverage, with a central value of 15 percent to 25 percent. 3/ The tariff equivalent of German quotas on men's and boy's shirts has been estimated at 54 percent. 4/ For Canada, estimates indicate that in the absence of quotas, landed prices would have been lower by 17 percent for outerwear and 25 percent for shirts. 5/ The above results are based on the hypothesis of perfectly elastic supply and may therefore be excessive. Estimates for the United Kingdom, which relax this assumption, suggest that abolishing the MFA would reduce the U.K. landed price of imports by only 5 percent to 10 percent. 6/

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1/ The GATT reports the existence of nine such arrangements in mid-1988; GATT, "Recent Developments in the Trading System," C/W/548, Geneva, 1988.

2/ W. R. Cline, "The Future of World Trade in Textiles and Apparel," Institute for International Economics, Washington, D.C., 1987.

2/ W. R. Cline, ibid.

4/ D. Spinanger and J. Zietz, "Managing Trade but Mangling the Consumer: Reflections on the EEC's and West Germany's Experience with the Multifibre Arrangement," Aussenwirtschaft 41.4, December 1986.

5/ G. P. Jenkins, "Costs and Consequences of the New Protectionism," North-South Institute, Ottawa, July 1980.

6/ Z. A. Silberston, "The Multifibre Arrangement and the UK Economy," Her Majesty's Stationary Office, London, 1984.

Under the second method, several studies have estimated import reductions and the associated welfare losses in importing countries due to MFA quotas. In the United States, imports were 26 percent to 44 percent below levels that would have been attained in the absence of quotas in 1978, 1/ while in Germany, the reduction in the 1980s was estimated at 30 percent. 2/ In terms of welfare, studies of shirt imports indicate a loss equivalent to 14 percent to 20 percent of the import value of shirts in the United States, and of 19 percent to 27 percent of import value in the case of Germany. 3/ Part of these losses constitute "rents" received by the more advanced developing countries; it is estimated that the annual transfer from OECD countries to exporters of textiles and clothing in the newly industrializing economies of Asia is at least US$2 billion. 4/

3. Other protective measures

Tariffs on textiles and clothing differ widely among industrial countries. In the EC market, most-favored-nation (MFN) duties are 15 percent or less, with half of the imports entering at a maximum rate of 10 percent. A similar situation exists in Sweden and Switzerland. In Japan, in 1984 nearly 40 percent of textile and clothing imports were duty free; the other 60 percent were covered by duties below 25 percent, for the most part less than 15 percent. Tariffs are somewhat higher in a number of other countries. More than half the tariff lines in Austria, Canada, Finland, Norway, and the United States carry duties in excess of 15 percent. The markets of the industrial country members of the MFA are also protected by a significant number of non-MFA voluntary export restraint arrangements. The GATT reports that these numbered 71 in mid-1988, compared with 28 in September 1977, directed exclusively against the exports of developing and Eastern European economies. 5/

Australia participated in MFA I, but not in subsequent MFAs, while New Zealand has never participated in the MFA. As in the case of other developed countries, tariffs on textiles and clothing in these countries are significantly higher than on other goods and tend to escalate with the stage of production: tariffs are lower than 20 percent on fibers, yarns, and fabrics, but on clothing tariffs average 50 percent in Australia and 96 percent in New Zealand. Australia also maintains a system of tariff quotas, which are being gradually phased out and replaced with tariffs, while New Zealand's imports of textiles and

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1/ D. G. Tarr and M. E. Morkre, ibid.

2/ J. Zietz, "Some Econometric Evidence of the Impact of the Multifibre Agreement on the German Clothing Industry," Kiel, Working Paper No. 238 (August 1985), quoted in D. Spinanger and J. Zietz, ibid.

3/ D. Spinanger and J. Zietz, ibid.

4/ OECD, Costs and Benefits of Protection, (Paris, 1985).

5/ GATT, 1988, op. cit.

clothing are subject to import licensing procedures, normally in the context of global quotas. Recently substantial tariff cuts were announced by Australia.

A detailed picture of protection levels in developing countries is not available. Partial information on textiles and clothing shows that protection in a number of these countries is fairly high in terms of tariffs as well as nontariff measures. 1/ In the early 1980s, Brazil, Egypt, India, Morocco, and Pakistan applied average tariff rates in excess of 75 percent on their imports of textiles and clothing, while rates in Argentina, Korea, and Mexico were in the 30 percent to 40 percent range. However, Hong Kong, Macao, and Singapore (with the exception of a low tariff on clothing) allow imports free of duty.

With respect to nontariff measures, Singapore has no GATT-notified restrictions while Korea, Malaysia, Sri Lanka, and Thailand have only a small number of such restrictions. However, other developing countries have a relatively large number of these barriers. Nonautomatic import licensing is the most frequently used measure, particularly in Argentina, Bangladesh, Brazil, Columbia, Peru, and Tunisia. A number of developing countries maintain these restrictions under the GATT's balance of payments provisions, to which they have easier and more frequent resort than industrial countries.

A comparison of nontariff measures in industrial countries and in developing countries 2/ shows that for clothing, their frequency in both groups of countries is in the 50 percent to 60 percent range. A number of industrial countries are of the view that it would be easier to liberalize trade in textiles and clothing, including the dismantling of the MFA, if the higher value added products of the industrial countries in this sector had improved access to developing country markets, and if greater protection of intellectual property rights was guaranteed by the latter countries.

Claims that protection of textiles and clothing is needed to provide time to adjust is questionable for a number of reasons. First, declining employment in these sectors in the industrial countries has been largely due to productivity growth, with imports playing a comparatively minor role. Second, these sectors are not submitted to pressures common to steel and shipbuilding where industrial country consumption has declined in real terms. Third, in the case of textiles, a number of industrial countries have become competitive, largely due to the growing capital intensity of the sector. Thus, in 1986, Germany, Italy, and Japan were the world's largest exporters of textiles. Finally, in the clothing sector, with the exception of "high-fashion" goods in which

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

2/ UNCTAD/UNDP, "Trade Control Measures and Developing Country Trade," UNCTAD/ECDC/TA/21, March 2, 1988, p.34.

some industrial countries hold a comparative advantage, comparative advantage has shifted away from industrial to developing economies. This shift reflects the fact that the clothing sector does not lend itself to automation and returns to scale. Trade protection hinders the adjustment necessary to adapt to this shift in market conditions. The above factors also undercut claims by a number of developing countries that protection is required for "infant industry" reasons.

Claims that protection is required for social reasons have also lost force. Although production and employment in the textile and clothing sectors is important in some regions, it has declined to such an extent that the evolution of this sector no longer has a significant effect on overall economic activity in industrial countries. In this context, regional problems can be better dealt with by other policies that do not distort trade.

Trade in textiles and clothing is an issue in the Uruguay Round of multilateral trade negotiations (see Annex I).

4. United States

Clothing imports, which account for some three quarters of total imports of textiles and clothing in the United States, increased in 1985 and 1986 by 11 percent and 15 percent, respectively, reflecting the continued strength of consumer demand. Similarly, imports of textiles grew by 8 percent and 18 percent in 1985 and 1986, respectively. The trade deficit for textiles and clothing rose to US$18 billion in 1985, and to US$21 billion in 1986; some 86 percent of these deficits were attributable to trade in clothing.

Pressures for protection have remained strong, in part due to the increasing trade deficits. Following the President's veto in 1985 of a bill restricting textiles and apparel, a new bill was introduced in early 1987, "The Textile and Apparel Act of 1987," which remains before Congress. It provides for comprehensive global quotas on imports of textiles and clothing (as well as footwear) based on actual 1986 volumes. 1/ The EC has declared that it will retaliate if the bill is enacted, and might also introduce new restrictions on textile and

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1/ Under the bill, the level of quotas would be constrained to grow at 2 percent annually in textiles and apparel (with the footwear quota frozen at the 1986 level). The inclusion of industrial country suppliers indicates not only concern about import growth from these countries but also an attempt, on behalf of the proponents of the bill, to neutralize charges in previous legislative efforts that the new protection would discriminate against developing countries. The bill seeks to deal with the risk of retaliation by providing that suppliers will be provided compensation for the new protection in the form of lower tariffs on textiles and clothing.

clothing imports into the EC to avoid possible diversion of trade from the United States to the EC market.

The United States maintains 30 bilateral agreements under Article 4 of the MFA (Table III.7) and 12 agreements with nonsignatories to the MFA.

5. European Community

Following a strong increase in consumer demand, expenditure on clothing in the EC rose in real terms by 1.5 percent in 1985 and 3 percent in 1986. Although this was accompanied by modest increases in production, imports grew rapidly in nominal terms in 1986, with the result that the combined trade balance for textiles and clothing recorded a deficit of US$850 million in 1986 after a surplus of almost US$900 million in 1985. Protectionist pressures, which had abated in 1985, have resurfaced.

The EC maintains 20 bilateral agreements under Article 4 of the MFA. In addition, it has eight export restraint agreements with Mediterranean developing countries in the context of overall cooperation agreements. It also has a consultation agreement with one signatory to the MFA and has negotiated export restraints with eight nonsignatories to the MFA. Furthermore, the markets of both Germany and the United Kingdom are protected by Turkish export restraints.

## IV. Automobiles

1. Recent trade trends

World automobile production was virtually stagnant in 1986, compared with an average annual growth of some 7 percent during 1983-85. This slowdown was mainly due to a decrease in apparent automobile consumption in the United States and Canada (of 1.6 percent and 6.3 percent, respectively) which led to declines of 2.9 percent and 3.8 percent, respectively, in production in these two countries. Production remained stable in Japan in 1986, in contrast to the 3 percent to 7 percent growth recorded in 1984-85. Production rose by about 5 percent in the European Community in 1986, in response to a strong increase in apparent consumption (9 percent) (Table III.8). Industrial countries account for more than 90 percent of world automobile production.

The volume of world trade of automobiles and automotive parts is estimated to have increased by 2.5 percent in 1986. The value of such trade (in U.S. dollar terms) rose by 23 percent in 1986, the strongest increase of the last ten years.

Industrial countries' exports of automobiles were stable in volume terms in 1986, with Japan and Canada both experiencing a 2 percent decline and the United States exporting approximately the same number of vehicles as in 1985. The European Community's exports rose by about 2 percent, mainly due to a strong increase (22 percent) in Italian car exports.

In value terms, exports of industrial countries of automobiles and parts rose by about 24 percent to US$200.5 billion in 1986 (Table III.9). Exports of the Community (including EC intratrade) increased by close to 30 percent, and Japan's exports to the United States increased by 38 percent, mainly in categories not subject to export restraints. In contrast, U.S. exports decreased by 4 percent and Canadian exports increased by only 2 percent. Japan, the world's largest exporter, expanded its share of industrial country exports from 24 percent in 1983 to 27 percent in 1986. Exports of developing countries rose by 3.5 percent, as a rapid expansion of exports of Korea and Mexico (which grew by 133 percent and 37 percent, respectively) more than compensated for the 20 percent decline in Brazil's exports.

A prominent feature of the world automobile industry in recent years has been the strong and continuing expansion of foreign investment by Japanese motor companies, first in North America and in developing countries, and subsequently in Western Europe. Protection against Japanese exports as well as the appreciation of the yen since 1985 have played a role in stimulating such investments. Such investment is likely to result in a decline in Japanese exports to the United States and Western Europe as Japanese production increases in those markets and as exports rise from Japanese companies in developing countries.

## 2. United States 1/

During the four-year period March 1981 to March 1985, discriminatory trade restrictions were maintained in the automobile sector, in the form of "voluntary" restraints (requested by the United States) on exports of passenger cars to the United States from Japan. The restraints were maintained against the background of severe difficulties faced by the U.S. automobile industry. In March 1985, following a turnaround in consumer demand and an improvement in the financial situation of the automobile industry, the United States announced that it would not seek a further extension of the "voluntary" restraints. However, the Japanese government decided to impose a ceiling of 2.3 million units (a 24 percent increase over the 1984 ceiling) for two additional years to March 1987. The ceiling was subsequently extended for the fiscal years ending March 1988 and March 1989, even though it was not reached during the year 1987-88.

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1/ The U.S.-Canada Automotive Agreement of 1965 and the effects of the U.S.-Canada Free Trade Agreement are covered in the section on Canada.

The financial position of the U.S. automobile industry has improved substantially in recent years. Owing to the "voluntary" restraints, the Japanese share of the U.S. car market, which had peaked at 22.6 percent in 1982, decreased to 18.3 percent in 1984 and was contained to 20.1 percent and 20.7 percent in 1985 and 1986, respectively, after the ceiling was adjusted upward. The U.S. car industry was thus able to take advantage of the growth of consumer demand in 1983-85, with the result that there was an increase in domestic production, capacity utilization, and employment. Production of passenger cars reached 8.2 million units in 1985, and employment (which had fallen to 699,000 in 1982) recovered to 876,000 by 1985. Simultaneously, losses of the U.S. automobile industry on U.S. operations were replaced by profits which reached US$10 billion in 1984 and about US$6.8 billion in 1985.

Since 1986, however, the impact of the "voluntary" export restraints has declined. First, the Japanese authorities increased the ceiling by 24 percent in 1985. Second, penetration of non-Japanese foreign cars and foreign investment in the United States increased strongly in a period of stable consumer demand. Passenger car production declined by 4.9 percent to 7.8 million units in 1986, while the foreign share of the U.S. market rose to 28.3 percent (compared with 25.7 percent in 1985). Employment fell in 1986 to 843,000 and profits declined to US$5.6 billion. Investment in automobile plants and equipment remained high in 1986 and was expected to increase in 1987.

The competiveness of the U.S. automobile industry vis-à-vis foreign producers improved significantly in 1987 due to the depreciation of the U.S. dollar. Prior to that, competitiveness was affected in part by relatively high labor costs in this sector; in 1986, hourly compensation in the U.S. motor vehicle industry was still more than twice that of Japan. The Japanese cost advantage in producing a subcompact model in 1984 was estimated at US$1,500 to US$2,500. One study 1/ estimated that the cost differential should be eliminated at an exchange rate of about ¥ 150 to the U.S. dollar. The effects of exchange rate changes were only progressively incorporated in foreign car stickers, but are expected to be fully incorporated in 1988 in favor of domestic producers.

The decline of the dollar and the regular extension of the "voluntary" restraints have encouraged investment by Japanese firms in the United States. In 1986, such plants accounted for some 5 percent of the total U.S. passenger car production against only 2.7 percent in 1984. The total annual capacity of Japanese-owned assembly plants in the United States is projected to reach at least 1.4 million units in

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1/ A. Aizcorbe, C. Winston, and A. Friedlander, "Cost Competitiveness of the U.S. Automobile Industry" in W. Clifford, et al, "Blind Intersection? Policy and the Automobile Industry" (Brookings; Washington, D.C., 1987).

1989, 1/ or more than 10 percent of domestic production. Some analysts argue that this internationalization of the motor vehicle industry will be irreversible as the U.S.-based production of Japanese models will erode consumer brand preference for American cars; they contend that from a long-term, competitive viewpoint, U.S. producers would have been in a more favorable position if trade restraints had not encouraged Japanese investment. 2/

3. European Community

Imports of automobiles from Japan into the EC are subject to formal or informal restrictions or equivalent measures, at the individual member level, or the Community level, or both. These restrictions have prompted Japanese companies to move into the upscale European market--an effect similar to that observed in the United States--and to increase direct investment in the EC. This investment is likely to increase in order to take advantage of the single European market. 3/ Such investments are subject to local content rules.

At the national level, Italy has imposed an annual quantitative limit on imports of Japanese passenger cars since 1956; the limit is currently fixed at 3,425 units (about 0.2 percent of total annual sales in Italy). Japanese imports are also restrained in France at about 3 percent of the domestic market since the end of the 1970s, and in the United Kingdom (11 percent of the market) since 1980. Export restraints are also applied to exports to Spain and Portugal. Overall, 63 percent of the EC market (excluding Community-wide restraints in this sector) operates under quota restraints, whether "voluntarily" agreed or unilaterally imposed.

At the Community level, surveillance has been exercised on imports of certain motor vehicles originating in Japan since early 1981. In 1983, a three-year agreement called for moderation in the growth of Japanese automobile exports to the Community, without a specific limit. In 1987, following record passenger car shipments during the first five months of the year, Japan stated that it intended to hold the increase in car sales to the EC in 1987 to 10 percent of the 1986 level. Despite renewed pressure for Community-wide controls, the Commission announced that it would not impose additional external

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1/ Japan Economic Institute, "The U.S. Automobile Parts Market and the Japanese Competition," JEI Report IIA, March 20, 1987.

2/ F. Mannering and W. Clifford, "U.S. Automobile Market Demand," Blind Intersection? Policy and the Automobile Industry (Brookings: Washington, D.C., 1987).

3/ Nissan currently has a factory in North-East England which aims to produce 200,000 cars by 1992. In accordance with an agreement between the U.K. Government and Nissan, it was to increase local content to 60 percent by 1988 and to 80 percent by 1992. Mitsubishi and Toyota are also considering setting up operations in the EC.

restraints. Japanese motor manufacturers indicated recently that their exports to the Community in 1988 would be limited to 1.21 million cars and commercial vehicles, representing a 3.2 percent increase over shipments in 1987.

State aids also provide some support to the EC automobile industry (see Supplement 1). In principle, state aids are prohibited. The Commission has authority to grant certain exemptions, however, if such aid does not distort trade and production within the Community. Certain exemptions that have been granted may, in practice, distort trade within the EC and in relation to non-EC countries.

In recent years, the Commission has made greater use of existing competition rules to eliminate state aids and ensure that such aids are not substituted for technical and other barriers that will be eliminated by 1992. In the automobile industry, this policy resulted in reductions of U.K. aid for Leyland trucks and in regional assistance in Germany for Daimler-Benz. 1/ In a recent case, however, the Commission agreed to an injection of FF 12 billion (consisting of FF 8 billion of equity and FF 4 billion of debt write-offs) by the French Government in Renault, provided that Renault was transformed from a Régie (under which its debt is guaranteed by the government) to a state-owned company subject to common commercial rules. A proposal by the United Kingdom to inject £800 million into Rover (which has received £3.8 billion of state aid since 1976) prior to its takeover by British Aerospace was initially blocked on the grounds that it contravened EC competition rules; it was subsequently accepted when the aid package was reduced to £470 million.

As part of the process to complete the internal market by 1992, the EC aims to create a single market for automobiles. Such a market will enable manufactures to take greater advantage of economies of scale and will likely encourage greater foreign investment as well as some concentration of the sector. Several issues must be settled before the single market in this sector is completed. First, substantial differences in indirect taxes on motor vehicles exist across the Community. Currently, manufacturers attempt to offset these differences by applying lower prices in high-tax markets. This has provided incentives for the purchase of cars in high-tax countries for shipment elsewhere, with possible trade distorting effects. While tax differentials have been narrowed to some extent in recent years, significant differences remain. Second, the harmonization of technical standards has not yet been completed because the standards proposed by the Commission for tires, safety glass, weight, and dimensions pose difficulties for France. Third, the elimination of national import restrictions is encountering strong resistance from producers, and might be difficult to achieve, given disparities in national levels of protection and in competitiveness among EC members.

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1/ Germany argued that its aid to Daimler-Benz had characteristics of regional aid.

Resistance to the elimination of national restrictions has raised concerns that national restrictions might be replaced by tighter EC-wide restrictions. In this context, automobile producers in a number of EC member states have stated that the lifting of restrictions was dependent on two conditions: (i) a reduction of Japanese sales in the European market to their average level prevailing in 1985/86 (about 10 percent of the EC market), and (ii) an increase in access for the EC automobile industry to 5 percent of the Japanese market, compared with just over 2 percent in 1987. In the latter respect, EC member countries believe that access to the Japanese market is restricted by the distribution system; by the indirect tax system which discriminates against large cars; and by technical barriers (standards, testing, and certification procedures). Some progress has been made in reducing technical barriers as a result of bilateral discussions between the EC and Japan in which Japan agreed to adopt international or EC-wide standards, where such standards exist. Further progress is held up partly by lack of EC-wide standards in a number of areas. The Japanese Government has proposed a tax reform plan, which replaces the commodity excise tax system with a new consumption tax system under which all automobiles are taxed at the same rate. The new tax system, if adopted, will mitigate the criticism against the current tax system.

## 4. Canada

The Canadian automobile trade policy has the following five main elements.

First, under the U.S.-Canada Automotive Agreement of 1965, duty free access is available to car manufacturers for new cars and parts for their production. The agreement requires manufacturers to produce finished automobiles in Canada that are at least equal in total value to the value of automobiles sold in Canada, thereby guaranteeing an important level of employment to Canadian workers. Also, under a "letter of intent," it is agreed that at least 60 percent by value of the parts in qualifying automobiles should be made in Canada. Currently, manufacturers from other countries can qualify for trade under the auto-pact; Volvo, for instance, currently operates in Canada under the terms of the pact. The U.S.-Canada Free Trade Agreement will limit the benefits of the auto-pact to foreign companies already benefiting from the scheme. 1/

Second, under the Free Trade Agremeent the prohibition on the import of used vehicles (excluding cars of the current model year) will be abolished. This is likely to help reduce the incentive for differential pricing by manufacturers on cars sold domestically and across the border.

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1/ It also provided for the phasing out or elimination of duty remission schemes which had previously augmented the benefits of the auto-pact to foreign manufacturers.

Third, between 1982 and 1985, export restraints limited Japanese car exports to about 18 percent of the Canadian market. These were partly intended to avoid diversion of Japanese exports from the United States to the Canadian market. Since 1985, Japanese car export to Canada are "monitored" by Japan and Canada. Since 1986, Korea has exercised "prudence" in its export of passenger cars to Canada; an indicative ceiling limits these exports to 10,000 units per annum. Hyundai's share of the Canadian passenger car market declined from 7 percent in 1985 to 6.4 percent in 1986 and 1987.

Fourth, a tariff--9.9 percent in 1986--is levied on most car imports not qualifying under the U.S.-Canada auto-pact. The duty free treatment applied in the past to imports from developing countries was replaced by a 7 percent levy applied on auto parts (in May 1985) and on automobiles (in January 1987). This tariff will be progressively phased out on trade between the United States and Canada under the Free Trade Agreement.

Fifth, in order to provide an incentive for automobile producers to locate investments in Canada, the Canadian authorities had established a program for export- and production-based duty remissions. In the case of export-based duty remissions, duty paid on imports of cars by foreign firms is refunded provided the same firm exports automotive parts from Canada to the United States or elsewhere. These remissions are considered by the United States to constitute export subsidies; under the Free Trade Agreement, they are expected to be eliminated beginning 1989. In the case of production-based duty remissions, duty paid on imports of cars by foreign firms is refunded provided certain production targets are met. Under the Free Trade Agreement these will be eliminated by 1995.

5. Costs of protection

Studies on the costs of restrictions imposed by countries on automobile imports from Japan include a special OECD study (1987) 1/ covering Canada, France, the United Kingdom, and the United States; a 1985 USITC study 2/ on the United States, as well as other studies.

The results of the OECD study are summarized in Table III.10. The study notes that the restrictive measures have resulted in losses for

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1/ OECD, The Costs of Restricting Imports - The Automobile Industry, (Paris, 1987).

2/ United States International Trade Commission, "A Review of Recent Developments in the U.S. Automobile Industry Including an Assessment of the Japanese Voluntary Restraint Agreements," Preliminary Report to the Subcommittee on Trade, Committee on Ways and Means of the U.S. House of Representatives, in connection with investigation No. 332-188, USITC publication 1648, Washington, D.C., February 1985.

consumers in the four countries, while the short-term benefits to domestic industry and employment were at best modest. The long-term effects on the protected economies were negative, due to distortion in investment patterns and possible delays in structural adjustment by U.S. and European producers. Also, productivity increases in Europe and North America, although resulting for a large part from Japanese investments, would likely have been achieved at a faster rate had competition not been mitigated by protection. Furthermore, protection may have encouraged concentration in the protected markets, with a risk that cooperation may have replaced competition among firms in the protected sector.

Other studies also show that the VERs on Japanese exports to the United States had a significant impact on automobile prices, entailed major costs to the consumer, and saved a relatively limited number of jobs; but the estimated effects differ substantially due to differences in assumptions. Estimates of the overall cost to consumers range from US$6.6 billion (assuming a competitive domestic market) to US$14 billion (assuming some degree of imperfect competition). 1/ The estimates for the increase in profits in 1985 due to VERs range from US$550 million to US$1,290 million in the OECD study; other studies give substantially higher estimates for 1984. (The latter are more in line with profits of US$8.9 billion made by domestic producers in 1984.) Estimates of employment gains due to the VER vary between jobs, from 20,000 to 35,000 (OECD), 44,000 (USITC), and 40,000-75,000 (Fund staff studies). These figures do not include possible gains in employment in steel and other supply industries as a result of the VERs, but they also exclude possible losses in employment in other sectors of the economy.

In Canada too, VERs were estimated to have resulted in higher automobile prices, but these increases were mitigated to some extent, by the availability of substantial import substitutes from Germany and Korea. Consequently, the increase in Japanese car import prices due to the restraints, although significant, was limited to between 8 percent and 14 percent in 1985. Under the assumption of a competitive domestic market, the OECD study estimated the gain in output to North American car producers at 22,000 cars, the cost to consumers at Can$199 million, and the increase in employment at 880 jobs; thus, the cost of each job to the consumer was close to Can$200,000. Under the assumption of a strongly oligopolistic market, the estimated cost of the VER to Canadian consumers more than quadruples to Can$913 million. In this respect,

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1/ R.W. Crandall, "The Effects of the U.S. Trade Protection for Autos and Steel," in Brookings Papers on Economic Activity, 1987, Vol. 1, pp. 277-288; C. Collyns and S. Dunaway, "The Cost of Trade Restraints: The Case of Japanese Automobile Exports to the United States," IMF Staff Papers, March 1987, Vol. 34, No. 1; and F. Mannering and W. Clifford, "The Economic Effect of Voluntary Export Restrictions," Blind Intersection? Policy and the Automobile Industry (Brookings; Washington, D.C., 1987).

comments in the study concerning the effect of the auto-pact are noteworthy: the limitation of the auto-pact benefit to manufacturers is considered to be partly responsible for imperfect competition in the Canadian market, as evidenced by the fact that Canadian prices for automobiles are not directly related to their actual costs. The observed deviations between prices of similar products in Canada and in the United States result from differences in emission control equipment, limits on large-scale arbitration by retail and franchise contracts, and a prohibition of used car imports into Canada.

In France, the impact of the VER was also estimated to be substantial, although it was limited by the substitution of cars imported without restriction from other EC members for Japanese vehicles. The OECD study assumed that the restraint had been binding since the early 1980s, but a more recent study, 1/ found that the restraint only became binding in 1984. Thus, the increase in Japanese prices between 1981 and 1983 was apparently motivated by quality upgrading. From 1984 on, the prices of Japanese imports were higher than they would have been in the absence of the VER; the consumer loss was limited to FF 320 million; the increase in French production due to the restraint was 5,000 units to 10,000 units and only 300 jobs were saved.

In the United Kingdom, the OECD study found that the VER had effects similar to those reported for other countries. However, a number of other factors could have contributed to the high level of U.K. car prices. 2/ Multinational producers have long had a large share in the U.K. industry, and their pricing behavior is not determined solely by their production costs in the United Kingdom. The penetration of European producers is very significant and the price increases observed in Japanese car imports are similar to those of their European competitors. The impact of the VER on the structure of the U.K. automobile industry may have been wider than indicated by the estimates in Table III.10. According to the OECD study, the large inroads the Japanese would have made in the absence of the VER would probably have led to the bankruptcy of British Leyland; however, mismanagement and failure of the 1975 restructuring plan may well have been avoided had competitive pressures been maintained. The direct costs to consumers, while difficult to estimate, were likely to have been substantial, given that several cash injections were necessary to support British Leyland and Chrysler U.K. between 1975 and 1986.

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1/ J. Melo and P. Messerlin, "Effects of Europlan VERs on Japanese Autos," Working Paper No. 21, The World Bank, June 1988.

2/ M. W. Ashworth, et al., Differentials in Car Prices in the U.K. and Belgium (Institute for Fiscal Studies, 1982); Greenaway and Hindley. What Britain Pays for Voluntary Export Restraints, (Trade Policy Research Center, 1985); G. Rhys, "The Impact of VERs" University of Cardiff Discussion Paper, 1985, quoted in OECD The Costs and Benefits of Protection, (Paris, 1985).

## V. Shipbuilding

### 1. Recent trade trends

The shipbuilding sector has suffered from overcapacity since the second half of the 1970s. Although world trade volumes recovered since the international recession following the oil shocks, this has not been accompanied by an increase in world seaborne trade. Hence, demand for new ships has remained low and the competition for available orders has been intense. World production and prices have been depressed in recent years. In 1987, production fell by 18 percent to 9.9 million gross register tons (GRT), equivalent to slightly over half the level of production in 1976 (Table III.11). Total new orders also continued their declining trend in 1987 (Table III.12).

As a result of shifts in comparative advantage, Japan, Korea, and other new suppliers from developing countries have improved their competitive positions compared with traditional producers in Western Europe. The share of the European Community in total world production has declined sharply, from about 31 percent in 1976 to 19 percent in 1987. The share of Japan, the world's leading producer, has fluctuated between 37 percent and 47 percent of world production during 1976-87, while that of non-OECD countries has more than doubled (from 13 percent in 1976 to 32 percent in 1987). Among the latter countries, Korea witnessed a dramatic expansion in production over the past decade, and is currently the second largest producer in the world.

The shipbuilding sector is characterized by extensive government subsidies and aid programs. This is the chief means of support for this sector, as there are few trade restrictions, given the difficulty of implementing border measures.

Under the auspices of the OECD Working Party on Shipbuilding, industrial countries are coordinating their efforts to modernize operations, reduce installed capacity, promote structural adjustment, and reduce and rationalize government aids to this sector. OECD guidelines aim to gradually reduce aid measures which distort trade and discourage capacity adjustment, such as, national aids, subsidized export credits, and discriminatory procurement practices.

Over the period 1976-86, physical capacities have been reduced by 50 percent to 60 percent in the EC and the Nordic countries, and by 35 percent in Japan (in terms of compensated gross tons). Notwithstanding these efforts, capacity in OECD countries remains excessive under current depressed market conditions. Overproduction of ships has also depressed freight rates.

Although the short-term outlook for this sector is not considered bright, it is generally believed that demand for ships may revive in the early 1990s, as a number of commercial fleets are due for replacement. Even so, the world order book may rise to only slightly above half of the 1976 level. Moreover, given the volatility of the oil market, forecasts of market prospects are fraught with uncertainty.

2. European Community

The Community's shipbuilding sector has had to adapt to reduced demand, intense international competition, and changing technology. Despite the sharp fall in capacity and employment that has taken place over the past decade, the Community's shipbuilding industry continues to face severe problems. The Community recognizes that these problems are structural rather than conjunctural, and that there is a need to further reduce overcapacity; however, the Community considers that this cannot be done too rapidly for social reasons, as shipbuilding is the only industry in some regions. Hence, state aids are permitted, subject to Community directives.

The European Commission has estimated that a further reduction of capacity, by one third from its 1985 level, is required, implying a greater than commensurate decline in employment as productivity improves. Such a reduction would enable the remaining installations to operate at 70 percent of available capacity during 1987-90, with the possibility of resuming an 80 percent capacity utilization rate thereafter. The Commission has forecast a loss of more than 30,000 jobs in the shipbuilding sector before the end of 1990.

The Community has also attempted to rationalize and reduce government aids to shipbuilding. The Fifth Directive on aid to shipbuilding (1981-86) established a Community discipline on direct and indirect state aids. It was aimed at preventing distortions in competition which may result from uncontrolled state intervention, and ensuring that public aid supports restructuring. Implementation of this Directive succeeded in rationalizing aids and making them digressive, but full transparency was not achieved, particularly for indirect aids such as aid to shipowners.

The Community's Sixth Directive (1987-90) on aid to shipbuilding uses a market-based approach to bring about the desired restructuring and reduction in capacity. This policy is designed to induce shipyards to adapt to market requirements, and to bring about a concentration of shipbuilding in the most viable yards, with a production mix oriented toward specialty ships with an advanced technological and engineering content. Toward this end, government aid is limited to 28 percent of the contract value. The ceiling includes all direct and indirect aids but excludes development assistance (in the form of grants, loans, and mixed credits); as to export credits, only the margin below the OECD consensus rate is counted against the ceiling. In the determination of the ceiling, account is taken of the extent of the gap between international prices and the costs of the most competitive firms in the Community. The ceiling is to be reviewed annually, and is expected to be reduced over time as Community shipyards become internationally competitive. State aid to investment may be granted only in support of restructuring plans that reduce capacity. Aid may be used to defray the cost of closure, such as, payments to redundant workers or yard redevelopment, but it must be commensurate with the extent of restructuring. The Commission expects that shipyards that are lagging in adapting to market conditions cannot be kept going on heavy government subsidies under the new policy.

The Commission recognizes that the implementation of the new directive will cause substantial difficulties for areas that are heavily reliant on shipbuilding and that have already suffered shipyard closures. The Commission proposed in July 1987 a program to help develop new job opportunities in these areas. It has also proposed Community financial support for national measures for the benefit of workers made redundant by restructuring; such assistance could take the form of early retirement or retraining assistance.

The Community has also emphasized that the success of its new approach on state aid will also depend on cooperation on the part of Japan and Korea to contain capacity and refrain from expanding their shares in the world shipbuilding market. In view of the continuing crisis in the shipbuilding sector, the Commission adopted in March 1988 the broad outline of an external policy for shipbuilding. This aims to re-establish a healthy international market by seeking, in conjunction with the main producing countries, the stabilization of trade, equitable reduction of capacity, normal prices, and transparency in prices, support and financing. The Commission is engaged in exploratory talks on these matters with Japan and Korea, and will subsequently seek formal negotiating directives from the EC Council. The aim is to arrive at a "sectoral arrangement on production" by the end of 1988; this is intended to be backed up by measures to restore prices to a level which will help cover operating costs of Community shipyards and enable a reduction in aids and capacities.

If the proposed arrangements do not materialize, the Commission will consider introducing a mechanism for a levy on every loading or unloading in a Community port of a ship purchased from Japan or Korea, provided that the ship was sold at "abnormal" prices (i.e., on general conditions of sale which are prejudicial to the Community shipyards).

## 3. Japan

For the Japanese shipbuilding industry, 1987 was a difficult year owing to the severe recession in this sector. New orders dropped by 15 percent in 1987, following a steady decline in the past several years. The short-term prospects do not appear encouraging.

In order to rationalize the industry, Japanese shipbuilders adopted adjustment programs to reduce capacity from 9.8 million compensated gross register tons (CGRT) in 1972 to 7.2 million CGRT in 1985, and to monitor the operation of shipyards with the help of ceilings on production. Despite these efforts, Japan's shipbuilding industry continues to suffer from a structural recession due to a number of factors. These include the continued sluggish trend in seaborne traffic of main cargoes, a resultant decline in ship demand, the rise of new competitors, particularly Korea, and the decline in competitiveness as a result of the appreciation of the yen.

The Council for Rationalization of Shipping and Shipbuilding Industries, an advisory panel to Japan's Ministry of Transport, advocated closing surplus shipbuilding facilities and restructuring the industry, which is currently affected by fragmentation and overcompetition. Toward these ends, the Council recommended reducing berths or docks by at least 20 percent of installed capacity, and integrating businesses through capital, business, and other tie-ups. On the basis of these recommendations, the Government promulgated a management stabilization law in April 1987. Under this law, more than 20 percent of installed capacity is to be scrapped, and some medium-sized shipbuilding companies with only one berth or dock are to withdraw from the shipbuilding business entirely. The Government announced support for these measures in the form of provision of loan guarantees and purchase facilities. As a result, a reduction of capacity by 24 percent (in terms of compensated gross tons) was made in the year following the promulgation of the guidelines.

In addition to seven major builders, there are 44 firms in Japan equipped with docks capable of constructing vessels of more than 5,000 tons. With a view to encouraging reorganization among shipbuilders and cuts in their surplus capacities, Japan's Fair Trade Commission authorized formation of a "cartel" of the 33 top ranking Japanese yards. This was intended to help limit production in fiscal year 1987 to 3.3 million CGRT, and in fiscal year 1988 to 3.1 million CGRT, or about half of construction capacity.

The appreciation of the yen and competition from Korea are exacting considerable pressures on Japanese builders. In the past, they had occasionally accepted foreign orders at very low profit margins or below costs in order to keep their yards operating, but the appreciation of the yen has made it difficult to continue this practice. The Shipbuilders Association of Japan has estimated that the break-even point for its members is around ¥ 200 per U.S. dollar.

4. Korea

In the past decade, Korea has rapidly built up its shipbuilding sector, and currently is the the second largest shipbuilding country in the world. Korea has enjoyed a significant price advantage due to both low labor costs and an efficient steel industry. In the 1980s, Korea's shipbuilding industry, which is heavily dependent on export production, has suffered a slowdown due to the long-term recession in the world marine transportation industry. In 1986 the industry began to show signs of recovery as new orders increased substantially. The increase was due mainly to a shift in demand away from Japanese-made ships following the rapid appreciation of the yen. According to a study made by the Korean Development Board, the yen's appreciation has given Korean-made ships a 25 percent price advantage over ships built in Japan. 1/ The expansion in orders is mainly due to orders for tankers, as shipowners have recently been taking advantage of the very low shipbuilding prices to meet the rising demand.

In 1987 new orders declined somewhat, but they were still higher than in 1985, and there was some improvement in prices. Despite the upswing in the past two years, the Korean shipbuilding industry faces a number of problems. These include increasing labor disputes and a deterioration in the financial position of shipbuilding companies: at end-1986 the industry's debt stood at US$105 million. A problem of a structural nature is the concentration of production on lower value ships. Technologically, Korea remains far behind Japan, its main competitor, because technological transfers have been limited, and Korea's own R and D activities have not been sufficient to fill the gap. Also, Korea's industry is heavily dependent on imported intermediate goods; since most of these come from Japan, the appreciation of the yen has not been wholly beneficial. Moreover, lower wage countries, such as, Brazil, China, Taiwan Province of China, and perhaps India, may well become major competitors in the 1990s.

The EC has been concerned about possible subsidization and dumping by Korean shipbuilding firms; while there is little concrete evidence of such practices, the concern is related to a lack of transparency of the Korean shipbuilding industry due partly to the nature of the industry's ownership structure. Some of Korea's shipyards are owned by conglomerates which also own banks and other manufacturing establishments. In some cases, a breakdown of group turnover is not available. In an industry beset with international price wars, Korea's low prices have been a source of considerable competitive pressure on OECD members, and have sometimes generated suspicions of dumping.

In November 1986, OECD Working Party No. 6 of the Council on Shipbuilding established a liaison arrangement with Korea for the exchange of information. The Community has increased contacts with Korea (and Japan) to evaluate market trends. Pursuant to an agreement two years ago with Japan, Korea has undertaken to end installation of new capacity in exchange for receipt of technological know-how.

## VI. Electronics

### 1. Recent trade trends

The share of electronic products in total world trade in manufactures has increased steadily from 8 percent in 1980 to 11.5 percent

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1/ Quoted in Korea Exchange Bank, Monthly Review, November 1987.

in 1986. World exports of electronic products expanded by nearly 21 percent to US$164 billion in 1986, due in part to exchange rate and price developments. Led by continued growth in demand for automatic data processing equipment, which includes computers, the industrial countries' exports of electronic products increased in 1986 by almost 21 percent to US$131.5 billion (Table III.13). At this level they constituted 12 percent of their total exports of manufactures. Exports from the European Community and Japan grew by some 28 percent and 25 percent, respectively, while U.S. exports expanded by about 6 percent. The exports of the four major developing economies in Asia--Hong Kong, Korea, Singapore, and Taiwan Province of China--grew by 33 percent, and these countries gained significant market shares, especially in standardized consumer electronic products.

The imports of electronic products by industrial countries rose by about 21 percent in 1986 to almost US$126 billion. Of these imports, the EC accounted for nearly one half, the United States for about one third, and Japan for somewhat less than 4 percent. The EC share is large because its imports are concentrated in the fast growing area of automatic data processing equipment, whereas those of Japan and the United States are diversified. Imports by the four major Asian developing economies grew by about 31 percent, in part because of significant increases in imports by Korea and Taiwan Province of China of computers and electronic parts. 1/

A characteristic of the sector is that many countries perceive elements of it, particularly microelectronics, to be of strategic importance to their economies, with the result that government intervention to support national producers has increased. 2/ Thus, the EC and the governments of France, Germany, Japan, the United Kingdom, and the United States have undertaken funding of projects in microelectronics; state support for the electronics industry is also important among such developing country producers as Brazil and Korea. Further, the use of export restraint arrangements has grown, notably in the areas of consumer electronics and numerically controlled machine tools.

Trade disputes in the electronics sector have increased. The most prominent of these disputes gave rise to a finding of dumping by the U.S. International Trade Commission (USITC) against a number of Japanese semiconductor producers. Antidumping duties were not imposed, with the matter being initially resolved by the conclusion of the Japan-U.S. Arrangement Concerning Trade in Semi-Conductor Products in September 1986.

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1/ GATT, International Trade, 1986-87 (Geneva, 1987).

2/ A discussion of the pros and cons of strategic intervention is given in the companion paper, "The Industrial Policies of Industrial Countries and their Effects on Developing Countries."

Under the terms of the arrangement, Japan was to: (a) improve access to its domestic market for foreign semiconductor producers on a most-favored-nation basis; and (b) prevent sales of Japanese semiconductors at less than fair value, both in the United States and in third countries. However, U.S. complaints continued, focusing on charges of Japanese dumping in third markets as well as on the perceived slow liberalization of the Japanese market. This led the U.S. Administration to impose, in April 1987, a 100 percent ad valorem tariff on US$300 million of U.S. imports of certain electronic products from Japan. Subsequently, in June and November 1987, the duties were rescinded on US$136 million of these imports because, in the U.S. view, Japanese companies had eliminated their "unfairly low pricing" of certain semiconductors in global markets.

The EC contested the conformity of elements of the arrangement with GATT rules. A GATT dispute panel was established in April 1987 to investigate the EC complaint and concluded, inter alia, that the arrangement entailed restrictions, through the Japanese implementation of price monitoring, on exports to non-U.S. markets that were inconsistent with the GATT. The GATT Council of Representatives adopted the panel's report in May 1988, and Japan has undertaken to implement its recommendations concerning third-country market monitoring.

2. United States

In July 1987, Korea restricted shipments to the U.S. market of several electronic products, including video-cassette recorders and color and black and white television sets. Korea announced that the measure was initiated in response to sensitivities in the United States, resulting from the debate over trade legislation. With respect to machine tools, including numerically controlled machine centers and punching machines, Japan and Taiwan Province of China agreed to limit their exports to the United States for a five-year period beginning in January 1987. In the absence of similar agreements with Germany and Switzerland, the United States has announced that it would monitor their machine tool exports to the United States, and that the President would be prepared to take unilateral action under U.S. trade law if limits in excess of those consistent with national security are exceeded.

In November 1987, the United States announced that it would retaliate against a wide range of Brazilian exports unless Brazil reconsidered its 1984 ban on foreign companies from the Brazilian computer market when the product has an equivalent manufacture in Brazil. Subsequently, following proposed Brazilian regulations to liberalize access to its computer market, the U.S. decision on retaliation was postponed.

In 1988, the U.S. Congress included in the Department of Defense Authorization Bill a US$100 million grant to a consortium to conduct research and development on advanced semiconductor manufacturing techniques. It is expected that the consortium will complete its work in 1993 and that it will receive annual aid of US$100 million. Also, in the area of semiconductors, a U.S. company recently concluded a licensing agreement with a Korean manufacturer of data storage chips, after the USITC had found patent infringement by the Korean firm and had proposed an import ban on its product. The President rejected the ban, partly on the grounds that it would have required all importers of items containing data storage chips to determine the type and source of the chips in the product; instead, he proposed a ban covering a narrower range of products.

The United States maintains, for national security reasons, certain restrictions on the exportation and transfer of high technology to certain destinations.

### 3. European Community

In 1984, the Community launched the 10-year ESPRIT program to promote increased cooperation in research and development between electronic industries, universities, and research laboratories in EC member states. The program has a first five-year budget of ECU 1.5 billion, half of which is provided by the Community. The EC also funds an ECU 0.5 billion project to set common EC standards for segments of the telecommunications industry. There are several initiatives by member states, including a French plan to strengthen research in its electronics sector, a DM 500 million program on microelectronics applications, and an advanced information technology research plan in the United Kingdom.

In mid-1988, some 19 arrangements limited exports of electronic products, including certain machine tools, to the EC or its member states, compared with nine such arrangements in early 1985, 1/ suggesting that pressures for protection in the area remain high. Japan monitors its exports of numerically controlled lathes and machine centers as well as color television sets and tubes to the Community market and it limits its exports of video tape recorders to that market to 1.7 million units a year. Korea restrains its exports of video cassette recorders to the EC to 1985 volume levels, or below, while the Community conducts a posteriori surveillance on its imports of Korean video tape recorders. In addition, a number of individual member states separately protect their markets; for example, imports of color television sets from Japan to France are limited to 84,000 units per annum.

In April 1988, the EC imposed antidumping duties on certain electronic typewriters and scales made by Japanese affiliated EC-based companies substantially using parts imported from Japan. The duties were imposed under the June 1987 EC extension of its antidumping legislation to include the products of assembly (screwdriver) plants,

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1/ GATT, "Developments in the Trading System," various issues, Geneva.

which the EC claims were set-up to circumvent existing antidumping duties. In this instance, the Community had imposed antidumping duties in 1985 on imports of some Japanese typewriters and scales. Japan has protested the duties in the GATT Committee on Antidumping Practices (see Annex I and Supplement 1). The Community maintains antidumping duties on imports of certain Japanese photocopiers and has recently initiated antidumping investigations on some Japanese semiconductors, on certain cellular mobile radio telephones from Canada and Japan, and on Korean television sets and tubes, microwave ovens, and video tape recorders.

4. Japan

Recent government-funded initiatives to promote research and development in the Japanese electronics sector include (with the duration of the programs in brackets) the Supercomputer Project (1982-90), the Optoelectronics Project (1980-91), and the New Function Elements Project (1982-89). Total funding for the projects by the Japanese Ministry of International Trade and Industry is estimated at ¥ 66 billion. The results of the projects, in which the leading Japanese manufacturers participate and cooperate, become the property of the government and can be made available on a nondiscriminatory basis to other Japanese and foreign firms. 1/ In addition to research funding, producers in Japan, including locally based foreign firms, are eligible for loans from the Japan Development Bank.

Some countries suggest that Japan has "targeted" the electronics sector, particularly by concentrating resources, at the Government's direction, in order to gain dominance in certain markets, especially semiconductors. Japan's response is that the role of government is largely consultative and mainly limited to fostering research and development, as is the practice in a number of other countries, and to creating an environment conducive to vigorous private sector activity. It is also sometimes thought that Japan prices its electronic products according to expected long-run costs; these costs, once economies of scale are in place, are likely to be lower than present costs. Partly as a result of this, a number of dumping investigations and duties, as noted above, have been undertaken on Japanese products by the EC and the United States. 2/

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1/ OECD, The Semi-Conductor Industry: Trade Related Issues, Paris, 1985.

2/ On the matter of dumping, see "The Industrial Policies of Industrial Countries and their Effects on Developing Countries."

## VII. Footwear

### 1. United States

Between 1983 and 1986, U.S. footwear consumption volume increased rapidly, by an average of 9 percent per year. This high growth rate was entirely accommodated by imports, which grew on average by more than 17 percent a year. Domestic production, faced with cost-efficient competition from developing countries, declined by more than 10 percent per year during the same period. In 1987, consumption and production decreased moderately, while imports remained stable in volume terms. Indications are that, due to the depreciation of the dollar, imports would decline sharply in 1988 while domestic production would increase. Korea and Taiwan Province of China are the two largest suppliers, and since 1983 their share in total imports is close to 60 percent. Other important suppliers are Brazil and Italy. China increased its share from almost nil in 1981 to 5 percent in 1987.

The penetration of foreign producers in the U.S. market is mostly a result of the large, long-standing gap between costs of imported and domestic footwear. However, the vulnerability of the domestic industry increased in the first half of the 1980s owing to the appreciation of the dollar, and to the removal of protection granted in the past. After the expiration of the orderly marketing arrangements with Korea and Taiwan Province of China in 1981, countervailing duty orders on imports from Brazil, India, and Spain were revoked in 1983. In that year, as well as in 1984, the industry petitions for import relief were rejected. In 1985, following the 1984 Trade and Tariff Act modification of the Section 201 of the 1974 Trade Act, the USITC instituted another escape clause investigation, and subsequently recommended a five-year quota on imports of nonrubber footwear. The Federal Trade Commission estimated that the quota would save 26,000 to 30,000 jobs at a cost of US$50,000 to US$80,000 per job while the average annual wage in the sector was about US$14,000. On this basis, it recommended adjustment assistance rather than import restrictions. In addition, the European Community and other trading partners threatened to retaliate against the proposed quotas. In view of these factors, the President refused to impose quotas or other trade restraints on footwear, but instead authorized the development of an adjustment and retraining program for workers in the shoe manufacturing industry. In 1986 and 1987, the industry lobbied for the approval of a Textile and Trade Act aimed at a freeze of nonrubber footwear, but could not obtain its passage. However, Korea is said to have applied a restraint on its exports to the United States in 1987.

### 2. European Community

The Community's apparent consumption of footwear grew slowly in volume terms during 1983-85, but production and exports increased, and import penetration was contained around 35 percent (Table III.14). Employment decreased to 291,000 jobs in 1985 from 311,000 jobs in 1983.

Buoyant domestic demand and the depreciation of the U.S. dollar brought a reversal of these trends in 1986 and 1987. The increase in consumption (4 percent in 1986 and 6 percent in 1987) was entirely satisfied by imports which surged by 41 percent in the two-year period, and brought the import penetration to over 42 percent in 1987. Production declined in 1986-87 due to the reduced competitiveness of EC manufacturers relative to East Asian competitors, and exports dropped by about 25 percent over the two years. Portugal and Spain were less adversely affected than other Community members because their producers were fairly competitive and were still benefiting from their new access to EC markets. In 1986, the main economies exporting footwear to the EC were Austria, Brazil, China, Korea, and Taiwan Province of China.

The deteriorating trade trends strongly increased protectionist pressures in the EC, and led to a multiplication of requests for safeguard measures. France and Italy, soon followed by Greece and the United Kingdom, requested the Community's authorization to impose restrictions on footwear imports. In the view of the EC, an undervalued Korean exchange rate was a major cause of the difficulties faced by the Community's footwear industry. The lack of homogeneity of the footwear industry within the EC was also a factor; Italy, for instance, has 9,000 companies, all of medium or small size, presently operating in the leather and footwear industry. Although the Commission was attempting via its SPRINT and BRITE research programs to encourage automation, the restructuring process was complicated. Consequently, the Community allowed Italy to impose quantitative restrictions on imports from Korea and Taiwan Province of China, conditional on the industry improving its structure with the introduction of new technologies. France was authorized to abstain from applying Community treatment to footwear originating from Taiwan Province of China. The legislation permitting restrospective control of imports of footwear into the Community from state trading countries and China was extended at the end of 1987 for one more year.

A series of VERs were also agreed. Korea, with whom some industry-to-industry arrangements had existed since 1982, agreed to limit its exports of shoes to Italy to 12.6 million pairs in 1988, with a 5 percent annual growth in its exports until June 1990. Taiwan Province of China entered into gentlemen's agreements with France and the United Kingdom for the period 1985-87. Previously, China had agreed to a voluntary limit of its exports of slippers and sandals to France. The European Commission expected that these national restrictions would be replaced by EC-wide safeguard measures as the internal market was opened.

The Community's exports face barriers in third countries: Japan, for example, imposes a tariff quota of 3 million pairs, with a within-quota duty of 20 percent. Counterfeiting of finished products and of the design of molds used in shoe manufacture is also frequently encountered by French, German, and Italian manufacturers. Competition in third markets, particularly the United States, is becoming fiercer with the development of EC manufacturers' investments in Indonesia, Korea, and Thailand, and with the multiplication of joint ventures with Asian competitors.

3. Canada

From 1977 to 1985, Canada maintained global quotas on imports of certain footwear. Following the recommendation of the Canadian Antidumping Tribunal, the Government ended import quotas effective November 30, 1985, on all categories of shoes, except women's and girls' dress shoes and casual footwear. On these items, quotas are being phased out over a three-year period, starting December 1, 1985, by increasing the quota level by 6 percent, 8 percent, and 10 percent, respectively, per year. However, Korea and Taiwan Province of China are at present maintaining unilateral export restraints, which have probably contributed to avoid a surge of imports in recent years. Italy and Spain rejected the notion of export restraints.

4. Australia

Since the beginning of the 1970s, Australian imports of footwear have been regulated by import licensing schemes. These were replaced in 1980 by tariff quotas sold, in part, by tender. In 1982, a seven-year assistance program for the textiles, clothing, and footwear sectors was introduced. It allowed for a modest amount of trade liberalization through an annual expansion of the quota greater than the market expansion.

In 1986, a new seven-year plan for textiles, clothing, and footwear, to begin March 1, 1989, was announced. It provided for the phasing out of the import quota system by 1996 through a gradual reduction in the rate of penalty applying to imports outside quota. The rate of duty applying to within-quota imports would be increased for footwear to 50 percent, for footwear components to 40 percent, and for clothing to 60 percent. These rates would apply once the plan makes quotas redundant in March 1996. At the same time, the plan provided for the progressive sale of quota by ad valorem tender so that by March 1, 1992, all quotas would be allocated in that manner. These measures will be accompanied by four programs at a total cost of US$120 million over the period. They aim at developing the textiles, clothing, and footwear industries by encouraging raw materials processing, raising industry efficiency, enhancing the skill base of workers, and promoting exports. Measures designed to assist retraining of workers and regional assistance measures are also included in the plan. However, owing to a decision made recently by the Australian Government to reduce tariffs across-the-board, the textile, clothing and footwear plan will be modified, with lower tariff end points for clothing and footwear.

# VIII. Civil Aircraft

## 1. Recent trade trends

World trade in civil aircraft is strongly cyclical: after increasing from 197 units in 1976 to 754 in 1979, orders for new commercial jet aircraft declined sharply until 1982 when they reached 87 units. New orders recovered during 1983-85 to around 300 units per year, and jumped in 1986 to 724 orders. Trade was mostly concentrated in three companies: Boeing, whose market share has declined to 50-60 percent, from 70 percent on average during the period before 1980; McDonnell Douglas, which lost market share in the 1970s but regained about 30 percent in the 1980s; and Airbus Industrie, which only entered the market in the mid-1970s, but quickly reached a 15-25 percent share (Table III.15). Owing to the aging of several airline fleets, current orders for civil aircraft are large. The division of these orders among the three major producers will likely affect the industry for the next several years.

Airbus Industrie is a consortium formed in 1966 by France, Germany, Spain, and the United Kingdom, and involving one company from each country, viz., Aerospatiale, Messerschmitt-Boelkow-Blohm, British Aerospace, and Construcciones Aeronauticas. Its success, and later the pressures that its development implied for other market participants, generated a debate between the United States and the European Community concerning support provided by the European governments, its funding, the subsidy element of its export credits, and, more generally, the rules that should govern trade in civil aircraft. These issues were abated after agreement on some guiding principles for trade in civil aircraft was reached in 1979 during the Tokyo Round negotiations. The debate was revived in 1987 with the development of new generations of commercial jetliners and greater pressure resulting from competition for new orders.

## 2. The institutional framework

Trade in civil aircraft is governed by the 1979 Agreement on Trade in Civil Aircraft signed on the occasion of the Tokyo Round. While recognizing the specific characteristics of trade in civil aircraft and its importance as a component of economic and industrial policy, the agreement aims to (i) achieve maximum freedom of trade in civil aircraft, parts, and related equipment, and (ii) eliminate adverse trade effects of government support of such activities. The main provisions of the agreement are as follows. First, all customs duties and other charges levied on civil aircraft in the course of their manufacture, repair, maintenance, modification, or conversion are to be eliminated. Second, it attempts to lay the basis for the regulation of state intervention in the civil aircraft industry through three articles. Article 3 states that the provisions of the Agreement on Technical Barriers to trade apply to trade in civil aircraft. Article 4 stipulates that "purchasers of civil aircraft should be free to select suppliers on the basis of commercial and technological factors." Further, signatories are prohibited from applying "unreasonable pressures" on airlines or others engaged in the purchase of civil aircraft to purchase them from any particular source which would discriminate against foreign suppliers. Article 6 of the agreement states that while special factors should be taken into account in the aircraft sector, the provisions of the GATT Agreement on Subsidies and Countervailing Measures are applicable. Finally, Article 8 established a Committee on Trade in Civil Aircraft, which is responsible for reviewing the implementation and the operation of the agreement. In 1981, an addendum to the OECD consensus on export credits was signed by France, Germany, the United Kingdom, and the United States to raise the minimum interest rate charged for government loans in support of commercial aircraft exports to 12 percent and limit loan terms to ten years.

3. The Airbus dispute

In March 1987 the United States, after unsuccessful bilateral discussions with the European Community, filed a complaint to the GATT Committee on Trade in Civil Aircraft on the grounds that Airbus Industrie had since its creation received US$10 billion subsidies and that these subsidies had allowed the company to sell below competitive prices. European countries argued that support had been provided to Airbus Industrie in the form of "reimbursable advances," repayment of which depended on the sales realized. However, figures for reimbursable advances were considered confidential. They also added that Airbus competitors had received indirect aid from the U.S. Government in the form of defense contracts and research and development support; the total subsidies received by U.S. companies were estimated by an Airbus Industrie study to be US$23 billion. The United States, for its part, claimed that the EC also provided indirect support for Airbus.

Outside observers made various comments on the role of subsidies in Airbus development and on the justification for such subsidies. It was pointed out 1/ that Airbus' initial success was due in large measure to the fact that the original A300 series (aircraft designed specifically to fly medium to short hauls) had, at the time of their launching, filled a void and, in comparison with other models, involved limited exploitation costs. Moreover, the act of subsidizing Airbus was defended by some economists on the grounds of efficiency, because its existence was necessary to avoid the inefficiencies otherwise likely to prevail should the market be reduced to a duopoly.

Multilateral discussions by the GATT Committee on Trade in Civil Aircraft failed to resolve the dispute because participants could not reach a common understanding of the 1979 Agreement, in particular concerning the appropriate use of subsidies. Discussions subsequently

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1/ B.A. Majumdar, "Upstart or Flying Start? The Rise of Airbus Industry," The World Economy, Vol. 10, No. 4, Oxford, December 1987.

resumed among representatives of the United States, the European Community and the four states, following a ministerial meeting in October 1987 which provided a mandate for the parties involved to define disciplines on the role of government support in aircraft production, and to formulate rules concerning transparency to ensure that disciplines are enforced. Following a second ministerial meeting in March 1988, an agreement was close to being reached on the following points: future government aid to Airbus would be granted only for research and development and not for production; negotiations should encompass direct and indirect aid; any final agreement would include a clause allowing governments to step in with assistance when companies faced unforeseeable financial troubles; a consultation method would be set up and other countries would be invited to adhere to the final U.S.-EC accord. The unresolved areas comprised the terms and conditions of government support, the degree of transparency for direct and indirect support, and commercial business practices to be considered acceptable. Recently another major point of disagreement emerged. Owing to the depreciation of the U.S. dollar, in which aircraft are invoiced, a proposal referred to as the "dollar clause" has been made by European governments which would allow these governments to compensate Airbus Industrie for losses due to exchange rate changes. The United States has opposed this proposal because it would, in effect, insulate Airbus Industrie from market forces.

Other developments may affect the outcome of the negotiations. Recently the consortium partners have decided to restructure Airbus management and to improve the transparency in its operations by a holding company which will own the four European companies' facilities presently used by the consortium, and will have a supervisory board, a global accounting system, and an independent financial department. The possibility of collaboration between Airbus and McDonnell Douglas on a long-range airliner project and of some sourcing of Airbus in the United States is also being discussed. Such collaboration might defuse possible disputes between McDonnell Douglas and Airbus that could result from the small market in which the MD11 (presently being developed by McDonnell Douglas) and the A340 (presently being developed by Airbus) will soon compete. The European Commission also unveiled plans to spend ECU 60 million on subsidizing cross border collaborative research in aircraft technology between 1989 and 1991. These plans, however, were met with reservations by some European countries, for fear they may appear as new Airbus subsidies. Finally, discussions between the German Government and Daimler Benz, which may buy Messerschmitt-Boelkow-Blohm if protection is provided against future Airbus losses related to exchange rate variations, have highlighted the importance of the "dollar clause."

PRESS COMMUNIQUÉ
RELEASE DE PRESSE
GENERAL AGREEMENT ON TARIFFS AND TRADE
ACCORD GÉNÉRAL SUR LES TARIFS DOUANIERS ET LE COMMERCE

CENTRE WILLIAM-RAPPARD, 154, RUE DE LAUSANNE, 1211 GENÈVE 21, TÉL. 022 310231

Text as received from Punta del Este

GATT/1396
25 September 1986

MINISTERIAL DECLARATION ON THE URUGUAY ROUND

Ministers, meeting on the occasion of the Special Session of CONTRACTING PARTIES at Punta del Este, have decided to launch Multilateral Trade Negotiations (The Uruguay Round). To this end, they have adopted the following Declaration. The multilateral trade negotiations (MTN) will be open to the participation of countries as indicated in Parts I and II of this Declaration. A Trade Negotiations Committee (TNC) is established to carry out the negotiations. The Trade Negotiations Committee shall hold its first meeting not later than 31 October 1986. It shall meet as appropriate at Ministerial level. The Multilateral Trade Negotiations will be concluded within four years.

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ATTACHMENT

## PART I

## NEGOTIATIONS ON TRADE IN GOODS

The CONTRACTING PARTIES meeting at Ministerial level

DETERMINED to halt and reverse protectionism and to remove distortions to trade

DETERMINED also to preserve the basic principles and to further the objectives of the GATT

DETERMINED also to develop a more open, viable and durable multilateral trading system

CONVINCED that such action would promote growth and development

MINDFUL of the negative effects of prolonged financial and monetary instability in the world economy, the indebtedness of a large number of less-developed contracting parties, and considering the linkage between trade, money, finance and development

DECIDE to enter into Multilateral Trade Negotiations on trade in goods within the framework and under the aegis of the General Agreement on Tariffs and Trade.

### A. OBJECTIVES

Negotiations shall aim to:

(i) bring about further liberalization and expansion of world trade to the benefit of all countries, especially less-developed contracting parties, including the improvement of access to markets by the reduction and elimination of tariffs, quantitative restrictions and other non-tariff measures and obstacles;

(ii) strengthen the rôle of GATT, improve the multilateral trading system based on the principles and rules of the GATT and bring about a wider coverage of world trade under agreed, effective and enforceable multilateral disciplines;

(iii) increase the responsiveness of the GATT system to the evolving international economic environment, through facilitating necessary structural adjustment, enhancing the relationship of the GATT with the relevant international organizations and taking account of changes in trade patterns and prospects,

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including the growing importance of trade in high-technology products, serious difficulties in commodity markets and the importance of an improved trading environment providing, inter alia, for the ability of indebted countries to meet their financial obligations;

(iv) foster concurrent co-operative action at the national and international levels to strengthen the interrelationship between trade policies and other economic policies affecting growth and development, and to contribute towards continued, effective and determined efforts to improve the functioning of the international monetary system and the flow of financial and real investment resources to developing countries.

## B. GENERAL PRINCIPLES GOVERNING NEGOTIATIONS

(i) Negotiations shall be conducted in a transparent manner, and consistent with the objectives and commitments agreed in this Declaration and with the principles of the General Agreement in order to ensure mutual advantage and increased benefits to all participants.

(ii) The launching, the conduct and the implementation of the outcome of the negotiations shall be treated as parts of a single undertaking. However, agreements reached at an early stage may be implemented on a provisional or a definitive basis by agreement prior to the formal conclusion of the negotiations. Early agreements shall be taken into account in assessing the overall balance of the negotiations.

(iii) Balanced concessions should be sought within broad trading areas and subjects to be negotiated in order to avoid unwarranted cross-sectoral demands.

(iv) CONTRACTING PARTIES agree that the principle of differential and more favourable treatment embodied in Part IV and other relevant provisions of the General Agreement and in the Decision of the CONTRACTING PARTIES of 28 November 1979 on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries applies to the negotiations. In the implementation of standstill and rollback, particular care should be given to avoiding disruptive effects on the trade of less-developed contracting parties.

(v) The developed countries do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of developing countries, i.e. the developed countries do not expect the developing countries, in the course of trade negotiations, to

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make contributions which are inconsistent with their individual development, financial and trade needs. Developed contracting parties shall therefore not seek, neither shall less-developed contracting parties be required to make, concessions that are inconsistent with the latter's development, financial and trade needs.

(vi) Less-developed contracting parties expect that their capacity to make contributions or negotiated concessions or take other mutually agreed action under the provisions and procedures of the General Agreement would improve with the progressive development of their economies and improvement in their trade situation and they would accordingly expect to participate more fully in the framework of rights and obligations under the General Agreement.

(vii) Special attention shall be given to the particular situation and problems of the least-developed countries and to the need to encourage positive measures to facilitate expansion of their trading opportunities. Expeditious implementation of the relevant provisions of the 1982 Ministerial Declaration concerning the least-developed countries shall also be given appropriate attention.

## C. STANDSTILL AND ROLLBACK

Commencing immediately and continuing until the formal completion of the negotiations, each participant agrees to apply the following commitments:

### Standstill

(i) not to take any trade restrictive or distorting measure inconsistent with the provisions of the General Agreement or the Instruments negotiated within the framework of GATT or under its auspices;

(ii) not to take any trade restrictive or distorting measure in the legitimate exercise of its GATT rights, that would go beyond that which is necessary to remedy specific situations, as provided for in the General Agreement and the Instruments referred to in (i) above;

(iii) not to take any trade measures in such a manner as to improve its negotiating positions.

### Rollback

(i) that all trade restrictive or distorting measures inconsistent with the provisions of the General Agreement or Instruments negotiated within the framework of GATT or under its auspices, shall be phased out or brought into conformity within an agreed timeframe not later than by the date of the formal completion of the negotiations, taking into account multilateral agreements, undertakings and understandings, including strengthened rules and disciplines, reached in pursuance of the objectives of the negotiations;

(ii) there shall be progressive implementation of this commitment on an equitable basis in consultations among participants concerned, including all affected participants. This commitment shall take account of the concerns expressed by any participant about measures directly affecting its trade interests;

(iii) there shall be no GATT concessions requested for the elimination of these measures.

Surveillance of standstill and rollback

Each participant agrees that the implementation of these commitments on standstill and rollback shall be subject to multilateral surveillance so as to ensure that these commitments are being met. The Trade Negotiations Committee will decide on the appropriate mechanisms to carry out the surveillance, including periodic reviews and evaluations. Any participant may bring to the attention of the appropriate surveillance mechanism any actions or omissions it believes to be relevant to the fulfilment of these commitments. These notifications should be addressed to the GATT secretariat which may also provide further relevant information.

## D. SUBJECTS FOR NEGOTIATIONS

Tariffs

Negotiations shall aim, by appropriate methods, to reduce or, as appropriate, eliminate tariffs including the reduction or elimination of high tariffs and tariff escalation. Emphasis shall be given to the expansion of the scope of tariff concessions among all participants.

Non-tariff measures

Negotiations shall aim to reduce or eliminate non-tariff measures, including quantitative restrictions, without prejudice to any action to be taken in fulfilment of the rollback commitments.

Tropical products

Negotiations shall aim at the fullest liberalization of trade in tropical products, including in their processed and semi-processed forms

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and shall cover both tariff and all non-tariff measures affecting trade in these products.

CONTRACTING PARTIES recognize the importance of trade in tropical products to a large number of less-developed contracting parties and agree that negotiations in this area shall receive special attention, including the timing of the negotiations and the implementation of the results as provided for in B(ii).

Natural resource-based products

Negotiations shall aim to achieve the fullest liberalization of trade in natural resource-based products, including in their processed and semi-processed forms. The negotiations shall aim to reduce or eliminate tariff and non-tariff measures, including tariff escalation.

Textiles and clothing

Negotiations in the area of textiles and clothing shall aim to formulate modalities that would permit the eventual integration of this sector into GATT on the basis of strengthened GATT rules and disciplines, thereby also contributing to the objective of further liberalization of trade.

Agriculture

CONTRACTING PARTIES agree that there is an urgent need to bring more discipline and predictability to world agricultural trade by correcting and preventing restrictions and distortions including those related to structural surpluses so as to reduce the uncertainty, imbalances and instability in world agricultural markets.

Negotiations shall aim to achieve greater liberalization of trade in agriculture and bring all measures affecting import access and export competition under strengthened and more operationally effective GATT rules and disciplines, taking into account the general principles governing the negotiations, by:

(i) improving market access through, inter alia, the reduction of import barriers;

(ii) improving the competitive environment by increasing discipline on the use of all direct and indirect subsidies and other measures affecting directly or indirectly agricultural trade, including the phased reduction of their negative effects and dealing with their causes;

(iii) minimizing the adverse effects that sanitary and phytosanitary regulations and barriers can have on trade in agriculture, taking into account the relevant international agreements.

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In order to achieve the above objectives, the negotiating group having primary responsibility for all aspects of agriculture will use the Recommendations adopted by the CONTRACTING PARTIES at their Fortieth Session, which were developed in accordance with the GATT 1982 Ministerial Programme and take account of the approaches suggested in the work of the Committee on Trade in Agriculture without prejudice to other alternatives that might achieve the objectives of the negotiations.

GATT Articles

Participants shall review existing GATT Articles, provisions and disciplines as requested by interested contracting parties, and, as appropriate, undertake negotiations.

Safeguards

(i) A comprehensive agreement on safeguards is of particular importance to the strengthening of the GATT system and to progress in the MTNs.

(ii) The agreement on safeguards:

- shall be based on the basic principles of the General Agreement;
- shall contain, inter alia, the following elements: transparency, coverage, objective criteria for action including the concept of serious injury or threat thereof, temporary nature, degressivity and structural adjustment, compensation and retaliation, notifications, consultation, multilateral surveillance and dispute settlement; and
- shall clarify and reinforce the disciplines of the General Agreement and should apply to all contracting parties.

MTN Agreements and Arrangements

Negotiations shall aim to improve, clarify, or expand, as appropriate, agreements and arrangements negotiated in the Tokyo Round of Multilateral Negotiations.

Subsidies and countervailing measures

Negotiations on subsidies and countervailing measures shall be based on a review of Articles VI and XVI and the MTN agreement on subsidies and countervailing measures with the objective of improving GATT disciplines relating to all subsidies and countervailing measures that affect international trade. A negotiating group will be established to deal with these issues.

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Dispute settlement

In order to ensure prompt and effective resolution of disputes to the benefit of all contracting parties, negotiations shall aim to improve and strengthen the rules and the procedures of the dispute settlement process, while recognizing the contribution that would be made by more effective and enforceable GATT rules and disciplines. Negotiations shall include the development of adequate arrangements for overseeing and monitoring of the procedures that would facilitate compliance with adopted recommendations.

Trade-related aspects of intellectual property rights, including trade in counterfeit goods

In order to reduce the distortions and impediments to international trade, and taking into account the need to promote effective and adequate protection of intellectual property rights, and to ensure that measures and procedures to enforce intellectual property rights do not themselves become barriers to legitimate trade, the negotiations shall aim to clarify GATT provisions and elaborate as appropriate new rules and disciplines.

Negotiations shall 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 shall be without prejudice to other complementary initiatives that may be taken in the World Intellectual Property Organization and elsewhere to deal with these matters.

Trade-related investment measures

Following an examination of the operation of GATT Articles related to the trade restrictive and distorting effects of investment measures, negotiations should elaborate, as appropriate, further provisions that may be necessary to avoid such adverse effects on trade.

## E. FUNCTIONING OF THE GATT SYSTEM

Negotiations shall aim to develop understandings and arrangements:

(i) to enhance the surveillance in the GATT to enable regular monitoring of trade policies and practices of contracting parties and their impact on the functioning of the multilateral trading system;

(ii) to improve the overall effectiveness and decision-making of the GATT as an institution, including, *inter alia*, through involvement of Ministers;

(iii) to increase the contribution of the GATT to achieving greater coherence in global economic policy-making through strengthening its relationship with other international organizations responsible for monetary and financial matters.

## F. PARTICIPATION

(a) Negotiations will be open to:

(1) all contracting parties,

(2) countries having acceded provisionally,

(3) countries applying the GATT on a de facto basis having announced, not later than 30 April 1987, their intention to accede to the GATT and to participate in the negotiations,

(4) countries that have already informed the CONTRACTING PARTIES, at a regular meeting of the Council of Representatives, of their intention to negotiate the terms of their membership as a contracting party, and

(5) developing countries that have, by 30 April 1987, initiated procedures for accession to the GATT, with the intention of negotiating the terms of their accession during the course of the negotiations.

(b) Participation in negotiations relating to the amendment or application of GATT provisions or the negotiation of new provisions will, however, be open only to contracting parties.

## G. ORGANIZATION OF THE NEGOTIATIONS

A Group of Negotiations on Goods (GNG) is established to carry out the programme of negotiations contained in this Part of the Declaration. The GNG shall, inter alia;

(i) elaborate and put into effect detailed trade negotiating plans prior to 19 December 1986;

(ii) designate the appropriate mechanism for surveillance of commitments to standstill and rollback;

(iii) establish negotiating groups as required. Because of the interrelationship of some issues and taking fully into account the general principles governing the negotiations as stated in B(iii) above it is recognized that aspects of one issue may be discussed in more than one negotiating group. Therefore each negotiating group should as required take into account relevant aspects emerging in other groups;

(iv) also decide upon inclusion of additional subject matters in the negotiations;

(v) co-ordinate the work of the negotiating groups and supervise the progress of the negotiations. As a guideline not more than two negotiating groups should meet at the same time;

(vi) the GNG shall report to the Trade Negotiations Committee.

In order to ensure effective application of differential and more favourable treatment the GNG shall, before the formal completion of the negotiations, conduct an evaluation of the results attained therein in terms of the Objectives and the General Principles Governing Negotiations as set out in the Declaration, taking into account all issues of interest to less-developed contracting parties.

## PART II

## NEGOTIATIONS ON TRADE IN SERVICES

Ministers, also decided, as part of the Multilateral Trade Negotiations, to launch negotiations on trade in services.

Negotiations in this area shall aim to establish a multilateral framework of principles and rules for trade in services, including elaboration of possible disciplines for individual sectors, with a view to expansion of such trade under conditions of transparency and progressive liberalization and as a means of promoting economic growth of all trading partners and the development of developing countries. Such 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 shall apply to these negotiations. A Group on Negotiations on Services is established to deal with these matters. Participation in the negotiations under this Part of the Declaration will be open to the same countries as under Part I. GATT secretariat support will be provided, with technical support from other organizations as decided by the Group on Negotiations on Services.

The Group on Negotiations on Services shall report to the Trade Negotiations Committee.

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IMPLEMENTATION OF RESULTS UNDER PARTS I AND II

When the results of the Multilateral Trade Negotiations in all areas have been established, Ministers meeting also on the occasion of a Special Session of CONTRACTING PARTIES shall decide regarding the international implementation of the respective results.

END