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February 25, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Trade Policy Issues and Developments - Supplementary Material

There is attached background material for the paper on trade policy issues and developments issued as SM/85/60 on February 19, 1985.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion on Monday, March 18, 1985, they should contact Ms. Kirmani (ext. 8358) or Mr. Petersen (ext. 8359).

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Trade Policy Issues and Developments: Supplementary Material

Prepared by the Exchange and Trade Relations Department

(In consultation with other departments)

Approved by C. David Finch

February 22, 1985

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Recent trade developments have been importantly influenced by a number of factors. Recovery of world output commenced in 1983, although growth was uneven among industrial countries. In the developing countries, the recent upturn in activity was significantly influenced by the extent of the economic recovery of their major trading partners. Just as the detrimental effects of the recent recession were not distributed uniformly among sectors, the benefits of the recovery have been uneven across sectors. Substantial amounts of resources remain idle and, with slower growth anticipated in the future, the situation is not expected to improve markedly in the next few years. Unemployment of labor in the major industrial countries, which averaged about 6 percent in 1980-81 and rose to 8 percent in 1982-83, declined to about 7 1/2 percent in 1984. Even in North America, where the unemployment rate fell significantly in 1984, current unemployment rates remain substantially above historical norms. Trade and current account balances have been affected by the impact of high real interest rates and shifts in exchange rates, and developments in commodity prices. While the United States witnessed a sharp increase in its trade deficit, Japan continued to experience large trade surpluses. The current account surpluses of oil exporting developing countries shrank, while non-oil developing countries faced severe balance of payments and external debt difficulties, though the latter's situation improved significantly after 1982, partly reflecting their substantial adjustment efforts.

1/ This paper contains supplementary material for the main paper, "Trade Policy Issues and Developments" (SM/85/60, 2/19/85). It contains six sections. Section I describes recent trade trends, briefly reviews the overall stance of trade policy in major industrial countries, and presents quantitative estimates of the extent and costs of protection. Section II describes the recent evolution in the framework for international trade. Sections III and IV describe trade actions by major industrial countries in individual manufacturing and agricultural sectors, respectively, including quantitative estimates of the costs of protection in individual sectors; the coverage of countries and sectors is selective. The trade policies of developing countries, and the implications for them of trade restrictions in foreign markets, are reviewed in section V. The role of the Fund in the trade field in the context of Fund surveillance and programs is described in section VI.

2/ 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.

3/ Unless otherwise specified, trade data and commodity and regional classifications of trade are based on the GATT. See Explanatory Note in SM/85/60, Supplement 2.

The volume of world trade recovered by about 2 percent in 1983, regaining the level of 1980-81 (Table I-1). Trade in manufactured products rose by 4 1/2 percent, in contrast to the decline in 1982, while agricultural trade increased by 1 percent, matching the 1982 increase. However, trade in minerals (including fuels) declined for the fourth consecutive year, led by an 8 percent decline in the volume of crude petroleum exports. In 1984, according to the World Economic Outlook (WEO), world trade expanded by an estimated 9 percent.

For the industrial countries as a group, export volumes grew by 2 1/2 percent in 1983, after declining by more than 2 percent in 1982; import volumes increased by nearly 4 1/2 percent in 1983, following three consecutive years of decline. Among the industrial countries, there were large differences in individual country trade performance in 1983. In the United States, for example, export volumes fell by 4 percent in 1983, whereas in Canada and Japan they rose by 9 1/2 and 8 1/2 percent, respectively. On the other hand, U.S. imports rose by 10 1/2 percent, in sharp contrast to the behavior of import volumes into France (which fell by 2 percent), and Italy and Japan (which remained relatively stagnant). In 1984, according to the WEO, growth of export and import volumes for the industrial countries are estimated at 10 percent and 13 percent, respectively. U.S. exports in volume terms are estimated to have increased by 9 percent, whereas the growth of U.S. imports in volume terms accelerated further to 25 percent.

The WEO estimates that the drop in export volumes in the developing countries during 1980-82 was arrested in 1983. Largely on account of increased manufactured exports to industrial country markets, export volumes are estimated to have expanded by close to 8 1/2 percent in 1984. Import volumes, which expanded significantly in 1980-81, fell in both 1982 and 1983; in 1984, import volumes rose by a little over 2 percent.

The industrial countries' share in world exports rose by 1 percentage point to 62 percent between 1980 and 1983. While export shares of the oil exporting developing countries declined by 5 percentage points to 10 percent, those of non-oil developing countries (excluding eastern trading countries) rose by 2 percentage points to over 14 1/2 percent in 1983. The eastern trading area also experienced an increase in its share in this period.

2. The stance of trade policy

Protectionist pressures were high in most industrial countries in the past several years. An important contributing factor was the world recession; with stagnating or declining output and rising unemployment, demands increased for protection from import competition and for government assistance to sustain exports. The commencement of world recovery did not ease the pressures for protection. In the European Community, high and rising unemployment rates contributed to maintaining significant protectionist pressures. Despite strong recovery and reduced unemployment in the United States, protectionist pressures increased discernibly as the recovery and the strong U.S. dollar led to an upsurge in imports.

In addition to the effects of cyclical factors on protectionist pressures, shifts in comparative advantage and the related pressure for structural adjustment also played an important role, as did domestic rigidities, which prevented sufficient adjustment of production structures, thus aggravating the problem of structural unemployment.

Governments in industrial countries have made efforts to resist protectionist demands. On balance, however, resort to trade restrictions increased significantly in many industrial countries in the past several years, mainly in the form of nontariff barriers of a discriminatory nature, and international trade frictions increased concomitantly.

In the United States, examples of resistance to pressures for protection included rejection of industry petitions for import relief for copper, tuna, footwear, and machine tools. In the case of copper, injury from imports was established, and the U.S. International Trade Commission (USITC) had recommended import relief. The United States has thus far not acted on demands for more general measures such as import surcharges and domestic content legislation. The Generalized System of Preferences (GSP) was extended and some of the more protectionist elements were excluded from the final version of the omnibus trade bill. Further, after 1980, restrictions were eased or terminated in a number of areas, including color televisions, footwear, CB radio receivers, high-carbon ferrochromium, lag screws and bolts, clothespins, porcelain-on-steel cookware, and preserved mushrooms. There were also liberalization moves in a regional context, for example, the Caribbean Basin initiative.

On the other hand, during 1983-84, there was an intensification of existing, and resort to new, U.S. import restrictions on steel, textiles and clothing, and motorcycles, at the same time as earlier restrictions on automobiles were extended. A perception which has gained more prominence in U.S. public opinion and greater credence in policy formulation is that trading partners have not shouldered adequate responsibility, concomitant with changing economic strengths, for promoting a liberal multilateral trading system. This perception arises from U.S. concerns about trading partners' subsidy practices and access to foreign markets, against the background of increasing integration of the U.S. economy with the world economy over the past decade and the consequent greater vulnerability of U.S. industries to foreign competition and external demand conditions. A consequence of this perception has been a tendency in the United States, which has traditionally been a leading proponent of liberal multilateral principles, toward greater acceptance of discriminatory trade measures, and a more aggressive endorsement of legal remedies to combat "unfair" competition. At the same time, the United States has sought international cooperation to improve and expand multilateral disciplines, and has been a leading proponent of new multilateral trade negotiations.

In the European Community, demands for protection were resisted in a number of areas, such as footwear. Restrictions were eased or terminated in other areas in the past several years, including preserved and cultivated mushrooms, frozen cod fillets, and tableware. In 1985, the Community accelerated tariff cuts agreed in the Tokyo Round by one year for products of interest to developing countries, and announced that it would do so for other countries, following similar action by the United States. The Community recently announced proposals to liberalize about 26 residual nontariff restrictions. The Lomé Convention, under which preferential treatment is granted to the ACP (African, Caribbean, and Pacific) countries, was extended, and the Community continued and improved its GSP. Despite intense opposition from farmer lobbies in 1984, the Community took some steps toward rationalizing the Common Agricultural Policy. There was also greater emphasis on strengthening the internal market in the Community by, inter alia, harmonizing technical standards and norms which could act as barriers to trade, and rationalizing competition policies, including unauthorized state aids.

During 1980-83, restrictions were tightened or imposed in the European Community in several areas, including steel, textiles and clothing, and consumer electronics. In 1984, the Community more or less maintained major existing restrictions, rather than resorting to significant new measures at the Community level. Pressures for protection in the Community have risen recently in the petrochemical industry, mainly with regard to newly emergent suppliers in the Middle East. The Community has thus far refrained from quantitative restrictions in this sector; however, consideration is being given to reducing GSP benefits for countries, including Saudi Arabia, which are becoming competitive petrochemical exporters. Recourse to Article 115 actions 1/ (Table I-2) continues to be significant, but there has been a downward trend in recent years; the coverage of import surveillance has increased.

In the Community, there has also been greater acceptance of discriminatory trade measures, as part of an evolving process whereby bilateral accommodation and management of trade have received relatively greater emphasis as an inevitable and pragmatic approach to economic "realities." Of course, views vary considerably in this respect within the Community, and, in the overall compromises that are reached, there is a dilution of the more liberal trade views and a brake on the more restrictive ones. Some Community members, particularly Germany, strongly support new multilateral trade negotiations, while the Community as a whole has recently expressed greater willingness to investigate the possibilities of such a new round.

In the past several years, trade policy in Japan has focused on liberalization measures. In response to trading partners' complaints that its market was unduly closed to foreign competition by tariff--and, more importantly, hidden nontariff--measures, Japan has undertaken a

1/ Temporary restrictions on free circulation of goods within the Community under Article 115 of the Treaty of Rome.

series of five market-opening measures. These entailed accelerating the cuts agreed in the Tokyo Round in the December 1981 package (1,653 items), the October 1983 package (1,280 items), and the April and December 1984 packages (1,130 items). In addition, tariffs were reduced or eliminated on 198 other industrial items in May 1982, 28 items in December 1982, 47 items in October 1983, 31 items in April 1984, and 39 items in December 1984. The packages led to a substantial simplification of standards and testing requirements; measures in this area were included in all five packages, with the most important changes in the January 1983 package, on the basis of which revisions were made to 16 regulatory statutes in March of that year in order to establish the principle of nondiscriminatory treatment of foreign products in approval procedures.

Other potentially significant commitments undertaken by Japan included arrangements for foreign participation in standards drafting committees (May 1982) and the acceptance of foreign generated test data in certain sectors (April 1984). Measures were also implemented to facilitate import penetration for products such as tobacco (January and October 1983, and April 1984) and telecommunications equipment and satellites (April 1984). Additional measures included the establishment of an Office of Trade Ombudsman (December 1981), the enhancement of the import promotion function of the Japan External Trade Organization (October 1983), the promotion of procurement of imported goods by government and other public sector entities (October 1983), and an increase in the ceiling quotas for industrial products under the GSP by 55 percent in 1984/85 (October 1983) and 8 percent in 1985/86 (December 1984). Japan has strongly supported the launching of new multilateral trade negotiations.

The short-term impact on trade flows of industrial countries' recent trade policies--whether more restrictive or more liberal--is more difficult to assess. Thus, for example, U.S. trade policy became relatively more restrictive, against the background of substantially higher exports to the United States that contributed importantly to renewed growth in both industrial and developing countries. On the other hand, trade liberalization in Japan has not yet induced a concomitant impact on import flows into Japan. This partly reflects the different domestic demand conditions, with the demand effect swamping the trade policy effect. In the case of Japan, while the liberalization measures have been generally welcomed, trading partners continue to express concern about difficulties in penetrating the Japanese market, and have called for further liberalization.

3. Selected recent legislation

Recently, there has been an increased tendency in industrial countries to broaden and sharpen trade legislation, particularly in order to deal with "unfair" foreign competition. Some examples are discussed below. While the impact of recent legislative changes will depend on how they are implemented, they broadly signal a tightening of the trade policy stance, particularly with regard to "unfair" foreign competition.

The 1984 Trade and Tariff Act of the United States ("the Act") extended the GSP, which would have expired in January 1985, for eight and a half years. 1/ The President was authorized to negotiate bilateral trade liberalization agreements, with specific authority for negotiations with Israel and Canada. Authority was also provided for negotiation of bilateral and multilateral liberalization of trade in services and high technology products and in trade-distorting barriers to foreign direct investment. The law clarified the President's authority to retaliate against discriminatory foreign practices that affect U.S. trade in services and expanded his authority to act against unfair foreign practices in the area of direct investment.

The Act clarified, codified, and extended the reach of antidumping (AD) and countervailing duty (CVD) laws. Its provisions included the possibility of applying CVDs to "upstream subsidies" on manufactured imports, 2/ and the extension of AD and CVD laws to cover sales that were "likely" to take place. 3/ In determining material injury, the USITC was required to assess the "cumulative" impact of imports of similar products from all countries under investigation. The USITC was also instructed not to consider any one factor as overriding in determining whether to recommend import relief; specifically, profitability of the domestic industry would not be taken to preclude a finding of injury by imports. The Act's provisions on steel and wine are described in sections III.2(a) and IV.7, respectively.

In September 1984, the European Community adopted the New Commercial Policy Instrument (NCPI), whose basic objectives are to enable the Community to respond rapidly and efficiently to "illicit" foreign commercial practices, and to exercise fully its "rights" in trading relations with nonmembers. "Illicit" commercial practices are defined as any practices that are incompatible with international law or with generally accepted rules, including infringement of any code or regulation agreed in the

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1/ The law included additional factors to be considered in determining eligibility for GSP benefits, such as the patent, trademark, and copyright protection offered by a country to foreign nationals, and the steps taken to reduce trade-distorting investment barriers and barriers to trade in services. The law provides the President broader authority to change duty-free treatment of eligible countries and provides for the gradual phasing out of benefits over a two-year period when a country's annual GNP per capita reaches a level initially set at $8,500. This trigger level is to be increased each year by one half of the percentage change in U.S. GNP.

2/ The potential for an upstream subsidy exists only when a sector-specific benefit meeting all the other criteria for being a subsidy is provided to the input producer. The provision is also limited to subsidies paid or bestowed by the country in which the final product is manufactured.

3/ In general, previous laws applied only to sales that had already taken place, and not those expected to occur.

context of the GATT, the OECD, or any other international intergovernmental institution. The Community's "rights" are defined as those international trade rights of which it may avail itself either under international law or under generally accepted rules. This applies in situations where a Community member believes that its access to the markets of another country may have been unfairly cut back, not as a result of an illicit trade practice, but of a decision to resort to safeguard or other protective measures which that country deemed to be justified under the GATT.

The NCPI lays down procedures for investigating illicit trading practices. 1/ Once the examination is complete, and unless a bilateral solution is agreed, the Commission will formally take up the complaint with the GATT or any other appropriate international institution. If the complaint is upheld, the defensive policy measures decided by the Commission at the end of its own examination will enter into effect automatically within 30 days, unless the Council of Ministers decides to the contrary by a qualified majority vote.

With regard to the exercise of commercial rights, whenever a Community member believes that its exports are being adversely affected in a third country by the latter's policies, it can request the Commission to take remedial action. Once the Commission is satisfied that the request is justified, it will seek accommodation with the concerned country or in a relevant international institution. However, in contrast to the procedures relating to illicit trading practices, the Council of Ministers must specifically approve the Commission's decision for it to enter into effect.

The policy measures envisaged by the NCPI include withdrawal of concessions, higher tariffs or other import charges, and introduction of quantitative or other restrictions. The NCPI will not apply in cases covered by other existing rules in the common commercial policy. It will not, for example, replace procedures with respect to dumping and subsidies.

New EC legislation on dumped or subsidized imports from countries outside the EC became effective on August 1, 1984. Under the legislation, foreign firms found to be dumping products on the EC market at below cost will have to raise their prices within 10 days of notification by the EC or pay duties. Provisions clarifying the EC's practices on dumping/subsidies relate to the period of investigation, the calculation of costs of production, the treatment of related parties, the allowance

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1/ Complaints may be presented to the Commission either by an association representing an industry throughout the Community or by a member state. On receipt of the complaint, the Commission must decide within 45 days (60 days in special circumstances) on the question of evidence and injury. In a positive determination, the Commission must decide within five months (seven months in complex cases) the policy measures to be taken to defend the Community's interests.

to be made for differences in the conditions and terms of sale, the level of trade at which the sales are made, and the remission or refund of import charges and indirect taxes and the calculation of subsidies. Along with a tightening of procedures, a feature of the new rules is the introduction of "sunset provisions," whereby duties will automatically lapse after five years unless the need for their continued existence has been established.

Canada's Special Import Measures Act (SIMA), which replaces the Anti-Dumping Act, came into effect on December 1, 1984, and deals with unfair competitive practices of foreign producers. Under its provisions, procedures are established to handle both antidumping and antisubsidy complaints; these are designed to simplify and expedite the processing of such complaints. 1/ Under SIMA, Revenue Canada is responsible for the investigation of complaints to determine whether goods imported into Canada are being dumped or subsidized. Determination of injury to the Canadian industry is made by the Import Tribunal. Based on an affirmative preliminary finding of dumping or subsidization, Revenue Canada can impose provisional duties on the imports under investigation. Final duties are levied on imports if affirmative determinations are made by both Revenue Canada and the Import Tribunal.

The Act specifies time limits for the processing of complaints. 2/ It also provides Canadian importers and foreign exporters with the right to challenge subsidy and dumping complaints. 3/ In addition, investigations may be suspended if agreement is reached with foreign exporters to eliminate dumping or subsidies or to limit the amount of subsidized goods exported to Canada. Such "undertakings" must be submitted to Revenue Canada before a preliminary determination has been issued.

1/ Previously, subsidy complaints against imports were covered under customs legislation. Cabinet approval was required to institute an investigation and to impose duties.

2/ Revenue Canada has 21 days from the date a complaint is filed to examine the complaint and to request any additional information. Once a case is properly documented, Revenue Canada must decide within 30 days whether or not to investigate the complaint. If an investigation is initiated, Revenue Canada has 90 days in which to reach a preliminary decision as to whether dumping or subsidization of imports has occurred and to estimate the margin of dumping or the amount of subsidy. It has a further 90 days in which to make its final determination. The Import Tribunal must determine within 120 days of an affirmative preliminary determination by Revenue Canada whether the dumped or subsidized imports have caused or threatened to cause material injury to, or retardation of, domestic industry.

3/ Within 30 days of the initiation of an investigation, affected importers or foreign exporters can request that the Import Tribunal review Revenue Canada's decision to initiate an investigation. The Tribunal can dismiss the case if it finds that there is little evidence that dumping or subsidization has occurred or that the domestic industry has been injured. Parties filing dumping or subsidy complaints have a similar right of appeal to the Import Tribunal when Revenue Canada decides not to initiate an investigation.

4. Evidence of rise in trade barriers and their effects

a. Difficulties of measurement

The rise in protectionism in the past several years has generated increased interest in the quantification of protection. Ideally, quantified estimates should capture the incidence and the direct and indirect effects on trade flows of all relevant external and domestic policies which impede or stimulate trade in a manner inconsistent with comparative advantage. Several factors in particular make this difficult. The first is the nontransparency of many measures. For example, administrative procedures at customs points can impede trade. Also, some actions may be difficult to identify, such as industry-to-industry export restraint arrangements, discriminatory government procurement policies, or "buy domestic" stipulations. As noted in an OECD (1984) study, trade measures may have become less transparent recently, both because governments have sought to bypass their obligations under the GATT, and because they have not wished to be obvious about departing from liberal trade principles. Second, even "official" actions may be restrictive in form but not in substance, and vice versa. Thus, licenses may be granted liberally even when a system of discretionary import licensing is in place, so that imports are not significantly impeded. Legislation to widen the authority to impose restrictions may itself have a dampening effect on trade by increasing the uncertainty of market access.

The third major difficulty lies in identifying an "undistorted" norm against which the distorted markets can be reasonably measured. 1/ Other difficulties in quantification include proper specification of homogeneous commodities or product categories, aggregation of diverse information, and separating out the effects of protection from those of other factors, especially under different or varying economic structures and data availability.

These numerous conceptual and empirical difficulties testify to the imperfect "state of the arts" on quantification, and largely explain why conclusions differ on the actual extent and costs of protection. The selective studies cited in this paper are meant to be illustrative, without attaching sanctity to any particular estimate.

1/ Under conditions of perfect competition, world supply and demand for a (homogeneously defined) commodity determine its equilibrium price, which can then be used as a benchmark to measure the protected market price against the "free" price and to calculate the trade flows that would have been realized in the absence of protection. However, if restrictions proliferate to the extent that they affect a large enough proportion of the commodity's world demand (supply), and especially if these restrictions are discriminatory (e.g., bilaterally agreed export restraints), the world market itself becomes fragmented and distorted. There is then likely to be a series of prices for trading goods, rather than a single "free" world market price, to use as a reference.

b. Tariff incidence

The height of tariff barriers is, in principle, the easiest to quantify. Successive GATT rounds of multilateral trade negotiations have reduced the average incidence of tariff protection in industrial countries to relatively insignificant levels. For example, average tariffs on industrial country dutiable imports will be below 6 percent in 1988, or some 25 percent lower than previous average base rates. In agriculture, the Tokyo Round resulted in tariff concessions being exchanged on 30 percent of trade in agricultural products, with the reduction on these products amounting to 40 percent on a weighted average basis (GATT, 1979). These tariff averages conceal some fairly wide variations in the structure of protection in the industrial countries. On the whole, however, tariffs have declined as barriers to trade.

c. Incidence of nontariff measures

Relative to tariffs, nontariff barriers (NTBs) have emerged as serious impediments to trade. The UNCTAD inventory, which is based on official data gathered by UNCTAD staff, includes some 21,000 cases of applications of product-specific nontariff measures. According to this inventory, almost 98 percent of the 1,010 four-digit CCCN product groups face a prohibition somewhere in the world, and often in more than one country. The IBRD recently prepared an updated estimate of the incidence of four types of nontariff barriers (quantitative restrictions, voluntary export restraints, measures for the enforcement of decreed prices, and tariff quotas), based on the UNCTAD inventory. The estimate showed that industrial countries applied nontariff measures to 13 percent of their imports when the incidence was weighted by world trade. Import data referred to 1981 and nontariff measures to several recent years, as specified in the UNCTAD data base.

Based on official notifications to the GATT by 53 of its 90 contracting parties, the justification for the imposition of NTBs varies across countries, and particularly across country groupings (Tables I-3 and II-3). Table I-3 excludes a number of restrictions, notably those relating to the Multifiber Arrangement, voluntary export restraints, and counternotifications by other contracting parties of measures maintained by their trading partners which affect their exports.

Most countries now employ some form of NTBs, and their use is growing. Balassa and Balassa (1984) note that the share of imported products restricted by NTBs in total manufactured imports in 1980 amounted to about 6, 11, and 7 percent in the United States, the European Community, and Japan, respectively; during 1981-83, NTBs were extended to other products, equivalent to 6 1/2 and 4 percent of 1980 manufactured imports of the United States and the EC, respectively (Japan imposed no new restrictions) (Table I-4). They also note that the consumption of product groups subject to restrictions accounted for 20, 24, and 16 percent of the consumption of manufactured items in the United States, the EC, and Japan, respectively, in 1980; restrictions during 1981-83 affecting other products were equivalent to 15 and 4 percent of 1980 consumption values in the United States and the EC, respectively. The study did not take into account some liberalization measures during 1981-83.

Cline (1984) finds that products affected by NTBs during the late 1970s to 1981 accounted for 45 percent of U.S. imports of manufactures in 1978; the corresponding percentages for Germany, France, the United Kingdom, and Japan were 28, 40, 26, and 22, respectively. Similar percentages for manufactured imports from developing countries ranged from a high of 43 percent for the United States to a low of 24 percent for the United Kingdom. In calculating the coverage of restrictions, the assumption was that, if part of a tariff line or a particular source of imports was restricted, all imports under that tariff line were affected; also, certain processed agricultural products (e.g., processed meat) were included. This broader coverage largely explains the higher ratios compared with Balassa and Balassa.

In an earlier and even broader study, Page (1981) defines "managed" trade as that subject to some form of nonmarket control, and calculates the percentage of managed to total imports for 122 countries, and the share of managed trade in total trade for countries in a given product category. The study finds that 40 percent of all countries' trade was managed in 1974; this ratio rose to 48 percent in 1980 (Table I-5). The aggregate data mask the incidence of NTBs on particular product categories. Page (1979) notes that the highest growth rates of measures appears in sectors where comparative advantage is shifting. Table I-6 shows that the most marked increases in managed trade occurred from 1974 to 1979 in sectors where developing countries had developed a comparative advantage (footwear, clothing and textiles, etc.), or, as noted by Greenaway (1983), where a combination of structural change and cyclical pressures had generated acute adjustment problems (steel, shipbuilding).

Measurements based on frequency indices of the above type generally provide information on the coverage of restrictions, but not on their effects. Further, frequency indices provide only a rough indicator of the incidence of restrictions and do not necessarily take into account differences in intensity of application of the restrictions.

d. Effects of protection and liberalization

Several studies have estimated the costs of protection by using fully integrated models of world trade. References to studies on the effects of protection in individual industrial and agricultural sectors are contained in sections III.8 and IV.8, respectively.

Klein and Su (1979) use Project LINK to study the effects of 5, 10, and 20 percent tariff increases on the manufactured imports of 13 OECD countries. 1/ By means of a world trade matrix, LINK inter-

1/ In cases where a country's import equations do not depend significantly on relative prices, the authors impose corresponding quantitative restrictions of 5, 10, and 20 percent.

relates demand-orientated, dynamic econometric models of 13 OECD and 7 centrally planned economies, as well as 4 developing areas (Africa, Latin America, the Middle East, and southeast Asia), and the rest of the world. Cumulating 1978 and 1979, the main results under the 5(20) percent increase in protectionism scenario are: (a) world trade declines by $60(213) billion; (b) real GNP in developed and developing countries is lower by $6(22) billion and $2(6) billion, respectively; and (c) the trade balances of the developed and developing nations deteriorate by $45(158) billion and $8(28) billion, respectively (Table I-7). Inflation rates and world trade prices rise under all scenarios.

Brown and Whalley (1980), using a Heckscher-Ohlin type numerical general equilibrium model of international trade involving the United States, Japan, the EC, and "the rest of the world," analyze, inter alia, the effects of trade liberalization. They find that worldwide abolition of all tariff and nontariff barriers raises world welfare (as measured by estimated changes in gross national product) by $20 billion per year in constant 1973 dollars, of which $9 billion accrues to the developing nations and $8 billion to the EC (Table I-7). The authors caution that the results pertaining to the developing countries should be interpreted with care, largely because "the rest of the world" is only schematically modeled. They conclude, however, that this latter bloc loses substantially from the trade policies of the major trading groups, especially because of the restrictive barriers applied to agricultural products and raw materials.

Deardorff and Stern (1983a, 1983b) use the Michigan model of world production and trade to assess Tokyo Round effects and the impact of complete elimination of post-Tokyo Round tariffs. The neoclassical model incorporates supply and demand functions and market-clearing conditions for 22 tradable and 7 nontradable industries in 18 major industrial and 16 major developing nations; an aggregated sector represents the rest of the world. They find that the Tokyo Round cuts in base tariff rates, together with negotiated reductions of nontariff barriers involving agricultural concessions and government procurement, bring (in 1976 prices) world welfare gains of $5.1 billion, increased exports of $13.2 billion, and a modest average decline in prices (Table I-7). 1/ The welfare benefits are estimated to be small, mainly because the price changes induced by the Tokyo Round shift demand away from sectors, such as agriculture and textiles, in which nontariff barriers dominate, and in which developing countries have a significant interest. In a subsequent study on the complete elimination of post-Tokyo Round tariffs, the authors find that the overall world welfare gains are limited to less than $1 billion, largely due to offsetting terms-of-trade effects.

1/ The authors do not quantify the other negotiated nontariff barrier reductions (e.g., customs valuations, import licensing procedures); they quote Brown and Whalley (1980) to suggest a potential welfare gain of $16 billion from the elimination of these nontariff barriers.

Whalley (1984), in a somewhat disaggregated version of Brown and Whalley's model, explicitly incorporates the trade policies of developing countries in estimating the welfare effects of trade liberalization. He finds that the abolition of all tariff and nontariff barriers in all countries increases world welfare (by $33 billion in 1977 prices), but that the welfare of developing countries declines by $31 billion (Table I-7). The major reason for this result is that liberalization leads to a decline in the terms of trade of the less developed and newly industrialized country groupings of 30 and 23 percent, respectively. This is explained by higher average rates of protection in the developing countries, and the smaller size of trade between developing countries as compared with intra-industrial trade. However, the foreign demand elasticities for the exports of developing countries appear to be unrealistically low.

Studies which seek to capture the costs of protectionism generally employ a comparative-static mode of analysis within the framework of a perfectly competitive model of economic behavior. As such, they do not capture the benefits from liberalization which might derive from, for example, increased economies of scale, higher growth rates, and improved economic efficiency. Harris (1984) demonstrates that, on a national level, introducing imperfectly competitive elements into the analysis can considerably enhance the estimated benefits from reduced barriers to trade. Within a static framework, he compares the competitive model with one which includes economies of scale (internal to the firm), explicit price-setting behavior by firms, and product differentiation in the non-competitive sectors. On a Canadian data base, the author finds that the latter model yields welfare gains from trade liberalization on the order of four times larger (8.6 to 2.4 percent of GDP) than those from the competitive model.

Dynamic elements are rarely introduced. When they are, modeling complexity enforces simplifying assumptions, so that elements relevant to the cost of protection may be underrepresented. Thus, supply-side effects do not play a significant role in Klein and Su's (1979) dynamic econometric model, and consequently the inter-industry and production-cost implications of protection are not captured. On the other hand, adjustment costs related to the implementation of a more open trading system are also ignored. Easton and Grubel (1982) argue that, since most studies measuring the cost of protection ignore--or inappropriately treat--the effects of economic growth, they seriously underestimate the benefits from trade liberalization. They show that growth in the costs of protection corresponds to growth in world trade. The latter has historically been greater than growth in world output, due both to reduced transportation costs and economies of scale in the production of differentiated goods. However, growth in the benefits from protection is at most equal to the growth of output. Hence, a multiperiod analysis will lead to larger estimates of the costs of protection than the "one-period" mode of analysis. They conclude that the net present value of the cost of protection is probably very high, certainly much higher than is implied by models which consider only instantaneous costs.

II. Evolving Framework for International Trade

1. Introduction

In the past several years, the maintenance and improvement of the liberal world trading order have received increased international attention, particularly in the GATT which, with its 90 members accounting for 85 percent of world trade, provides the central framework of rules, rights, and obligations governing international trade. Tokyo Round codes have been accepted by virtually all industrial countries and several developing countries (Table II-1).

The declaration adopted by the GATT CONTRACTING PARTIES in November 1982 recognized that the multilateral trading system was seriously endangered, and that protectionist pressures had multiplied, disregard of GATT disciplines had increased, and shortcomings in the functioning of the GATT system had been accentuated. GATT contracting parties agreed, individually and jointly, to undertake:

> ... to make determined efforts to ensure that trade policies and measures are consistent with GATT principles and rules and to resist protectionist pressures in the formulation and implementation of national trade policy and in proposing legislation; and also to refrain from taking or maintaining any measures inconsistent with GATT and to make determined efforts to avoid measures which would limit or distort international trade. 1/

Trade policy and protectionism have been addressed also in the OECD, UNCTAD, the Commonwealth Group, the Interim and Development Committees, and elsewhere. 2/ This section reviews the key developments stemming from the adoption by the GATT and the OECD of a wide-ranging program of discussion, analysis, and consultation.

2. Quantitative restrictions and other nontariff measures

A newly created GATT Group on Quantitative Restrictions and Other Non-Tariff Measures embarked on a comprehensive review in January 1983, aimed at compiling measures, reviewing their conformity with GATT, and establishing a basis for eliminating illegal measures and liberalizing others. The Group had no negotiating mandate per se.

Broadly, GATT rules do not permit contracting parties to apply quantitative restrictions; tariffs are recognized as the main instrument of protection. However, the GATT provides for specified exceptions

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1/ GATT document L/5424 (11/29/82). A report by the Fund observers on the meeting (SM/82/234, 12/16/82), includes the text of the ministerial declaration.

2/ See also Commonwealth Secretariat (1982); Camps and Diebold (1983); Cline (1983); Corden (1984); and Adam Smith Institute (1984).

under which quantitative restrictions may be maintained. Since the early 1970s, governments have recognized the importance of liberalizing nontariff restrictions. Table II-2 provides a summary of residual import restrictions maintained by some industrial countries.

The Group on Quantitative Restrictions and Other Non-Tariff Measures compiled two sets of comprehensive information on nontariff measures, one based on "self notifications" by contracting parties applying them, and the other on "reverse notifications" by contracting parties of measures applied by other contracting parties. 1/ Table II-3 summarizes the information on quantitative restrictions for 84 of the 90 contracting parties, only 2 of which reported that they maintained no quantitative restrictions. The principal GATT provisions under which contracting parties justify the maintenance of quantitative restrictions are: (a) agricultural import restrictions, including those linked to limitation of domestic agricultural production (Article XI:2(c)); (b) restrictions associated with state trading enterprises (Article XVII); (c) balance of payments restrictions (Articles XII and XVIII:B); (d) restrictions associated with governmental assistance to promote the establishment of an industry (Article XVIII:C); (e) restrictions to safeguard domestic industry from injurious import competition (Article XIX); (f) restrictions under one of several "general exceptions" provided for in the GATT (Article XX); (g) restrictions on national security grounds (Article XXI); (h) restrictions under waivers granted by the CONTRACTING PARTIES (Article XXV:5); and (i) restrictions under the Protocol of Provisional Application, Protocols of Accession, and the Agreement on Import Licensing Procedures.

For at least some of their quantitative restrictions, 49 of the 84 notifying contracting parties invoked no specific GATT provision. The Group suggested that, in cases where no GATT justification was advanced, the working hypothesis would be that the restriction was not in conformity with the GATT, and, in other cases, the hypothesis would be that it was in conformity with the GATT, so long as this was not challenged by another contracting party.

As regards nontariff measures other than quantitative restrictions, the Group compiled an inventory of some 400 notifications, including those relating to government aids, government procurement, state trading, customs valuation, consular formalities, technical barriers and standards, testing requirements, marking and labeling requirements, surcharges, port taxes, and border tax adjustments (Table II-4). It was noted that this was not a comprehensive inventory of all nontariff measures, but a listing of problems governments wished to raise in the GATT. In some cases, the countries maintaining the measures suggested that the measures either did not restrict trade or did not unnecessarily restrict trade.

1/ GATT document L/5713 (10/26/84).

The GATT secretariat suggested possible techniques for liberalizing quantitative restrictions and other nontariff measures or bringing them into conformity with GATT provisions. As regards the liberalization of quantitative restrictions, the techniques could range from immediate elimination to a standstill, combined with progressive liberalization and elimination. Different techniques could be used for different types of quantitative restrictions, depending, for example, on whether the measures were considered to conform with the GATT. As to bringing quantitative restrictions into conformity with the GATT, the techniques suggested ranged from invocation of GATT provisions permitting the maintenance of quantitative restrictions, to replacement of quantitative restrictions by permissible restrictions such as tariffs. The main techniques identified for liberalizing other nontariff measures were for contracting parties to follow a request-and-offer procedure, or to agree on new interpretations or multilateral rules in order to reduce their restrictive effects on trade.

The Group also considered possible actions on quantitative restrictions affecting products of export interest to developing countries. Examples of alternative techniques were: immediate removal of quantitative restrictions; increasing the share of a quota allocated to developing countries more rapidly than to other countries; more rapid liberalization on a most-favored-nation basis of restrictions affecting developing countries; and periodic reviews of possibilities for action on products of interest to developing countries.

The CONTRACTING PARTIES' session in November 1984 agreed that, by the end of April 1985, contracting parties would make specific written proposals on ways to eliminate GATT-inconsistent quantitative restrictions or bring them into conformity with the GATT. The Group's findings and conclusions are to be considered at the next session of the CONTRACTING PARTIES.

3. Safeguards

A crucial element in the international discussion of nontariff barriers is the question of safeguards--viz., the GATT provisions that govern the temporary imposition of import restrictions. 1/ Table II-5 lists safeguard actions taken since 1978.

In practice, governments have often found the injury and the nondiscrimination provisions of Article XIX to be too onerous, and many

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1/ Under GATT Article XIX, a contracting party may impose import restrictions, either by raising tariffs or through quantitative measures, if, "as a result of unforeseen developments and of the effect of the obligations ... under this Agreement, including tariff concessions, any product is being imported ... in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers ... of like or directly competitive products." Safeguard actions under Article XIX are expected to be nondiscriminatory.

governments have imposed bilateral (discriminatory) restrictions that are inconsistent with the GATT. Recognizing the need for an effective multilateral safeguard system, the 1973-79 Tokyo Round negotiations considered how trade discipline in this area could be strengthened. Controversy arose among governments on whether discrimination should be sanctioned under the GATT, albeit under stringent conditions and strict international surveillance, or whether the principle of nondiscrimination should be reinforced by eliminating GATT-inconsistent safeguard actions. The Tokyo Round did not resolve this issue, no agreement on new disciplines in safeguards was possible, and the discussions on this subject were continued after 1979.

Despite intensive efforts subsequently in the GATT, agreement on safeguards has still eluded governments, owing principally to different views on the question of discrimination. Meanwhile, restrictions outside the GATT, particularly in the form of bilateral export restraint arrangements, many of which are not formally notified to the GATT, have tended to proliferate. According to a recent GATT secretariat tabulation, new voluntary export restraints, orderly marketing arrangements, and export forecasts involving 13 exporting and 6 importing countries were reported in the period April-September 1984; in addition, 41 of the bilateral restraints on trade introduced since 1978 are still in force. 1/ Furthermore, since 1980, an increasing number of GATT members has shown interest in countertrade or compensation trade arrangements; in the same six-month period, the GATT secretariat reported that eight such arrangements came to its attention. The majority of specific countertrade arrangements are negotiated on an intercompany basis, and this is one reason why they are so difficult to take up. 2/

The issue of the supposed legality or illegality of measures, particularly bilateral restraints, also impinges on the discussions on safeguards. If the GATT were formally to accept or acquiesce in bilateral restrictions, one of its main principles would be compromised; greater transparency and surveillance of restrictions might be achieved, but only at the risk of encouraging further proliferation of bilateral restrictions. On the other hand, the status quo, while it may have exercised a braking influence on the use of bilateral restrictions in some countries, has, overall, not prevented GATT-illegal or gray area measures from proliferating; trade actions of this type almost entirely escape international scrutiny. One reason may be a general weakening of support for the unconditional most-favored-nation principle of the GATT; some governments that have traditionally regarded this principle as a cornerstone of the multilateral system appear to be more willing, in practice, to acquiesce in bilateral restrictions.

The current status of the discussions on the safeguards issue was outlined in a report by the GATT Director-General on his own responsibility to the November 1984 CONTRACTING PARTIES' session.

1/ GATT document C/W/448, Rev. 1 (12/18/84).
2/ See also section V.2.

The report states that it cannot be argued both that the multilateral trading system should be preserved and that GATT Article XIX should be applied on a discriminatory basis.

4. Agriculture

Since the inception of the GATT, trade measures have been applied more extensively and more restrictively in the agricultural sector than in manufactures. The General Agreement itself provides relatively generous exceptions for agricultural trade, and, more fundamentally, liberal trade in agricultural products has not been accepted as a policy objective per se by countries accounting for the bulk of world trade in agricultural products. A significant advance at the 1982 GATT ministerial meeting was the establishment of a Committee on Trade in Agriculture in order to carry out an examination of trade measures affecting agriculture, with a view to achieving greater liberalization in agricultural trade.

The Committee examined trade measures and agricultural subsidies by 41 countries and the European Community. 1/ During the deliberations, divergent views emerged on many substantive issues. Some countries felt that the Committee's mandate was to improve compliance with existing rules rather than to develop new disciplines. Some major traditional agricultural exporters emphasized the importance of introducing stricter rules, particularly on import and export measures, and on individual support price levels. On subsidies, some countries stressed that all subsidies, including domestic subsidies, had an influence on production and international trade, while others attached priority to prohibiting export subsidies. All countries recognized the link between domestic agricultural policies and the openness of the trading system. Most took the view that, while domestic policies as such were not internationally negotiable, the General Agreement already envisaged that constraints would apply on the use of import restrictions and export subsidies in relation to measures to limit domestic production. Therefore, the linkages that already existed under the relevant GATT provisions could be strengthened further to provide clearer definition of the permissible limits to the impact of domestic agricultural policies on trade.

Important differences of view also emerged on other questions, such as the consistency of variable import levies under GATT provisions; the treatment, in the trade liberalization context, of restrictions maintained under GATT waivers, which, by virtue of the waiver, are legal

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1/ GATT documents AG/W/6 (3/16/84), AG/W/7 (5/11/84), AG/W/9 (6/26/84), L/5733 (11/19/84), AG/M/3 (2/29/84). The countries examined were Argentina, Australia, Austria, Bangladesh, Brazil, Canada, Chile, Colombia, Cuba, Czechoslovakia, Egypt, Finland, Hungary, Iceland, India, Indonesia, Israel, Ivory Coast, Jamaica, Japan, Kenya, Republic of Korea, Malaysia, New Zealand, Nigeria, Norway, Pakistan, Peru, the Philippines, Poland, Portugal, Romania, South Africa, Spain, Sweden, Switzerland, Thailand, Turkey, the United States, Uruguay, and Yugoslavia.

under the GATT; the impact of phytosanitary regulations on agricultural trade; and the treatment of voluntary export restraints under existing or reinforced GATT rules.

The conclusions reached after two years of deliberation by the Committee on Trade in Agriculture, which were endorsed by the November 1984 CONTRACTING PARTIES' session, envisage a three-pronged approach to the question of agricultural trade liberalization. It was agreed that future negotiations should (1) bring all quantitative restrictions and other trade measures within the purview of strengthened GATT rules; (2) bring all subsidies, including agricultural subsidies, under GATT purview, and introduce disciplines on agricultural export subsidies in parallel, on "an approach based on improvements in the existing framework of rules and disciplines," as well as on "an approach based on a general prohibition subject to carefully defined exceptions;" and (3) minimize the adverse trade effects of sanitary and phytosanitary regulations. 1/

In presenting the conclusions of the Committee on Trade in Agriculture to the CONTRACTING PARTIES late in 1984, its chairman noted that:

> in reaching this agreement, the European Communities recalled that the 1982 Ministerial Declaration covered a certain number of areas and made its definitive approval of the recommendations conditional on an overall assessment of the results achieved in these other areas. 2/

Given the technical complexity and political difficulty of issues in agricultural trade, the recent progress is generally viewed as a meaningful and essential first step toward eventual liberalization.

Work on agricultural policies and trade issues has also been intensified in the OECD. A study by the OECD (1982) concluded that adjustments in domestic agricultural policies could best take place within a concerted multilateral approach, aimed at integrating agricultural trade more fully with the multilateral trading system. The OECD secretariat is currently embarked on a major study and research effort on agricultural trade issues.

5. Trade relations between developed and developing countries

In compliance with the 1982 ministerial mandate, the GATT Committee on Trade and Development initiated a substantial work program in 1983. This involved (1) examination of how contracting parties are putting into practice the provisions of Part IV of the General Agreement, which includes an undertaking by developed countries to strive to reduce trade barriers affecting developing countries and to refrain from establishing

1/ GATT document L/5732 (11/16/84).
2/ GATT document L/5733 (11/19/84).

new ones; (2) review of the operation of the GATT enabling clause agreed in 1979, which provides the legal basis for generalized preferences in favor of developing countries and encourages developing countries to assume greater GATT obligations "with the progressive development of their economies and improvement in their trade situation;" and (3) examination of the prospects for increasing trade between developed and developing countries under the GATT. Also, consultations have been held on tropical products and the possibility of eliminating barriers to trade in this area. Separately, the Working Party on Textiles and Clothing is considering the possibilities of returning to normal GATT rules in the textiles and clothing sectors after the expiration of the current Multifiber Arrangement.

Several past changes in GSP schemes were reviewed by the Committee. By 1984, all preference-giving countries had extended their GSP schemes beyond 1985. In particular, Canada extended its preference scheme to mid-1994, and the United States to 1993. A number of preference-giving countries (including Austria, Canada, and Switzerland) lowered their GSP tariff rates on eligible products on which MFN duty rates were also reduced. Some preference-giving countries improved GSP treatment of products originating in the least developed countries, in particular by broadening the definition of least developed countries and expanding the coverage of items eligible for duty-free GSP treatment. Japan notified improvements and modifications in its GSP scheme, including an increase in the total amount of ceilings on industrial products for the 1984 fiscal year by about 55 percent.

In reviewing the GATT enabling clause, several developed countries suggested that its main objective--viz., to authorize temporary departures from the most-favored-nation principle of the GATT in order to allow preferential treatment of developing countries--could be served effectively only if it encouraged more advanced developing countries to phase out progressively their use of preferential treatment. They argued in favor of additional differentiation among developing countries in the degree of preferential treatment received, and the degree of reciprocity expected, owing to the wide variation in trade and development performance among individual developing countries. It was agreed that the Committee on Trade and Development would continue to keep the operation of the enabling clause under review.

In order to carry out its examination of the implementation of Part IV, the Committee on Trade and Development embarked on individual country consultations for the first time in 1983. So far, consultations have been held with Austria, the European Community, Finland, Hungary, Norway, Sweden, and the United States, as well as with several members of the Latin American Integration Association (ALADI)--Argentina, Brazil, Chile, Colombia, Peru, and Uruguay. In 1985, consultations are planned with Australia, Canada, New Zealand, and Switzerland. It was agreed that developed countries had a special responsibility to implement Part IV provisions and participate in Part IV consultations. Developing countries also had a role, and it was agreed that the Part IV consultations should cover developing countries as well. 1/

In the consultations with developed countries, developing countries expressed varying concerns about specific aspects of the trade policies of the developed countries. These related to the structure of imports by most-favored-nation and preferential tariff treatment (see, for example, Tables V-16, V-17, and V-18), GSP schemes and policy toward "graduation" of countries or products from preferential treatment, nontariff measures in sectors of interest to developing countries (such as textiles and clothing), tariff escalation, the application of internal fiscal levies on primary products mainly imported from developing countries, and special measures being applied to improve export prospects of the least developed countries. In the consultation with ALADI members, the discussion focused on measures being taken in the ALADI to promote trade prospects of the relatively less advanced developing countries within the region.

The Committee on Trade and Development also considered the prospects for increasing trade between developed and developing countries on the basis of a comprehensive GATT secretariat study. 2/ The study noted that trade policy factors--in particular, the postwar movement toward trade liberalization--had played a major role in the expansion of trade between developed and developing countries. With the onset of the global recession, developing countries' exports began to be more severely affected both by direct restrictions such as export restraint and orderly marketing arrangements, and by the wider deterioration in the trade policy environment, including increased resort to domestic and export subsidies. It identified trade policies in both developed and developing countries that their trading partners considered to be impeding trade expansion. The study expressed doubts that protectionist pressures could be expected to subside as economic recovery progressed, and suggested that GATT contracting parties could improve the prospects for trade expansion by joint action aimed at liberalizing trade. It referred to the steady evolution that had already taken place in the rules of the GATT toward accommodating the special interests and difficulties of the developing countries. Several developing countries had participated increasingly in the negotiating process, and had assumed higher levels of commitment through tariff bindings and accession to GATT codes negotiated in the Tokyo Round.

1/ GATT Article XXXVII:4 states: "Less-developed contracting parties agree to take appropriate action in implementation of the provisions of Part IV for the benefit of the trade of other less-developed contracting parties, in so far as such action is consistent with their individual present and future development, financial and trade needs taking into account past trade developments as well as the trade interests of less-developed contracting parties as a whole."

2/ GATT document COM.TD/W/412 and Add. 1 (8/8/84).

The GATT secretariat study suggested that, in any new initiative aimed at further trade liberalization, a logical first step could be a rollback of recent restrictions on exports of developing countries. Developing countries could continue to improve prospects for trade with industrial countries to the extent that they could simplify their import regimes, make them more transparent, stabilize levels of protection, and progressively lower excessive protection. Finally, the GATT secretariat paper noted that various GATT provisions included an element of flexibility that could be utilized to encourage fuller participation in the GATT system by developing countries. For example, developing countries could obtain time-bound exemptions from certain GATT commitments, or stage the implementation of measures. Furthermore, under the GATT provisions relating to import restrictions for development purposes, commitments by developing countries could be revised or temporarily suspended in certain circumstances. During the Committee's discussion, it was recognized that the issues and approaches outlined in the GATT secretariat paper should continue to be considered in the Committee.

6. Restrictions for balance of payments purposes

The GATT contains two main provisions permitting the imposition of trade restrictions for balance of payments purposes. Article XII authorizes such restrictions by developed contracting parties, and Article XVIII:B contains similar provisions for developing countries. Full consultations under Article XII are conducted annually by the GATT Committee on Balance of Payments Restrictions. Under Article XVIII:B, the Committee schedules consultations under simplified procedures every other year; the Committee may, however, request full consultations in any particular case. Fund background documentation is supplied to the CONTRACTING PARTIES for all consultations, and a Fund statement is made on the occasion of full consultations.

Table II.6 provides a list of GATT balance of payments consultations held in recent years. Since 1983, consultations have been held with two GATT members--Hungary and Nigeria--for the first time. Hungary has subsequently announced its decision to eliminate restrictions for balance of payments purposes and to disinvoke Article XII. In 1985, consultations will be held with Colombia for the first time, and with Argentina for the first time since 1978.

The primary focus of GATT balance of payments consultations is on the balance of payments situation and prospects of the consulting country, and the justification advanced for the use of restrictions; the Fund statement is designed to assist this aspect of the consultation process. In addition, the GATT consultations provide Committee members with an opportunity to examine the restrictive system of the consulting country in some detail. The conclusions of the Committee on each consultation are forwarded to the GATT Council.

The Committee is also charged with taking account in consultations of all factors, both internal and external, which affect the balance of payments position of the consulting country. Although the importance of such factors, including access to markets, has been recognized in some past consultations, relatively little concrete consideration has been given to this aspect until recently. In December 1983, at the initiative of Brazil, the Committee's examination included consideration of the external trade environment facing Brazil. In order to deal with the problems of access to markets, the representative of Brazil put forth specific proposals for action by Brazil's major trading partners, including (a) a rollback of import restrictions inconsistent with the GATT that affected products of interest to developing countries; (b) suspension, for the duration of the adjustment program agreed upon with the Fund, of safeguard actions on products exported by a developing country consulting in the Committee; (c) avoidance, for the duration of the Fund program, of countervailing or antidumping duties on products exported by these developing countries. The Committee agreed that members should jointly consider this issue in the broader GATT context, and that they would reflect further on Brazil's proposals. Following Brazil's initiative, there was a general discussion in the Committee of how the external trading environment confronting consulting countries could be given greater weight in the Committee's work. A report was delivered to the GATT Council by the chairman of the Committee, which contained some proposals for possible actions which partner countries could take in favor of expansion of consulting countries' trade, on a multilateral basis. In October 1984, the external trade environment facing Korea was considered by the Committee in the consultation with that country. The Committee welcomed a special study on the effects of protectionism presented by Korea, and agreed to carefully consider it further.

At the October 1984 meeting, Brazil expressed regret that no concrete results had thus far been achieved as a result of the bilateral contacts with trading partners that it had launched following its December 1983 initiative in the Committee.

More recently, Chile, supported by Colombia, suggested that the Committee on Balance of Payments Restrictions should consider the possibility of holding advance discussions prior to the introduction of import restrictions by a consulting country. The purpose of such discussions would be to explore the possibility of some actions by its trading partners to improve the consulting country's export prospects, and thus possibly obviate or mitigate the need to introduce restrictions for balance of payments purposes. This suggestion is under discussion in the Committee.

7. Subsidies

Following the first oil price shock, subsidies grew in importance in most OECD countries. Charts II-1 and II-2 show their evolution in the industrial countries and the European Community, respectively.

Pressures for government intervention and subsidies have been high in specific sectors such as steel, agriculture, shipbuilding, and textiles and clothing. Although some understandings have been reached on greater discipline in subsidization (for example, in the European Community and at the OECD) in specific sectors such as steel, this has not yet been translated into actual reductions in government aids to ailing industries.

The issue of how subsidies should be defined remains open. If a broad measure of what constitutes a subsidy is used, the incidence of subsidization may be much higher than that shown by the definition used in Charts II-1 and II-2. For example, in a recent study for Germany, Schmidt (1984) broadened the definition to include not only current payments by the Federal Government, but also other subsidy payments by the Federal Government (in particular, one-time grants to enterprises), subsidy payments by other levels of government, and payments through special national and EC funds. The estimates also included the value of tax relief granted to enterprises. Thus, for 1981, the study arrived at an estimate for total subsidization of about DM 102 billion, comprising DM 70 billion in direct financial aids and DM 32 billion in tax relief, compared to the conventional estimate of DM 30 million. The study also found that the growth rates since 1973 for both measures of subsidization were approximately equal at an average annual rate of about 8 percent.

The complexities of improving the effectiveness of international disciplines on subsidization are reflected in the recent discussions on this subject in the GATT, the OECD, and elsewhere. The GATT subsidies code agreed at the Tokyo Round sought to improve and codify subsidy practices and disciplines. As a general principle, the code prohibits export subsidies on manufactured products; it also provides an illustrative, non-exhaustive list of practices that constitute export subsidies. The code does not prohibit domestic subsidies, but enjoins countries to avoid domestic subsidies that have adverse trade effects on other countries and permits the latter to offset these adverse trade effects through countervailing duties.

In the past three years, the Committee on Subsidies and Countervailing Measures, established to oversee the operation of the subsidies code, has attempted to define and make more operational the specific obligations of code signatories. Attention has focused especially on two issues: how to deal with export subsidies on agricultural products, and how to apply the rules on subsidies to developing countries.

The issue of agricultural export subsidies arose in a case 1/ brought before a GATT subsidies code panel by the United States, which contended that the European Community's subsidized sales of wheat flour in several individual markets had contributed to a loss in the U.S. market share, and that these Community practices were contrary to the

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1/ GATT document L/5719 (11/21/84); and Hufbauer and Erb (1984), pp. 37-41.

GATT stipulation that agricultural export subsidies should not be applied in a manner that resulted in the subsidizing country "having more than an equitable share of world trade" in that product. In its March 1983 report, the panel characterized the Community's export refunds for wheat flour as a subsidy under the GATT. However, the panel was unable to conclude that the Community's increased share represented "more than an equitable share" under the GATT code. The panel suggested that disputes in the area of agricultural export subsidies could only be resolved by strengthening the provisions of the code.

In another case brought before a panel, the United States complained about the European Community's subsidization of wheat used to produce pasta exported by the Community. 1/ The main issue concerned the use of a rebate on wheat used as an input in the manufacture of pasta. The European Community contended that the rebate on wheat was designed only to bring the European wheat price, protected by a variable levy, down to the world price. The U.S. view, however, was that, since European pasta manufacturers were not permitted to buy wheat at the world price from foreign sources, the export industry (pasta) was a conduit for enlarging the size of the subsidized activity (wheat), and the practice should be considered to be an export subsidy. The May 1983 panel report accepted the U.S. position. In both the wheat flour and the pasta cases, consultations on the panel reports are continuing in the Committee on Subsidies and Countervailing Measures. These and other recent cases are illustrative of the practical difficulties of agreeing on, and applying, operationally meaningful guidelines in the complex field of subsidy practices.

A further set of issues relates to the participation of developing countries in the GATT disciplines in the area of subsidies. For the developing countries, Article 14 of the code recognizes that "subsidies are an integral part of economic development programmes of developing countries," and, accordingly, the code "shall not prevent developing country signatories from adopting measures and policies to assist their industries, including those in the export sector."

In practice, domestic producers in industrial countries requiring relief against subsidized imports from developing countries seek redress primarily under national legislation. National legislation of code signatories is subject to multilateral review in the GATT Committee on Subsidies and Countervailing Measures. U.S. legislation mandates the application of the injury criterion to subsidy cases only for GATT code signatories (and to seven countries that had bilateral treaties with the United States but were not GATT members). In addition, the United States does not recognize a developing country as a signatory unless there is a commitment by that country to phase out or freeze its export subsidies.

1/ Hufbauer and Erb, op. cit., pp. 94-95.

In the past few years, there has been increased resort to countervailing duty petitions and investigations in a number of countries, with the sharpest rise occurring in the United States (Table II-7). This partly reflected the extensive resort to CVD petitions in the steel sector in the United States. More generally, recourse to the legal system is strongly embedded in the attitudes of U.S. firms; in addition, with the implementation of and publicity related to the subsidies code, countervailing duty petitions may have been considered by affected firms as a first line of investigation of the possibilities of protection. Procedures for dealing with unfair competition have also been strengthened in other countries, including Canada and the European Community.

A related--and equally complex--issue concerns the remedies available to producers injured by subsidized foreign competition. The main GATT-authorized remedy, viz., the countervailing duty, is designed to offset precisely the injurious effect of a foreign subsidy. As an authorized exception to the broad GATT principle of nondiscrimination, countervailing duties on a given product may be imposed at different rates on different suppliers. 1/ In lieu of the countervailing duty, the code allows an equivalent price undertaking by the exporter, or some other "equivalent understanding." While procedures have long existed for assessing the extent of the subsidy and the size of the countervailing duty, it is difficult, if not impossible, to determine accurately the quantity restriction that would be "equivalent" to a countervailing duty. When countervailing duty investigations are resolved through bilaterally agreed export restraints on quantities or market shares (even when this is the option preferred by the exporter, as often happens), the traditional distinction may be blurred between the concepts of "fair" and "unfair" competition, and a potentially GATT-legal action may assume the character of a "gray area" measure.

The recent frequency of complaints against subsidization (and dumping) has led some countries to complain of harassment. It is acknowledged that filing a complaint of unfair competition can, by itself, have a negative effect on the trade flow by increasing uncertainty of future access to the export market and by imposing considerable legal costs on the respondent. 2/ In several GATT fora, developing countries have suggested that the scope for automaticity in the response of industrial countries to industry petitions should be reduced. 3/ The industrial

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1/ Antidumping duties also fall within the category of permitted selective (discriminatory) measures, as do compensatory withdrawals of concessions occasioned by a safeguard action under Article XIX that does not lead to compensatory trade concessions on other products by the restricting country.

2/ This does not apply only to developing country exports. For example, the Canadian lumber industry, which had been found in the United States to have a subsidy margin of a fraction of 1 percent, is estimated to have spent some Can$500,000 in defending its case.

3/ GATT document COM.TD/118 (11/12/84), p. 15.

countries view provisions in domestic legislation for relief from unfair competition as a legitimate response to subsidized and dumped imports authorized under the General Agreement. Some observers have suggested that recourse by industry and labor groups to the provisions against unfair trade may have been made somewhat easier under amended domestic procedures applied since the Tokyo Round. Of the 21 signatories to the GATT code on subsidies, only six (Australia, Canada, Chile, the European Community, Japan, and the United States) took countervailing duty actions in the period January 1983-June 30, 1984. This suggests the difficulty that any attempt to harmonize approaches and procedures internationally in this area is likely to entail.

In recent years, the OECD Arrangement on Guidelines for Officially Supported Export Credits has been substantially revised in order to reduce the subsidy element in government export credit guarantees. Under the GATT subsidies code, export credit practices that conform to the OECD Arrangement do not constitute an export subsidy. In October 1983, the minimum interest rate permissible under the OECD Arrangement, which had been adjusted periodically in the light of market developments since 1981, became subject to an automatic adjustment mechanism. Minimum rates are adjusted every six months to reflect changes in market long-term bond rates in the United States, Germany, the United Kingdom, France, and Japan, provided that the weighted interest rate movement is at least 50 basis points since the previous change. Two unresolved issues relating to the OECD Arrangement are its inclusion of mixed export credits and concessional financing packages, and the minimum interest rate provisions applicable to so-called "low interest rate" countries. These issues remain under discussion in the OECD.

8. Services

The issue of trade in services has gained prominence in recent years. Following extensive initial study and deliberation, the United States has taken the lead in suggesting that a relatively high priority should be accorded to bringing trade in services within the GATT rules. At their November 1982 meeting, GATT ministers decided to recommend to each contracting party with an interest in services to undertake a national examination of the issues in the sector, and invited contracting parties to exchange information on such matters among themselves, inter alia, through international organizations such as the GATT. To date, 13 studies on services have been submitted to the GATT. 1/ At the November 1984 CONTRACTING PARTIES' session, it was agreed, after considerable discussion, to organize the exchange of information on services in the GATT with the support of the GATT secretariat. The CONTRACTING PARTIES also decided to review the results of national examinations, along with the information and comments provided by relevant international organizations, at their next session. At that time, they are also expected to consider "whether any multilateral action in these is appropriate and desirable."

1/ The national studies cover Canada, Denmark, the European Community, Finland, Germany, Italy, Japan, the Netherlands, Norway, Sweden, Switzerland, the United Kingdom, and the United States.

The issue of whether services should be dealt with in the GATT context, and whether barriers to trade in services should be addressed in any new round of trade negotiations, remains controversial. The question of whether some--or all--individual service sectors should receive priority attention also remains unresolved. Most industrial countries have expressed their willingness to consider options and to begin international discussions with a view at least to clarifying the potential parameters or approaches in respect of trade in services. Table II-8 shows the service sectors identified in four of the national studies. The studies provide indicators of the importance of service sectors to the national economy and to international trade, and summarize the main features of existing legislation governing the services sector, including in particular whether special barriers exist to international trade in services.

The U.S. submission, which is one of the most comprehensive national studies available on this subject, identifies certain conceptual issues that would need to be addressed in an international context. First, the existence of natural monopolies in some service industries is noted. The question is raised whether government monopolies discriminate between domestic and foreign purchasing firms, or, where public service monopolies are allowed to compete with private firms in providing services not covered by the monopoly, foreign private competitors are not unduly disadvantaged. Second, the study draws a distinction between investment in services and trade in services. For example, the provision of data processing services by a computer center located abroad may be considered to be a trade activity, while similar services provided locally by a foreign-owned firm may be regarded as an investment activity. Third, the study draws a distinction between the broader issue of immigration and labor movement across borders, and the more limited issue of facilitating the movement of people engaged in international sales and providing technical and professional services.

The U.K. study identifies several practices in the services sector that place suppliers of services originating abroad at a competitive disadvantage. Restrictions in the services sector may take different forms, but they have similar effects. For example, they may be imposed on the movement of funds, either across the board or in individual sectors, or on the movement of labor, for example, through regulations limiting the entry of professionally qualified foreign nationals. Restrictions on the flow of information (e.g., regulations on transborder data flows) may limit free trade in services. Other possible barriers include restrictions on consumers and industries limiting purchase of foreign services, discrimination in public procurement, and availability of state aids or tax holidays for local firms. The U.K. study suggests that any international approach to services problems should consider services as a whole rather than only addressing the special problems of individual sectors.

9. Trade policy surveillance

Since the November 1982 ministerial meeting, the GATT has stepped up its monitoring and surveillance of developments in the trading system. Thus far, eight special sessions of the GATT Council have been held to conduct this review. Since early 1984, the GATT secretariat has prepared more extensive background documents providing the basis for the special Council discussions. A major premise underlying the discussions is that greater transparency in national trade policy actions will contribute to resisting protectionist pressures and maintaining a liberal world trading order. Many governments expressed the view during these discussions that protectionist pressures had continued to mount, even during the recent period of economic recovery, and that greater efforts were required to resist protectionism.

As part of the Tokyo Round decisions, the GATT Consultative Group of Eighteen was established as a permanent body in 1979 to assist the CONTRACTING PARTIES with their responsibilities to maintain trade policies consistent with GATT objectives, to forestall sudden disturbances that could threaten the multilateral trading system and the international adjustment process, and to facilitate coordination between the Fund and the GATT in this context. In 1983-84, the Group reviewed the degree to which governments had adhered to the political commitments of the 1982 ministerial declaration, and discussed several other issues, including subsidies, structural adjustment, countertrade, and dispute settlement.

The Group also considered the links between trade policy and the international financial system. It emphasized that trade problems and negotiations should be dealt with under the aegis of the GATT and in conformity with GATT principles. It was generally accepted in their discussions that developed countries had a responsibility to liberalize access to their markets for developing countries' exports, in order to ease debt problems of developing countries and contribute to their development. However, it was stated that the ability to maintain such a positive attitude depended in part on the readiness of the developing countries themselves to maintain relatively liberal trade policies and to enlarge trade opportunities for their partners. The Group underlined the impact of large budget deficits and high interest rates on the debt burden of developing countries. 1/

The Consultative Group of Eighteen also supported GATT contacts with the Fund and the Bank, which it believed would "sensitize the 'constituencies' of the three institutions to the linkages between the subjects which are their primary concern, while respecting their different fields of competence." 2/

1/ GATT document L/5721 (11/6/84), p. 2.
2/ GATT document L/5721 (11/6/84), p. 3.

In May 1984, the OECD governments agreed to advance the implementation of the Tokyo Round tariff reductions by one year. This agreement was subject to completion of the requisite domestic procedures. The OECD ministers also expressed the hope that it would be possible to achieve the final reduction in tariff cuts, scheduled for 1987, in 1986. In addition, OECD member countries that did not already provide duty- and quota-free access for all imports from the least developed countries would seek to move further in that direction. 1/

The proposed acceleration of Tokyo Round tariff cuts has not yet been fully implemented. Action by the United States will depend on Congressional approval. As already noted, the European Community has announced that it will advance the tariff reductions for products of interest to the developing countries, but that the timing of the remaining advance cuts will depend on action by the United States. In addition, the European Community has announced proposals for liberalizing certain quantitative restrictions. For 1985, Japan has announced that its Tokyo Round tariff cuts on industrial products will be advanced by two years, and those on agricultural products by one year. The accelerated tariff reduction by OECD countries is generally regarded as a positive, confidence-building measure; its main result will be to lower the average tariff on industrial products by less than 1 percentage point from its current level of about 5 1/2 percent.

At the 1984 OECD Council, ministers also agreed on an extensive work program aimed at developing "specific proposals for individual and collective action." 1/ Accordingly, the OECD is currently engaged in a series of sector-specific studies on textiles, footwear, steel, consumer electronics, automobiles, and machine tools, to identify, for each sector, the scope for action to liberalize trade-restricting and trade-distorting measures. A report "on the possibilities for concerted action, including specific actions to expand imports from developing countries," is to be prepared for the 1985 meeting of the OECD Council.

10. Other issues

a. Natural resource products

At the initiative of Canada and some developing countries, a GATT Working Party on Trade in Certain Natural Resource Products was established in early 1984. The Working Party is conducting an examination of tariff and nontariff barriers to trade in nonferrous metals and minerals, forestry products, and fish and fish products, with a view to recommending possible solutions to trade problems in these sectors. The nonferrous metals and minerals under study include zinc and lead, copper, nickel, tin, and aluminum.

1/ OECD Press Release, Press/A(84)28 (5/18/84).

b. Dispute settlement

In recent years, there has been increased recourse to GATT dispute settlement procedures (Table II-9 provides a list of panels established in the GATT). Considerable attention has also been focused on improving the GATT dispute settlement procedures. The November 1984 CONTRACTING PARTIES' session endorsed a proposal authorizing the Director-General of the GATT to appoint persons to GATT panels in the event that countries in a panel dispute failed to agree on its composition under certain circumstances.

The GATT Council also considered how to improve its surveillance role with respect to the implementation of panel reports. The improvements would be aimed at encouraging greater compliance by contracting parties to panel recommendations. In the past, panel opinions have on occasion been ignored, or not allowed to come to the stage of formal adoption by the GATT by the contracting party whose trade measures or policies were deemed to be inconsistent under a panel finding.

III. Industrial Trade Policies

1. Trade trends in manufactured products

World output of manufactures rose by 4 percent in 1983, in contrast to a decline of 2 percent in 1982. Tables III-1 and III-2 present the regional and commodity compositions of world trade in manufactures. The value of world manufactured exports (in U.S. dollars) increased only marginally in 1983. Export values declined in industrial countries in every major manufacturing category except chemicals and "other semimanufactures." In the engineering products category, however, a substantial increase was registered for office and telecommunications equipment (16 percent), and moderate increases occurred for road motor vehicles, and household appliances.

Developing countries' exports of manufactures rose in 1983, and their share in world trade in manufactures increased to 12 percent. They increased their exports of textiles and clothing by 4 percent, and substantially expanded their exports of office machinery and telecommunications equipment (by 26 percent), general machinery (15 percent), household equipment and motor vehicles (10 percent each), and iron and steel (7 percent).

2. Steel

The steel sector has been under strain during much of the past decade, owing to the existence of overcapacity and sluggish demand. Tables III-3 through III-5 present information on steel production, capacity, and trade. World consumption and production of steel declined sharply between 1979 and 1982. The emergence of new steel producers in some of the developing countries, including Brazil, Korea, and Mexico, increased the need for adjustment in some of the OECD countries.

In 1983, a mild recovery took place in the OECD countries as a whole, with consumption and production rising by about 2 percent each, mainly attributable to recovery in North America. Installed capacity continued to decline in the OECD countries, but rose in the rest of the world. The rate of capacity utilization in the OECD countries improved marginally to 60 percent in 1983, but employment continued the declining trend observed since 1974. In the first three quarters of 1984, steel production in the OECD countries was about 12 percent higher than in the corresponding period of 1983. However, the year-on-year increase in the third quarter production was much more moderate, reflecting a slowdown in the growth of steel demand.

The volume of world steel exports rose by 5 percent in 1983; exports of OECD countries expanded by 4 percent, and those of developing countries rose by 14 percent. Steel prices (in U.S. dollars) generally remained weak, partly due to increasing competition from developing countries. Prices on world export markets were some 10-20 percent lower than Japanese and EC home market prices which, in turn, were significantly lower than U.S. list prices; in practice, however, list prices in the United States are subject to considerable discounts.

a. United States

The steel industry experienced very depressed conditions in 1982. Crude steel production fell by 38 percent to less than 68 million tons, the lowest level since 1946. Capacity utilization fell markedly to only 37 percent in the last quarter of 1982. Although the volume of imports declined by 16 percent, the import penetration ratio rose by nearly 3 percentage points to a record of nearly 22 percent. These conditions precipitated substantial layoffs and industry-wide operating losses of about $2.5 billion.

Reflecting the pickup in domestic demand, production rose by 13 percent in 1983 and by 18 percent in the first three quarters of 1984, although growth began to decelerate around mid-year. Capacity utilization picked up, but was still below 60 percent by the third quarter of 1984. Employment continued to decline, and, by end-1983, amounted to a little over half of the 1974 level.

The faster increase in demand in the United States compared with other countries, together with the substantial appreciation of the U.S. dollar in the past several years which further weakened the competitive position of the domestic steel industry, resulted in an upsurge in imports. The volume of imports of steel mill products rose by 72 percent in the first eight months of 1984 compared with the corresponding period of 1983, and the import penetration ratio rose by over 6 percentage points to 25.8 percent (Table III-6). The increase in imports derived from virtually all suppliers. Imports from the three largest suppliers--Japan, the EC, and Canada--rose by 48-81 percent. Increases of 20-50 percent derived from Argentina, Brazil, and South Africa, 50-100 percent from Finland, Korea, and Mexico, 200-230 percent from Spain and Sweden, and over 1,000 percent from very small suppliers such as Austria, the German Democratic Republic, and Romania.

Against this background, demands for protection rose sharply in 1982-84. They were formulated both in terms of the need for traditional safeguard measures from "fair" competition, and for measures to offset the effects of perceived "unfair" competition arising from alleged dumping and foreign subsidies.

Since 1981, the number of antidumping (AD) and countervailing (CVD) duty petitions filed by U.S. steel producers has increased sharply. The implementation of the Tokyo Round code on subsidies and enactment of the U.S. Trade Act of 1979 increased awareness of the possibilities of recourse against "unfair" import competition; at the same time, industry dissatisfaction mounted regarding the operation of the Trigger Price Mechanism (TPM), which had been set up as an alternative mechanism to the filing of dumping and subsidy complaints in the steel sector. The TPM was abolished in January 1982.

The AD and CVD petitions investigated during 1982-84 covered a wide variety of steel products from both industrial (mainly European) and developing (mainly Latin American and European) countries. Although several petitions were dismissed on grounds of insufficient evidence of dumping/subsidization or injury, affirmative rulings were made in a substantial number of cases. In a significant number of cases, foreign suppliers limited the volume of steel exports in return for a withdrawal of petitions by U.S. firms. This probably reflects a preference for market-sharing arrangements compared to the uncertain effects of price measures on volumes traded and the risk of new complaints being filed.

A notable example of such voluntary export restraints (VERs) following positive dumping/countervailing determinations was the EC-U.S. VER concluded in October 1982, under which the Community agreed to limit, for the period November 1, 1982-December 31, 1985, exports of specified carbon steel mill products to the United States to specified shares of the U.S. market. Based on 1981 data for consumption of the various products, this agreement restricted imports from the Community to around 5 1/2 percent of U.S. consumption of the steel products covered by the arrangement, compared with 9 percent late in 1981. At about the same time, there was a separate, less formal arrangement, through an exchange of letters, under which a U.S. market share of 5.9 percent for Community exports of pipes and tubes was agreed, and consultations would be triggered in the event this level was exceeded. The two arrangements together covered about 90 percent of the Community's steel exports to the United States. The Community made the arrangements conditional on the withdrawal of all AD and CVD petitions by U.S. producers against Community suppliers, and avoidance of new complaints.

In July 1983, the U.S. President imposed safeguard measures in accordance with GATT Article XIX, in the form of duty increases and global quotas on certain specialty steel products for a four-year period. 1/ This import relief was granted following a finding by the U.S. International Trade Commission (USITC) that imports were a substantial cause of injury to the U.S. specialty steel industry. Similar protection from imports under the escape clause had been given to the specialty steel industry from June 1976 to February 1980.

A new escape clause petition (under Section 201 of the U.S. Trade Act of 1974) covering all imports of carbon and alloy steel, excluding stainless and tool steel, was filed by U.S. firms in January 1984. In June, the USITC issued an affirmative determination of injury, and, in early July, it recommended import relief for five years in the form of higher tariffs and global quotas.

On September 18, 1984, the official steel decision was announced, based on four main elements: (1) reaffirmation of the U.S. commitment to an open world trading system and a determination that protectionist relief for the steel industry under Section 201 of the U.S. Trade Act of 1974, as recommended by the USITC, was not in the national economic interest; (2) vigorous and comprehensive action against unfair trade practices by steel exporting countries; (3) negotiated "surge control" arrangements with countries whose exports had increased rapidly, excessively, and unfairly, to the detriment of the U.S. economy; and (4) a steel import stabilization framework in which comprehensive action against unfair trade practices could be expected to result in a moderate and stable import share of the U.S. steel market and provide the domestic industry time to undertake adjustment, modernization, and strengthening of its competitive position.

The specific actions under the new steel policy were based on the conviction that "unfair" trade practices were the preponderant source of the injury to the domestic steel industry. These actions included, inter alia, negotiation of bilateral arrangements with suppliers, consultations with trading partners to eliminate trade distortive practices,

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1/ An additional 10 percent ad valorem tariff was imposed on stainless steel sheet and strip in the first year, declining by 2 percentage points in each succeeding year. Stainless steel plate is subject to an additional 8 percent tariff in the first year, declining to 6, 5, and 4 percent in the next three years. Imports of stainless steel rod are limited to 19,100 tons in the first year, 19,700 tons in the second, 20,300 tons in the third, and 20,900 tons in the fourth. Alloy tool steel is subject to a quota of 22,400 tons in the first year, rising by 700 tons in each of the following three years. The U.S. Special Trade Representative was authorized to negotiate orderly marketing arrangements with supplier countries. Agreements were reached with Argentina, Austria, Canada, Japan, Poland, Spain, and Sweden. In response to this action, following failure to reach agreement on appropriate compensation, effective March 1984, the EC took measures to suspend "substantially equivalent" concessions under GATT provisions, by imposing tariff increases and quotas on imports from the United States of methanol, vinyl acetate, burglar and fire alarm systems, and certain sporting goods.

monitoring of efforts by the U.S. steel industry to adjust and modernize, and examination of domestic tax, regulatory and other policies which hindered such efforts. The Administration expected the return to "normal" market forces and "fair" trade represented in the new steel policy to result in a "market-determined" import penetration ratio of approximately 18 1/2 percent, excluding semifinished steel.

In October 1984, the President was given legal authority to enforce bilateral arrangements with foreign steel suppliers as part of the steel provisions under the Trade and Tariff Act of 1984. The authority was provided for a maximum period of five years, annually renewable, on condition that the domestic steel industry reinvested profits in plant modernization and worker retraining. It was the "sense of the Congress" that implementation of the steel policy would result in a market share for steel imports in the 17-20 percent range. If the policy did not produce satisfactory results within a reasonable period, Congress would consider further legislative action.

Within three months after the steel decision, bilateral agreements, generally covering a period of five years and restricting shares in the U.S. market to specified proportions, were negotiated with seven suppliers: Australia (0.18 percent), Brazil (0.8 percent), Japan (5.8 percent), Korea (1.9 percent), Mexico (0.3 percent), South Africa (0.42 percent), and Spain (0.67 percent). Imports from other suppliers were to be monitored. The 1982 carbon steel agreement with the EC remained intact. However, trade frictions arose on pipe and tube imports from the EC, which had risen sharply above the levels in the 1982 "understanding," and, in late November 1984, the United States banned such imports until end-December 1984. In early 1985, a new agreement for a period of two years was reached with the Community, under which imports of pipes and tubes would be limited to 7.6 percent of the U.S. market, compared with an estimated market share of 14.6 percent in 1984.

The outstanding ADs and CVDs applying to the agreement countries were suspended. Subsequently, the U.S. industry filed 28 AD and CVD petitions against eight nonagreement countries (Austria, Czechoslovakia, the German Democratic Republic, Hungary, Poland, Romania, Sweden, and Venezuela).

b. European Community

Over the five-year period ending 1983, the Community steel market was generally depressed; apparent consumption and crude steel production declined continuously, with the latter reverting to its mid-1960 level. Partly reflecting restructuring efforts, installed capacity has declined steadily since 1980. Employment has fallen markedly, and, by end-1983, stood at about 63 percent of the 1974 employment level.

Some signs of recovery emerged in 1984, with production rising by an estimated 12 percent in the first three quarters, compared with the depressed level of the corresponding period in 1983; the decisive factor in the increase was a rise in stocks and in exports, rather than a significant upturn in domestic consumption of steel.

The Community has traditionally been a net exporter of steel. The substantial gain in net exports in 1981 was reversed in 1982, improved marginally in 1983, and is estimated to have improved significantly in 1984. Import penetration declined during 1980-81, but rose to 12.7 percent in 1982, and was maintained at this level in 1983.

Since 1980, the Community's steel industry has been declared to be in a state of "manifest crisis," and internal and external measures have been applied to achieve a better balance between supply and demand and to allow an orderly rationalization of production capacity.

The internal measures comprise establishment of production quotas (mandatory or voluntary) and target guide prices for a number of steel products. The quotas are determined quarterly on the basis of the current situation and prospects, and take into account the objective of rationalizing capacity in the medium term. Since the inception of the system, the range of products under mandatory quotas has been broadened, its coverage has been widened to both production and deliveries, and its application has been extended to the currently agreed expiration date of December 31, 1985.

In 1983-84, the internal measures were strengthened by, inter alia, the introduction of requirements for production certificates and accompanying documents for deliveries within the Community, the introduction for some products of a system of minimum prices in addition to the target guide prices, sanctions against transactions below the minimum prices, and the introduction of the payment of a deposit which would be retained should underpricing or overproduction be ascertained. An examination of the medium-term outlook by the Commission in March 1983 indicated that, up to 1985, surplus production capacity for crude steel was expected to be of the order of 56-58 million tons, and that for finished products of the order of 48-50 million tons.

The Community also operates a code on state aids to the steel industry, which aims at progressively phasing out state aids over the medium term so that normal market conditions may be restored without recourse to distorting subsidies. The aids code, adopted in 1980 and substantially strengthened in 1981, called for the termination (with certain exceptions) of operational aids by the end of 1984, and of general aids by the end of 1985. Aids could be granted only to enterprises engaged in restructuring programs leading to capacity reductions, and in proportion to the restructuring efforts. Further, aids had to be notified to the Commission by September 30, 1982, and authorized by July 1, 1983. The number of cases submitted to the Commission were 23, 95, and 27 in 1981, 1982, and 1983, respectively; in 1983, the Commission rejected 9 cases.

In accordance with the timetable laid down by the code, the Commission gave its final decisions on June 29, 1983 on member states' proposals for steel aid and the corresponding restructuring plans. It determined that, in all important cases, these plans were sufficient "neither to restore the viability of the undertakings concerned by 1986 nor to achieve a general reduction of capacity of sufficient magnitude to enable the industry as a whole to recover the minimal degree of utilization capacity necessary to make it viable." 1/ Consequently, the Commission made its decisions on the aids subject to further restructuring, and extended the period for submission of member states' final plans to January 31, 1984. The Commission required minimum additional capacity reductions of 8.3 million tons, bringing the total capacity reduction during 1980-85 to at least 26.7 million tons (Table III-7), in line with the original objective of reducing capacity by 30-35 million tons by end-1985. The Commission decisions contained a number of provisions to ensure that aid was used only for its authorized purpose, and that it did not result in unwarranted distortions of competition. In view of the difficulties of some members, the deadline on operational aid was extended from end-December 1984 to end-December 1985.

Complementing the internal measures is a system of external measures aimed at maintaining traditional trade flows and import price monitoring. This takes the form of bilateral arrangements with the main foreign suppliers to regulate import volumes, or a basic import price system.

The bilateral agreements are negotiated annually, based on expected domestic consumption and in reference to 1980 import levels. Under the arrangements, import volumes were set at 12.5, 9, and 12.5 percent below the 1980 import level in 1981, 1982, and 1983, respectively. The number of bilateral agreements has been steadily increased, and totaled 15 in 1984, covering 75-80 percent of the Community's total imports. 2/ The import volumes negotiated for 1984 were about the same as in the 1983 arrangements. Some of these arrangements include a "triple clause" provision dealing with staggering of imports over the year, geographical distribution among the Community members, and breakdown of imports by product. Monitoring was strengthened in 1983-84 in order to ensure compliance with the triple clause.

The basic import price system applicable to nonagreement countries sets floor prices which, if not observed, can lead to dumping actions against the foreign supplier. Monitoring was strengthened in 1983-84; in particular, a system was set up to collect and transmit import data so that the Commission, the member states, and the domestic industry could assess import trends speedily and, if necessary, initiate anti-dumping measures. Under the bilateral arrangements, foreign suppliers may provide "discounts" (of up to 4-6 percent) on basic import prices.

1/ Commission of the European Communities, Seventeenth General Report on the Activities of the European Communities, 1983, (Brussels: 1984), p. 117.

2/ In 1984, the Community maintained bilateral agreements with Australia, Austria, Brazil (pig iron only), Bulgaria, Czechoslovakia, Finland, Hungary, Japan, Korea, Norway, Poland, Romania, South Africa, Spain, and Sweden. Regulation of imports in the arrangements with the four EFTA countries is less specific than in the other arrangments. The arrangement with Japan is of a special nature.

c. Canada

The Canadian steel industry is highly competitive, owing to major investments and modernization of plants undertaken in the last two decades. Apparent consumption and production declined significantly in 1982, but recovery began in 1983 and strengthened in 1984. Canadian steel exports are mostly directed toward the United States, while the latter supplies a significant share of Canadian imports; thus, the North American market is highly integrated.

Canada does not maintain quantitative restrictions on steel imports. Since 1978, a system of benchmark prices has been operative as a monitoring mechanism. AD and CVD investigations increased during 1983-84. In the period October 1983-September 1984, definitive ADs were imposed on carbon and alloy steel plate (Belgium, Brazil, Czechoslovakia, West Germany, France, Korea, Romania, Spain, Sweden, South Africa, and the United Kingdom), steel beams (Belgium, Korea, West Germany), and carbon steel welded pipe (Korea).

d. Australia

In May 1982, the government requested the Industries Assistance Commission (IAC) to investigate whether assistance should be accorded the steel industry. In August 1983, despite a negative report by the IAC, the government announced a five-year assistance package for the industry, commencing January 1, 1984. The main element was the introduction of sliding-scale bounties on four 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 per year, with that for individual bounties being 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 share of the domestic market in eight specified product categories fell below 80 percent or rose above 90 percent. In the first four months of 1984, four of the eight monitored product categories had fallen below 80 percent and four had exceeded 90 percent. Thus far, the only change in the scheme due to this deviation from target levels has been the withdrawal of developing country preferential treatment for Korean exports of hot-rolled steel strip and plates. The steel plan 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 plan provided for the introduction of a "fast track" dumping mechanism for steel products.

3. Textiles and clothing

a. Recent trade trends

World output of textiles and clothing recovered in 1983. In the industrial countries, production of textiles rose by 2 1/2 percent, and that of clothing by 1 1/2 percent, in contrast to the declines in 1982. In the developing countries, output of textiles rose by 2 1/2 percent, and of clothing by 7 1/2 percent, based on the United Nations production index for the first nine months of 1983.

World exports of textiles (in U.S. dollars) remained virtually unchanged in 1983, compared with a decline of 7 1/2 percent in 1982. Exports of industrial countries declined, but those of developing countries increased, and their share in world exports rose by 1 percentage point to 25 percent in 1983. Industrial countries' share of world imports rose somewhat to 56 1/2 percent in 1983. Imports rose strongly in the United States (15 percent) and Canada (24 percent), but declined, for the third consecutive year, in the EC and Japan (Table III-8).

World exports of clothing (in U.S. dollars) rose by 1 1/2 percent in 1983, in contrast to a decline in 1982. Exports of industrial countries declined, while those of developing countries rose, and their share in world exports rose to 42 percent. By contrast, the share of industrial countries in world imports rose again in 1983 to 76 percent. Imports rose strongly in the United States (19 percent) and Canada (23 percent), but declined in the EC (by 4 percent) and Japan (18 percent).

Volume estimates indicate that world trade in textiles and clothing taken together increased by around 6 percent in 1983, in contrast to the stagnation in 1982. Growth in industrial countries' import volumes accelerated from 1 1/2 percent in 1982 to around 7 percent in 1983. U.S. import volumes, in particular, accelerated sharply from 4 percent to 21 percent in 1983. Imports into the EC, which had stagnated in 1982, increased by about 4 percent in 1983, while those into Japan declined by around 8 percent.

b. Multifiber Arrangement

Over the past 25 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 Multifiber Arrangement (MFA) came into existence as a "temporary" derogation 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 succeeded by MFA II (1978-81), and extended by MFA III (1982-July 1986). By mid-1984, there were 42 participants in the MFA.

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. The "flexibility" provisions of the MFA refer to 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 1981 protocol of extension of the Multifiber Arrangement (commonly known as MFA III) allows, on a bilaterally agreed basis, a growth rate lower than 6 percent in "exceptional" cases, and the possibility of stricter terms of access for "dominant" suppliers and of additional safeguard action (with compensation) in the event of sharp and substantial increases in imports within the agreed quotas. In addition, there are various provisions relating to restraints on exports of small suppliers, importing countries with small markets whose "minimum viable production" may be threatened, special consideration for cotton-producing exporting countries, and problems of circumvention caused by transshipment or rerouting of exports.

Restraints under the MFA have been applied almost exclusively to products from developing countries. Table III-9 lists the bilateral agreements (over 80 in number) in effect in mid-1984 under Article 4 of the MFA. Under MFA III, the number of bilateral agreements increased in relation to MFA II. Most bilateral agreements continued to be multiyear agreements, and 12 of them were valid beyond 1986.

A recent GATT review of operations so far under MFA III indicates that restraints were generally more extensive and more restrictive, compared with MFA II. The product coverage of the bilateral agreements tended to be more comprehensive, and, in a large number of agreements, growth and/or flexibility provisions were applied more restrictively. In particular, in all agreements concluded with major suppliers (Hong Kong and Korea), and in most agreements concluded with eastern European suppliers, the growth and flexibility provisions were lower than in previous agreements. There was also greater recourse to unilateral measures under Article 3 of the MFA, particularly in 1983-84. In restraining imports under the MFA, most importing countries had extensive recourse to provisions relating to "exceptional circumstances," or "minimum viable production." It is difficult to determine conclusively whether this was attributable to a change in economic factors relevant to trade in textiles and clothing, or to a change in attitudes of governments toward the utilization of the MFA; a combination and interaction of both factors was probably at work.

The brunt of the more severe application of MFA provisions has been borne by developing countries, some of which have had their production and marketing adversely affected, even though the MFA explicitly recognizes the need for developing countries to receive special treatment. Against the background of a difficult world economic environment, MFA III may have contributed, on an aggregate basis, to the orderly development of world trade in textiles and clothing and the increased export earnings of developing countries, particularly if it is assumed that, in the absence of MFA III, more severe and uncoordinated unilateral restrictions would have been imposed by the importing countries. However, no headway has been made in the objectives of achieving reduced barriers and progressive liberalization of world trade in these sectors.

c. GATT study

The GATT secretariat recently completed a major study, GATT (1984), on textiles and clothing in the world economy. The study notes that textile industries have played a key role in the initial industrialization process in most countries, and the pattern has been for new suppliers to successfully challenge countries further up the development ladder. The transition process has not been smooth for the textile and clothing sectors in the developed countries, due to the lack of sufficient structural flexibility, the fact that these industries were large employers concentrated in particular geographic regions with work forces having special characteristics, and because the slow growth of world consumption added to the difficulty of making room for new producers.

The GATT study observes that the concept of "market disruption" was introduced in the 1960s as a basis for controlling "low wage" imports into industrial countries. The market disruption concept in a GATT-sanctioned special international trade regime for textiles and clothing implied that a potential (rather than actual) injurious increase in imports was sufficient to justify additional restrictions; these could be applied on a discriminatory rather than an MFN basis, and the existence (size) of a price differential could be used to determine the need for additional restrictions.

Over the past three decades, while intra-industrial trade in textiles was liberalized, the scope of nontariff restrictions against developing countries continued to expand. In the developing countries, with certain important exceptions, tariffs on textiles and clothing remained high and unbound and quantitative restrictions continued to be applied on infant industry grounds or for balance of payments purposes.

The study observes that the adoption of labor-saving automation has helped restore comparative advantage to the developed countries in many types of textiles. Despite their relatively strong competitive positions, the synthetic fiber and textile industries in the developed countries have continued to be active supporters of the MFA. The synthetic fiber producers sell more than 80 percent of their output to domestic textile firms, which in turn sell more than 80 percent of their output in their own domestic markets, and both industries are thus affected by changes in the level of imports of clothing and household furnishings. Synthetic fiber and textile producers in developed countries have argued that import restrictions in developing countries are the main obstacle to their efforts to reduce dependence on domestic sales.

In designing future trade policies for textiles and clothing, the argument of the uniqueness of the competitive challenge facing textiles and clothing is less defensible than in the 1930s or the 1950s. The two principal criteria used in the past to justify a separate trade regime were the unique challenge posed by "low cost" imports, and the crucial importance of employment and production in the two industries in overall economic activity. The first point would be difficult to argue in the 1980s, since a number of developing countries have become competitive in a wide range of manufactured goods (footwear, ships, radios, televisions, other light consumer goods, steel, and other manufactures) for which special GATT rules do not exist. Moreover, several advanced developing countries are also subject to pressures from "low cost" imports. On the second criterion, the relative importance of the textile and clothing sectors in the developed countries has declined steadily since the 1950s. By 1980, the two sectors together contributed less than 3 percent to total employment and around 1.5 percent to output in the United States and Western Europe (Table III-10).

The study concludes that trade policy officials face essentially the same general issues in dealing with textiles and clothing as they do in dealing with several other tradable goods industries, and that:

> [T]he fundamental issue is structural adjustment, that is, the way in which economies respond to the pressures for changes in the patterns of production and trade that are inherent in the process of economic growth. In many respects, the structural adjustment problem confronting the textiles and clothing industries in the developed countries is the prototype for structural adjustment in general. Future policy decisions regarding these two industries will be a key test of the developed countries' approach to structural adjustment. 1/

d. United States

There was a marked acceleration in the growth of U.S. clothing imports in 1983, reflecting both the recovery in consumer expenditure and the continued strength of the dollar. Clothing imports, accounting for just over three fourths of total imports of textiles and clothing, grew in 1983 (19 percent) at more than double the rate of the previous year. The 14 1/2 percent increase in textile imports in 1983 was in sharp contrast to the 1982 decline of 7 percent. Textile and clothing exports continued to decline in 1983, for the third consecutive year for textiles and the second consecutive year for clothing. The combined trade deficit for textiles and clothing jumped by $2 1/2 billion to $10 1/2 billion, of which only around $1 billion was in textiles and the rest in clothing.

In 1984, imports of textiles and clothing accelerated further to 32 percent. The upsurge in imports generated intense protectionist pressures during 1983-84, and a number of import measures were taken.

1/ GATT, Textiles and Clothing in the World Economy (Geneva: July 1984), page 12.

In December 1983, the internal criteria 1/ were announced for reviewing imports of certain textile or apparel products from particular sources, in order to determine the existence of market disruption or threat thereof. The new mechanism enabled a relatively more automatic and speedier consideration of "calls" to be made on supplying countries in cases of actual or potential market disruption. In the year since the measure was announced, about 120 "calls" were made. While the number of actual calls was well below the potential calls implied by an automatic application of the internal criteria, it represented a marked increase in recourse to calls, compared to the previous year.

Effective September 7, 1984, new rules of origin were introduced governing imports of textiles and textile products, in order to prevent "circumvention or frustration of multilateral and bilateral agreements" and to "facilitate efficient and equitable administration" of the U.S. Textile Import Program. These were published as "Customs Service Regulations on Textiles and Textile Products (49 Fed. Reg. 31248, August 3, 1984)." Under these rules, an article's country of origin is determined (1) when it is wholly the growth, product, or manufacture of the concerned country, or (2) when it consists in whole or in part of materials originating from another country, but meets a double requirement: first, the manufacturing or processing in the concerned country is substantial compared to that occurring in the original country, and second, the manufacturing/processing is so substantial that the article can be considered new and different from the original. The specific (and non-exhaustive) list of manufacturing/processing activity which does not confer origin includes (a) simple combining or packaging; (b) joining together by sewing, looping, linking, or other means of attaching otherwise completed articles; (c) cutting or separating materials already marked for the purpose; and (d) processing such as dying, printing, showerproofing, superwashing, or other finishing operations. To determine whether substantial manufacturing/processing has occurred, a comparison will be made between the article before and after such manufacturing/processing. The criteria for this purpose include the extent of material, labor, and other direct processing or manufacturing costs; the time, complexity, and skill or technology involved in the manufacturing/processing operation; and the physical change of the

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1/ Under the criteria, imports would be reviewed when (a) total growth in imports in the particular product/category were more than 30 percent in the most recent year, or the ratio of total imports to domestic production in the product/category was 20 percent or more; and (b) imports from a particular foreign country equaled 1 percent or more of the total U.S. production of that product/category. For countries with which Export Authorization Arrangements had been concluded, calls on each supplier would be made on any product/category when export authorizations in that particular product/category reached 65 percent of the specified Maximum Formula Level (MFL) or, in the opinion of the Chairman of the Committee for the Implementation of Textile Agreements, would exceed the MFL level in the absence of such a call, or if the product was in a category with an import-to-production ratio of 20 percent or more, or in categories with an increase of 30 percent or more.

article at each stage. Criteria to determine whether a new/different article has been made include changes in commercial identity, essential character, and commercial use. This information must be provided in a declaration accompanying the relevant shipment, so that U.S. Customs can make a determination on origin.

The United States maintains bilateral agreements with 20 countries under Article 4 of the MFA; 19 represent renewed agreements under MFA II, while one (Uruguay) was concluded for the first time (Table III-9). An agreement was negotiated with China in mid-1983, which superseded unilateral restrictions imposed in January 1983 against imports of textiles and textile products from China. A consultation agreement is maintained with Egypt. Bilateral agreements are also maintained with two nonparticipants in the MFA (Mauritius and Taiwan Province of China). Most of the agreements are comprehensive in nature and include all MFA categories; eight agreements have termination dates beyond 1986.

In comparison with MFA II, bilateral agreements under MFA III in some cases moved away from aggregate and/or group limits to individual product limits. Agreements with the dominant suppliers (Hong Kong and Korea) were tightened. The provisions of other agreements were generally at or above the MFA norms, except for wool categories.

The bilateral agreements contain consultation provisions under which unrestrained products may be exported without restraint, but procedures are included under which the United States can seek restraints. Based on notifications to the GATT's Textile Surveillance Body (TSB) under Article 4 of the MFA, over 100 consultation calls were made pursuant to the specific consultation provisions contained in these agreements in the period January 1, 1982-August 3, 1984; most of the notifications pertained to 1984. Consultations were requested with 13 exporting countries, with most taking place with Hong Kong, Korea, and China. Of the 89 new restraint limits set, approximately half were agreed bilaterally. Separately, 12 unilateral measures were notified to the TSB in the same period under Article 3:5 of the MFA with respect to certain imports from 7 countries; 1/ they were replaced by bilaterally agreed solutions with 4 countries.

In 1984, U.S. firms filed countervailing duty petitions covering a wide range of textile products imported from 13 countries; 2/ the petitions are under investigation by the U.S. Department of Commerce.

The measures taken in 1983-84 have been viewed with deep concern by trading partners, especially developing countries, as a reflection of a significant tightening of the U.S. policy. The new rules of origin especially have generated strong protests by trading partners at the

1/ Dominican Republic, Haiti, Indonesia, Korea, Maldives, Peru, and Turkey.

2/ Argentina, Colombia, Indonesia, Malaysia, Mexico, Panama, Peru, the Philippines, Portugal, Singapore, Sri Lanka, Thailand, and Turkey.

GATT, owing to the increased complexity and uncertainty associated with the trade regime and the feared adverse consequences on "legitimate" trade and efficient resource allocation.

e. European Community

During 1981-83, the textile and clothing sectors faced generally depressed domestic demand conditions, and output declined continuously. Imports of both textiles and clothing fell continuously in this period (Table III-8). Exports also declined, albeit at a slower rate. As a result, the trade deficit for clothing was reduced by $0.62 billion to $3.74 billion in 1983, while the trade surplus in textiles improved marginally to $1.58 billion.

During discussions on MFA III, the EC was concerned, inter alia, with two aspects--the market access enjoyed by the "dominant suppliers," and the need for an "anti-surge procedure" to prevent sharp and substantial increases in imports within quotas. While these concerns were reflected in the provisions of MFA III, the EC made its acceptance of the 1981 Protocol of Extension conditional on negotiation of satisfactory bilateral agreements. Such negotiations took place through most of 1982, and agreements under the 1977 Protocol of Extension remained operative in this period. During 1981-82, modifications were made to 13 bilateral agreements operative under the 1977 protocol, generally involving new restraints on clothing imports into individual EC members. 1/

The EC maintains 23 bilateral agreements under the MFA, in addition to agreements with Bulgaria, Haiti, and China. Agreements are maintained with eight other countries 2/ in the context of preferential arrangements. The EC took several safeguard measures against imports of certain textile products from Turkey in 1982-83, some of which were applicable only to imports of some EC members. Some EC members maintain quantitative restrictions on imports from those state-trading countries with which the EC has no bilateral textile agreements.

Bilateral agreements under MFA III are all effective January 1, 1983 through December 31, 1986. With the exception of the agreement with Egypt (which covers cotton products except yarn), all MFA products are covered by these agreements. The pattern of the restraints varies considerably in the different agreements; some products have been

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1/ The modifications notified to the Textile Surveillance Body concerned new limits on specified imports from Brazil, Egypt (France, Ireland), India (Ireland), Indonesia, Korea (France, Benelux, the United Kingdom, Ireland), Macao (France, Benelux, the United Kingdom, Ireland), Malaysia (Italy), the Philippines (Italy, the United Kingdom, Germany), Poland (Benelux, Ireland), Romania (Benelux), Singapore (the United Kingdom, Ireland), Sri Lanka (Benelux, France, the United Kingdom), and Thailand (Benelux, Denmark, France, the United Kingdom).

2/ Cyprus, Malta, Morocco, Tunisia, Turkey, Portugal, Spain, and Yugoslavia.

liberalized in several agreements, while new restrictions have been imposed on others. Agreements with dominant suppliers (Hong Kong, Korea, and Macao) have been tightened. In other agreements, growth rates for most restrained products, particularly "sensitive" categories, are lower than 6 percent, and also lower than in the previous agreements; in several cases, however, increases in base levels, together with the growth rates, provide compounded growth higher than 6 percent. Flexibility provisions are generally the same as in the previous agreements, except that their cumulative use is set at lower levels than in previous agreements for the three dominant suppliers. Acute and exceptional circumstances in the Community's market have been cited as the reasons for providing less than 6 percent growth rates and less than 7 percent swing.

Categories not subject to specific restraints are subject to the consultation procedure and are said to be "in the basket." A "call" for consultation may be made if imports of a particular product from the relevant country exceed a specified percentage. 1/ The bilateral agreements also specify the duration of the consultation period (typically two months) and the level at which exports may be suspended during consultations (typically 25 percent of the previous year's imports for three months). In the absence of mutual agreement, the new restraint level may be set at the minimum level specified in the agreement (typically 1980 imports, or 106 percent of the previous year's imports). Growth in subsequent years is subject to consultation, but may not be lower than the highest rate given to third MFA countries with a comparable level of trade.

Under the consultation procedure, 28 new restraints (all bilaterally agreed) involving nine suppliers 2/ were notified to the Textile Surveillance Body in the period January 1, 1983-August 3, 1984. With two exceptions, restraints were set at the member state level for imports into the United Kingdom (10), France (10), Ireland (4), and Italy (2).

Other provisions in the bilateral agreements include adjustments for the sensitive categories in the event of rapid increases in imports of underutilized quotas (the "anti-surge" mechanism); supplementary quotas on reimports of products after processing ("outward processing traffic"); price clauses (contained only in agreements with Czechoslovakia, Hungary, Poland, and Romania); and adjustment of quotas where circumvention has been established.

1/ In the majority of agreements, the percentages are 0.5, 2.5, and 5 percent of the previous year's extra EC imports of Group I, II, and III, respectively. For the dominant suppliers (Korea, Macao, and Hong Kong), they are lower: 0.2, 1.0, and 3 percent, respectively. In the case of Korea, all categories in Group I are under specific restraint. This procedure is also applicable at the individual EC member level.

2/ Czechoslovakia (1), Indonesia (4), Korea (3), Macao (8), Peru (2), the Philippines (1), Poland (1), Romania (4), and Thailand (4).

f. Other countries

Canada maintains 16 bilateral agreements under MFA III (Table III-9) and an agreement with Bulgaria. In January 1983, unilateral restrictions were imposed on imports of tailored-collar shirts from Indonesia for a one-year period; this measure was superseded by a bilateral agreement between the two countries. New bilateral agreements were negotiated in 1984 with Mauritius and Sri Lanka.

Under MFA III, a bilateral agreement with Japan was not renewed, while agreements were concluded for the first time with three suppliers (Czechoslovakia, Hungary, and Uruguay). The number of products included in the agreements varies. Quotas on certain products were liberalized in several agreements, but, in the case of Hong Kong, some liberalized products were subsequently placed under restraint at levels lower than previous restraint levels. In three agreements, some quotas were reduced, while base levels for other products were raised by more than 6 percent. In all agreements except those with Hong Kong, Korea, Poland, and Romania, increases in base levels together with growth rates provided for annual increases in access for products under restraint at 6 percent or above. While growth and flexibility provisions were generally set in accordance with MFA norms and were more liberal than those available under MFA II, limitations on the combined use of flexibility were set in several agreements. Two agreements were subsequently amended by introducing restraints on certain products.

Since the implementation of MFA III, based on notifications to the TSB, consultation provisions have been applied in nine cases, two of which resulted in restraints on trousers and jackets from Thailand, and the remainder in restraints on textile products from Hong Kong.

The Australian textile and clothing industry has experienced sustained import pressure since 1973. Subsequently, extensive restrictions were introduced under GATT Article XIX and now cover most textile and clothing products. Tariff quotas are the principal form of restriction. From 1975 to 1980, domestic clothing production protected by quota rose from about 40 percent to 90 percent of the total, and the proportion of textile production subject to quotas rose from 20 percent in 1974 to 30 percent in 1979.

In April 1980, the Australian Industries Assistance Commission (IAC) concluded that, since the existing level of assistance in the textile and clothing sector was delaying adjustment, its continuation could not be justified in the long run, and reductions in assistance were recommended.

In January 1982, the Government commenced a new seven-year program aimed at permitting a modest amount of trade liberalization. Broadly, the 1980 quota arrangements were maintained, but they allowed for greater flexibility and a controlled increase in imports. Quota increases in each period were determined by applying a quota expansion factor of about 2 percent per annum of existing imports and a market growth factor based on advice received from the Textiles, Clothing, and Footwear Advisory Committee. Tariff quotas were applied to a broader range of clothing and household textile products, while import quotas for most yarns and most fabrics were replaced by domestic subsidies. A new preference scheme for developing countries also applied to textiles and clothing, thus giving developing countries the opportunity to raise their share of the Australian market.

In October 1984, the Government asked the IAC to recommend assistance arrangements applicable from December 31, 1988, to examine the suitability of tariff and nontariff protection, taking account of the Government's desire to encourage restructuring by gradually reducing protection while maintaining specific positive adjustment measures.

4. Motor vehicles

a. Recent trade trends

World automobile production experienced a turnaround in 1983. Output rose by nearly 10 percent, in contrast to the recession-induced contraction in the previous four-year period. Industrial countries account for about 85 percent of world automobile production. In 1983, production rose sharply in the United States (32 percent) and Canada (22 percent), and moderately in the European Community (5 percent) and Japan (3 1/2 percent) (Table III-11).

A prominent development in the world automobile industry in the past several years has been the strong expansion of international investment by Japanese motor companies, especially in North America, and also in a number of developing countries. Protectionism against Japanese exports has played a role in stimulating such investments.

In volume terms, industrial countries' exports of automobiles increased by 6 percent in 1983, with strong growth in the United States (44 percent), Canada (17 percent), and Spain (25 percent). European Community exports rose moderately (3 percent), with Italy experiencing a strong increase (17 percent), but Germany witnessing a decline. Affected by trade restrictions abroad, Japan's export volume rose by only 1 percent in 1983. Japan remained the world's largest single exporter, but its share in total industrial country exports declined to 38 percent in 1983, compared with 41 percent in 1980.

In value terms, industrial countries' exports of automobiles and parts rose by 4 1/2 percent to $131.8 billion in 1983 (Table III-12). Developing country exports to the industrial countries, consisting mainly of parts exported by Mexico and Brazil, increased by 28 percent to an estimated $2.1 billion. Japan's passenger car exports rose considerably faster in value (8 percent) than in volume; a contributing factor was that voluntary export restraints induced Japanese industries to shift toward higher-valued products and enabled them to extract "economic rent" by raising export prices.

b. United States

Since March 1981, discriminatory trade restrictions have existed in the automobile sector in the form of "voluntary" restraints by Japan on exports of passenger cars to the United States. The restraints limited exports of Japanese passenger cars to the United States to 1.68 million units in the year ending March 1982 (about 8 percent below their 1980 level). This limit was maintained in the subsequent two years. The restraints were extended for a fourth year (April 1984-March 1985), with a 10 percent increase in the ceiling to 1.85 million units.

The restraints were introduced against the background of severe difficulties faced by the U.S. automobile industry. Between 1978 and 1980, domestic car sales in the U.S. market fell by 28 percent, U.S. producers shifted from a profit of $5.6 billion to a loss of $4.2 billion, and production and employment were curtailed sharply. Imports from Japan continued to rise rapidly and captured 21 percent of the domestic market in 1980, compared with less than 10 percent five years earlier.

In response to a petition for import relief under the escape clause filed by the U.S. industry in June 1980, the USITC ruled that, while imports were a contributing factor, the "substantial" causes of the industry's difficulties were a general decline in the demand for automobiles and a switch by consumers toward more fuel-efficient vehicles. The USITC recommended that no restrictive import action be taken. Following the USITC findings, Congress introduced legislation to restrict imports of passenger cars from Japan. The Japanese Government responded by agreeing to restrain exports to the United States.

Consumer demand remained depressed during 1981-82, and U.S. auto sales continued to decline, while the Japanese share of the U.S. market increased further to 22.6 percent in 1982, despite a drop in Japanese car sales. However, in 1983-84, there was a substantial turnaround in the situation of the U.S. automobile industry as production, domestic sales, and profits expanded sharply against the background of a marked pickup in consumer demand and continued restraints on Japanese exports. U.S. auto production rebounded from 5.1 million units in 1982 to 7.8 million units in 1984, and capacity utilization rose from 68 percent in 1981 to 87 percent in 1984. Overall capacity in 1984 remained below the 1979 level, principally because of the permanent closings of many older, inefficient assembly plants, while other plants were temporarily shut down to facilitate retooling and renovation. Employment in the industry also rebounded, though there were some 200,000 fewer employees in 1984 compared with the peak year 1979 employment level (930,000 employees). Following four years of losses, profits of the U.S. auto industry on U.S. operations amounted to $5.3 billion in 1983 and an estimated $10 billion in 1984.

The industry has dramatically reduced many of its fixed and variable costs since 1979, thus reducing its breakeven level. Labor costs were reduced by cutting both the salaried and hourly workforce and increasing productivity. Further, the industry lowered inventory-carrying costs, reorganized major divisions, increased component outsourcing, and made significant gains in quality control. Despite these improvements, there continues to be a production cost advantage in favor of Japanese producers; the estimates of the advantage range from $200 to $2,000 per unit. Based on a comparison of the Ohio-built Honda and a similar Honda built in Japan, the cost advantage of Japanese production is probably between $1,000 and $1,500 per auto. The cost advantage is generally attributed to lower wages and higher productivity of Japanese workers, better management, and exchange rate factors.

b. European Community

For a number of years, imports of automobiles from Japan have been subject to formal or informal restrictions, or equivalent measures, at the Community level and/or the individual member level.

Since 1956, Italy has imposed an annual quantitative limit of 2,200 units on imports of Japanese passenger cars. France maintains a de facto stabilization of Japanese automobile sales on the domestic market at about 3 percent of total sales. Japanese import penetration in the United Kingdom has been maintained below 11 percent on the basis of understandings existing since 1980 between the industries of the two countries. Japan has provided the Benelux countries with "forecasts" on the level of car exports, or assurances of moderation in their growth.

Since early 1981, the Community has exercised surveillance on imports of certain motor vehicles originating in Japan. Automobiles are among the ten products included in the three-year voluntary export restraints agreement reached in 1983 between the Community and Japan; the agreement calls for moderation in the growth of Japanese automobile exports to the Community, without a specific limit.

In 1981, the Commission observed that, while the economic recession following the second oil shock had aggravated the problems of the EC's auto industry, the fundamental source of its difficulties was its slow response to technological change. The Commission proposed that a Community policy and strategy be pursued in the auto sector with a view to effectively supporting the industry's restructuring efforts. Its guidelines placed priority on strengthening the internal market and coordinating and promoting research and development. At the same time, cooperation would be sought with Japan to reduce the trade imbalance.

With regard to strengthening the internal market, measures are being taken or formulated to (i) reduce the wide divergence in prices charged in different member states, 1/ and establish conditions to be fulfilled by selective distribution systems under Community competition law; (ii) harmonize technical and safety standards for cars; and (iii) abolish barriers and restrictions on the free movement of vehicles within the Community.

1/ For example, the untaxed price of a car in Denmark is about half that of the same car in the United Kingdom.

c. Canada

Since 1981, imports of passenger cars from Japan have been restricted by "voluntary" export restraints by Japan, similar to the latter's arrangement with the United States. These restrictions were motivated by the difficulties facing the automobile industry as a result of the economic recession and the rapid growth of Japanese imports, and by fears that the restraint arrangement between Japan and the United States could divert exports to Canada.

In June 1981, Japan announced that exports of passenger vehicles to the Canadian market from April 1, 1981 to March 31, 1982 were "forecast" to be 5.8 percent below the previous year's level, implying a limit of 174,213 units. Difficulties in negotiating restraints for the second year prompted a tightening of border checks and clearance delays for Japanese exports at Canadian customs. In response, Japan announced that its exports would not exceed 79,000 units in the period January 1, 1983-June 30, 1983. A limitation to 202,600 units for the period January 1, 1983-March 31, 1984 was subsequently announced. For the period April 1, 1983-March 31, 1984, such exports were limited to 153,000 units. For the period April 1, 1984-March 31, 1985, the ceiling on Japanese automobile exports was increased by 11 percent to 170,400 units.

In 1983, the Canadian Government commissioned a committee of eight representatives of Canadian manufacturers and the Auto Workers Union to report on the future of the automotive industry. The committee's report recommended, inter alia, adoption of local content rules with a view to reaching a ratio of 60 percent by 1987 for foreign cars whose sales exceeded a specified number; change in the purchase tax structure, which was considered to currently benefit imported models; and duties on imported cars from developing countries enjoying duty-free privileges. The committee also recommended the negotiation of an automotive pact with Japan, similar to the U.S.-Canada Automotive Agreement of 1965.

Demands for local content rules have not been implemented, but are being kept under review. The Canadian Government has encouraged Japanese investment in Canada's automotive sector, and some Japanese firms are believed to be considering establishment of automotive assembly plants in Canada. The Japanese Government has resisted linking the issue of its export restraints with the issue of investment.

5. Shipbuilding

a. Recent trade trends

The shipbuilding sector continues to face severe problems of excess capacity. Owing to government subsidies and aid programs, capacity in traditional producing areas has adjusted to an insufficient degree in response to a dramatic shift in comparative advantage to Japan and newly emerging producers. The outlook for a significant increase in demand in the short term is not bright.

Production data are presented in Table III-13. The share of EC producers fell from over one fifth in the late 1970s to below 15 percent during 1980-83. Conversely, Japan's share increased from one third in the late 1970s to about one half in the early 1980s, reflecting a rapid restructuring of its shipyards. There is an informal understanding that Japanese shipyards will limit their share of total production to 50 percent in terms of compensated gross tons. The share of the rest of the world has increased considerably, reflecting in particular the rapid rise of Korea as a major producer. The shifts in competitive positions are even more marked in terms of new orders (Table III-14).

Industrial countries are coordinating their efforts to modernize the shipbuilding industry and reduce installed capacity under the auspices of the OECD Working Party on Shipbuilding. The OECD General Guidelines for Government Policies in the Shipbuilding Industry, and General Arrangement for the Progressive Removal of Obstacles to Normal Competitive Conditions in the Shipbuilding Industry, were revised early in 1983, and aim to gradually reduce assistance measures that distort trade and discourage capacity adjustment, such as national aids, subsidized export credits, and discriminatory government procurement practices. The OECD Working Party's 1981 understanding on export credits for ships remains unchanged.

b. European Community

The Fifth Directive on shipbuilding, adopted in 1981, establishes a Community discipline for the granting of direct or indirect state aids to prevent distortions of competition which may result from uncontrolled state intervention and to ensure that public aid provides support for the necessary restructuring. The reduction in capacity and the phasing out of aid are to be achieved according to a varying timetable for each member state in the light of individual circumstances. The application of the Directive has been extended from end-1984 to end-1986.

In its 1983 review, 1/ the Commission considered that the Fifth Directive had worked reasonably well with regard to rationalization and the degression of aids, but that the initial emphasis on quantitative aspects needed to be redirected to the qualitative aspects of improving competitiveness and viability. The Directive has been less effective regarding indirect aid (e.g., aid to shipowners) and stronger disciplines are needed in this area. The implementation of the Directive has enabled Community shipyards to maintain a minimum work load. Restructuring has differed among members in terms of both the quantity and the nature of capacity reduction. In some cases, this has been achieved by shorter working hours rather than redundancies; in others, production capacity has been mothballed rather than dismantled. Not all member states have put into effect overall restructuring plans to eliminate the least viable yards. Generally speaking, restructuring has been insufficient,

1/ Commission of the European Communities, "Policy Guidelines for Restructuring the Shipbuilding Industry," COM(83)65 final, Brussels, March 24, 1983.

particularly in qualitative terms, and the competitiveness of the Community shipyards has not been substantially improved. Some member states consider that a threshold has been reached regarding capacity reduction, which cannot be readily crossed in view of social objectives, particularly as regards employment.

On February 23, 1983, the Commission adopted a communication on the policy guidelines for restructuring the shipbuilding industry, which stressed that the prolonged crisis in the industry called for renewed efforts to revive its efficiency. It recommended that measures focus on (i) modernization, rationalization, and optimum use of the work force; (ii) technological improvements and product innovation; and (iii) further standardization, research and development, and greater cooperation with Community shipowners.

In examining the competitiveness of the shipbuilding industry, the Commission considered that, compared with principal foreign competitors, the Community industry was less flexible in adapting to technological change; overmanning in the shipyards also added to costs. Regarding material inputs, the Community industry enjoyed less upstream integration and component standardization, resulting in higher component prices. Hourly labor costs differed substantially between member states; average basic wage scales were not much higher than in Japan, but social security charges were significantly higher. Although difficult to quantify, the impact of this difference on ship prices may be around 5-10 percent.

c. Japan

Under the Basic Stabilization Plan for the shipbuilding industry, capacity was reduced by 35 percent from 9.8 million compensated gross register tons (CGRT) in FY 1979 to 6.2 million tons in 1982, and has remained at that level subsequently. In response to a temporary revival of demand, the cartel established to allocate new ship orders between participating shipyards (the Designated Shipbuilding Enterprises Stabilization Association) was abolished in April 1982. At the same time, the Japanese Government also discontinued interest rate differential subsidies for new shipbuilding projects. With a renewed decline in demand, a yard operations adjustment program was introduced with effect from fiscal year 1983. Under this program, the Minister of Transport--in accordance with the recommendations made by the Council for Rationalization of Shipping and Shipbuilding industries--establishes guidance ceilings for yard operations of the nation's 33 major shipbuilders on a launching basis. The overall ceiling, set at 4.4 million CGRT in FY 1983, was reduced to 4.1 million CGRT for FY 1984, equivalent to 68 percent of capacity. 1/

1/ The data in Tables III-13 and III-14 are in gross register tons (GRT) rather than in CGRT, since data for new orders were only available for the world as a whole in GRT. Production of ships in Japan in calendar year 1983 amounted to CGRT 5.0 million, or somewhat above the guidance ceiling.

The ceilings were set so as to broadly maintain a share of 50 percent in total world shipbuilding construction. The yard operations adjustment program is likely to be extended in FY 1985.

According to official forecasts, demand for Japanese production of ships will remain weak in FY 1985, but will increase gradually thereafter. The Japanese authorities therefore do not expect any further cuts in production capacity. In view of the considerable rationalization and investment in new technology, they expect Japan to be able to maintain its 50 percent share of the world market, despite the increased exports of Korea and other developing countries.

d. Other countries

Production at Korean shipyards has increased rapidly from a very low level in the late 1970s to 1.5 million CGRT in 1983 (10 percent of world production). Korea captured an even larger share of new orders (19 percent in 1983). A further increase in Korean production may be expected over the medium term. Korea has a significant price advantage in shipbuilding, owing in part to its competitive production of steel and its labor cost advantage. Korea is not a member of the OECD Working Party on shipbuilding, but informal consultations between Korea and OECD countries take place.

6. Footwear

a. United States

In 1983, the economic recovery led to a surge in consumer spending and a sharp increase in retail sales of nonrubber footwear. Following a decline of 8 percent in 1982, domestic production of nonrubber footwear stagnated in 1983. U.S. exports dropped substantially in 1982-83, while imports rose sharply (Table III-15). Taiwan Province of China and Korea are the two largest suppliers, and their share in total imports rose to over 60 percent in 1983. Other important suppliers are Italy, Brazil, and Spain. The gap between the cost of imported and domestic footwear is large. The average factory price of domestic nonrubber footwear during January-May 1983 was $12.82, about 125 percent higher than the imported f.a.s. (free alongside ship) price.

Pressures for protection have intensified in the past two years. The vulnerability of the domestic industry has increased, owing to both the appreciation of the dollar and the removal of protection granted in the past. While orderly marketing agreements (OMAs) with Korea and Taiwan Province of China were in effect from June 1977 to June 1981, U.S. imports of footwear as a proportion of apparent consumption stabilized at around 50 percent. With the expiration of the OMAs, import penetration climbed up to 64 percent by 1983. The ratio of imports to domestic production rose from 95 percent to 170 percent between 1980 and 1983. In May 1983, CVD orders were revoked on imports of certain nonrubber footwear from Brazil, India, and Spain, following a determination by the USITC that such an action would not cause material injury to the U.S. industry.

In June 1983, the footwear industry filed a petition for import relief with the U.S. Trade Representative (USTR) under Section 301 of the Trade Act of 1974, claiming that the industry was being hurt because world footwear exports were being diverted to the U.S. market owing to unfair trading practices abroad. In August 1983, this petition was rejected by the USTR. In January 1984, the industry filed a petition for import relief under the escape clause (Section 201) of the Trade Act of 1974. In July 1984, the USITC determined that imports were not a substantial cause of serious injury, and it did not recommend import relief. The President accepted this recommendation.

In the leather sector, the United States reached a three-year agreement with Japan in 1979 to allow U.S. tanners greater access to the Japanese market. Following unsuccessful negotiations for a new agreement, the United States filed a complaint with the GATT in April 1983. It argued that Japan's import quotas were inconsistent with the GATT prohibition on quantitative restrictions, and Japan's failure to publish administrative rulings concerning the quotas was inconsistent with GATT regulations. Following a report by a GATT panel, in May 1984 Japan agreed to make efforts to progressively liberalize import restrictions on leather, with a view to eventual conformity with GATT rules.

b. European Community

Production of footwear recovered in 1981-82, but declined in 1983 (Table III-16). Imports rose by 11 percent in 1983, after two years of relative stagnation. With apparent consumption stagnating, import penetration rose to 32 percent in 1983, against less than 29 percent in the previous year.

The Community maintains a lower tariff (8 percent on leather shoes and 10-12 percent on nonleather shoes) than the United States and Japan. There are no formal quantitative import restrictions at the Community level. Since 1978, the Community has maintained import surveillance, for statistical purposes, on imports of footwear from major developing country suppliers (Hong Kong, Korea, China, Taiwan Province of China, Brazil). While there are no formal restraint agreements, the Community has maintained close contacts with these countries on trade in footwear, which serve to persuade them of the desirability of avoiding excessive increases in exports that could disrupt the Community's market.

Separately, certain Community members maintain informal bilateral agreements with certain suppliers. Ireland and the United Kingdom negotiated bilateral export restraints with Korea in 1979. Ireland's restraint agreement with Poland expired in 1981, and the United Kingdom's agreement with the same country lapsed in 1983. Restrictions are maintained by France and Ireland on imports from Taiwan Province of China.

Pressures for protection have intensified in recent years in some member countries, and industry demands for an arrangement on shoes similar to the Multifiber Arrangement have been increasingly voiced; the Community has so far resisted such pressures.

c. Canada

Since 1977, Canada has maintained restrictions on imports of certain footwear. A global import quota was introduced on footwear, excluding canvas footwear, in 1977. The quota on leather footwear was discontinued in December 1981, but that on nonleather footwear (this time including canvas footwear) was continued for an announced period of three years. The quota provided an annual growth of imports of 3 percent in relation to the base period April 1980-March 1981.

Following a finding of the Anti-Dumping Tribunal that increased imports of footwear caused or threatened serious injury to Canadian producers, in July 1982 the Government reintroduced a global quota on leather footwear and reduced the existing quota on nonleather footwear. In February 1983, the Government implemented tariff reductions on a number of products to compensate the EC for the imposition of quotas on leather footwear. In August 1983, the import quota on footwear was modified to exempt women's shoes of size 10 1/2 and above, as well as certain specialty sports footwear.

The Government extended the import quotas on leather and nonleather footwear, from the original expiry date of November 30, 1984, for an additional 16 months, until March 31, 1986. The original restrictions were intended to provide local producers with a reasonable period to develop and implement necessary restructuring plans. The Government stated that the recent recession had delayed the restructuring of the industry and that, accordingly, an extension of quotas was necessary.

The annual quotas to November 1985 were to be increased by 3 percent from the previous year; in addition, with effect from December 1984, the price points above which leather footwear was exempt from quotas were lowered to Can$40 per pair for shoes and sandals and Can$67 per pair for boots. In late 1984, the Government announced that the period of extension of the quotas on footwear would be shortened, and the extension would therefore be in effect through November 30, 1985. Further, for the period December 1984-November 1985, the quota on leather footwear would be increased by 5 percent to 12.3 million pairs, and the nonleather footwear quota would be increased by 4 percent to 37.7 million pairs.

d. Australia

In 1974, in response to intense import competition, Australia introduced an import licensing scheme under GATT Article XIX for most footwear products. In August 1980, in conjunction with the import liberalization program for the textiles and clothing sector, the import licensing scheme for the footwear industry was replaced by tariff quotas. A seven-year assistance program was introduced with effect from January 1, 1982, in conjunction with the assistance program for the textiles and clothing sector. The program aimed at allowing a modest amount of trade liberalization by broadly maintaining the 1980 quota arrangement, but providing for a controlled increase in imports. The extent of the annual increase will be determined on the basis of a quota expansion factor of 2 percent in addition to an estimated market expansion factor. In October 1984, the Government asked the IAC to report on what assistance arrangements should apply in the textile, clothing, and footwear industries from December 31, 1988.

7. Electronics

Following a short period of stagnation in 1982, the electronics industry resumed its impressive output growth to the point of straining existing capacities and promoting strong investment activity in certain areas. The industry mainly benefited from the rapid pace of innovative activity and strong increased demand for computers and consumer electronics. The recovery was mainly concentrated in Japan and North America, while growth in Western Europe remained significantly lower.

The industrial countries' exports of electronic products increased by 13 percent to $83.9 billion in 1983 (Table III-17). At this level, they constituted about 10 percent of their total exports of manufactures. Exports by the EC and the United States grew by 9 1/2 and 8 percent, respectively, while Japan's exports expanded by 25 percent.

The industrial countries' imports of electronic products rose by 12 percent in 1983. The EC accounts for about one half of industrial countries' imports, the United States for about a third, and Japan for about 4 percent. Whereas in the United States and Japan there appears to be more diversification of imports by product category, the EC's imports are concentrated in automatic data processing equipment, the share of which has been growing rapidly. Industrial countries' imports from the developing countries surged by 28 percent, and is dominated by trade between the United States and various South East Asian countries. By product category, these shipments were concentrated in electronic parts and consumer electronics.

Protectionist measures affecting electronics have been increasing steadily. Such measures include voluntary export restraints (mainly affecting trade in consumer electronics), restrictive procurement policies (particularly in telecommunications), and government subsidies (to computer industries). Nevertheless, world trade in electronic products expanded substantially in 1983, while trade in manufactured goods (excluding electronics) stagnated.

a. United States

Orderly marketing arrangements on exports to the United States of color television receivers from Japan, Korea, and Taiwan Province of China expired in 1982. Currently, the United States does not maintain quantitative restrictions on imports of consumer electronics. Recently, antidumping duties ranging from 7 to 15 percent were imposed on imports of color television sets from Korea.

Pressures for protection have increased in the U.S. machine tool industry, mainly directed against imports from Japan. In April 1983, the U.S. Government denied import relief requested by a U.S. manufacturer of numerically controlled machining centers and punching machines. Consultations with the Japanese Government are continuing on the possible effects on U.S. commerce of certain Japanese practices. A working level task force has been formed to discuss the impact of government policies on trade in machine tools.

The 1980 agreement with Japan's Nippon Telegraph and Telephone Company (NTT), aimed at opening Japan's telecommunications market to U.S. exporters, was extended for three years from January 1984. In 1983, the two governments accepted the recommendations of the U.S.-Japan Work Group on High Technology, aimed at ensuring mutual access to trade and investment opportunities in high-technology industries, including the mutual elimination of the 4.2 percent tariff on semiconductor imports maintained by the two countries. The United States maintains, for national security purposes, certain restrictions on the exportation and transfer of high technology to certain destinations.

b. European Community

In February 1983, the European Community concluded a three-year voluntary export restraint agreement with Japan covering ten products (video tape recorders (VTRs), color television tubes, color television sets, numerically controlled lathes and machining centers, passenger cars, light commercial vehicles, forklift trucks, motorcycles, audio equipment, and quartz watches). Specific quantitative limits are involved only on VTRs and color television tubes; Japan has agreed to exercise moderation in exports of the other products to the Community. The agreement on VTRs contains both a quantitative limit and a minimum price undertaking; in the first year (1983), such exports were limited to 4.55 million units, including 600,000 knocked-down kits for final assembly in Europe. A ceiling of 300,000 units was set for exports of color television tubes. In November 1983, agreement was reached to limit 1984 VTR exports from Japan to 5.05 million units; the ceiling for kits was raised to 1.1 million units, but remained unchanged at 3.95 million units for finished VTRs. In December 1984, agreement was reached to reduce finished VTR exports to the EC to 2.25 million units in 1985. The minimum price for VTRs was lowered for 1985 to take account of exchange rate changes. Japanese exports of machine tools to the EC have been subject to a floor price system since 1981; the floor price was raised in 1983. The recent evolution of Japan's exports of the ten products to the EC is shown in Table III-18.

In 1982, Hong Kong complained to the GATT about unilateral restrictions by France on imports from Hong Kong of ten products, including in particular quartz watches. In 1984, the Community, on behalf of France, took safeguard measures under GATT Article XIX on quartz watch imports; the measure limits such imports into France to 6.8 million units, of which 4.4 million units is the limit for Hong Kong. The Community raised tariffs on certain high technology products (compact discs), raising concerns in Japan about protection of "new" industries. Pressures for protection in the high technology area remain high.

In order to promote the high technology sector, the Community is placing increased emphasis on research and development in this field. In 1979, a limited research program was begun in the field of information technology, concentrating on micro electronics. This was bolstered at the end of 1982 by the pilot stage of Esprit (European Strategic Program for Research and Development in Information Technology), which involved a nucleus of 15 projects linking 200 research ideas and 638 businesses and universities in the 10 member states. A larger scale, ten-year Esprit program was launched in 1984 with a budget of ECU 1,500 million in the first five years, half of which will be provided by the Community and the rest by European industries. The program aims to lay the foundations for a fully competitive European industry in the next decade. Its priorities are (i) advanced micro electronics (the EC consumes one fifth of world production of integrated circuits, but only manufactures 6 percent; the aim is to develop a unified concept of production and quality control of circuits with a very high degree of integration); (ii) advanced information processing; (iii) software technology; (iv) office automation; and (v) computer control in manufacturing.

8. Costs of protection

The scope of protection in industrial sectors in the OECD countries has both deepened and widened since the early 1970s. The OECD (1984) found that the absolute number of nontariff barriers (NTBs) in OECD countries quadrupled between 1968 and 1983 in the main protected sectors (steel, automobiles, motorcycles, consumer electronics, and textiles and clothing combined). During the past decade, the share of OECD trade affected by discriminatory restrictions rose from 1 to 50 percent for automobiles, from 31 to 73 percent for steel, and from 53 to 61 percent for textiles and clothing.

Several recent studies have investigated the effects of protection in individual industrial sectors. As noted by the OECD study, existing empirical research is concentrated on North America and Australia. In continental Europe, in particular, there has been relatively less interest in promoting analysis of the costs and benefits of trade and trade-distorting domestic measures.

a. Automobiles

There have been several recent studies on the effects of the VER agreement on passenger cars between Japan and the United States. A 1984 study by the Fund staff 1/ indicates that the consumer price index for new cars in the United States was 4 1/2 percent higher in 1983 than it

1/ United States--Recent Economic Developments, SM/84/178, Suppl. 1, (7/20/84), Appendix IX, pp. 64-73.

would have been in the absence of Japanese restraints. In addition to this pure price increase, the quota induced a shift in car purchases toward larger cars and the installation of additional optional equipment. As a result, the average transaction price of a new car in 1983 was estimated to be 13 1/2 percent higher than it would otherwise have been. The higher basic prices of given models resulting from the restraints are estimated to have cost consumers over $4 billion in 1983. If the quota-induced shift in the mix of new car purchases and the installation of extra equipment are also taken into account, the VER is estimated to have cost buyers a total of almost $12 billion. The study suggests that export restraints have cost U.S. car buyers nearly $24 billion since 1980.

A study by the USITC (1985) on the same VER estimated that transaction prices of Japanese automobiles sold in the United States in 1984 averaged $1,300 more per auto as a result of the VER than they would otherwise have been. Transaction prices of domestically produced new autos may have increased by $660 on average in 1984 owing to the VER. The VER cost U.S. consumers an estimated $8 1/2 billion in 1984, and a combined total of close to $16 billion during 1981-84. In the absence of the VER, Japan's share of the U.S. market would likely have been 28 percent, compared with the actual 18 percent in 1984; consumers would have purchased an estimated one million more Japanese autos in 1984 in the absence of restraints. The arrangement resulted in an additional 44,000 jobs in the U.S. automobile industry in 1984; the employment gains would be significantly higher if the VER's effects on gains in employment in the steel industry and in other supplier industries were taken into account. The estimated increase in retail sales of U.S. automobiles brought about by the VER was approximately 620,000 units in 1984, or about 8 percent higher than the level which would have prevailed in the absence of the restraints. Finally, in the absence of the VER, the U.S. trade deficit with Japan in automobiles would have been nearly $2 billion and $4 billion higher in 1983 and 1984, respectively.

The Netherlands Economic Institute (1984) analyzed the consumer effects of trade restrictions in the EC's automobile sector. Eliminating the EC customs duty of 10.4 percent on non-EC, non-EFTA car imports in 1985 would result in a gain for consumers (assuming they had borne the full costs of the tariff) of about $1 billion in 1982 prices. These gains would derive mainly from a redistribution in their favor from domestic producers and from the government, leaving net welfare gains of $42 million (in 1982 prices). Abolishing quantitative restrictions on imports of Japanese cars in France, the United Kingdom, and Italy would have far greater benefits. In 1982 prices, the increase in the consumer surplus for the three countries together was estimated at $3.7 billion, while the net welfare gains would be more than $1.5 billion.

b. Textiles and clothing

The OECD (1984) carried out simulations of import behavior in 1982 and 1983, based on estimated import demand and supply equations for textiles and clothing in the United States and the EC. Comparisons of observed with predicted magnitudes provided estimates of the effects of the implementation of MFA III. The study warns, however, that, because of the longstanding nature of restrictions in these sectors, there is really no benchmark against which to assess the impact of protection accurately. The study concludes that compression of imports from non-OECD sources in 1982 and 1983 was around 10 percent in volume terms. Moreover, after the implementation of MFA I, OECD imports of textiles and clothing became almost totally unresponsive to price signals; at the same time, markups on import prices increased. Deviations from market equilibrium appeared stronger in the United States relative to the EC, and in clothing relative to textiles.

In a study of the U.K. textile and clothing industries, Silberston (1984) suggests that, as a result of relaxing or abolishing the MFA, U.K. landed prices would fall by 5-10 percent. He reports the results of a simulation by Cambridge Econometrics of the effect of such a price drop on the U.K. textile and clothing industries and the economy in general. Abandoning the MFA by 1987 would lead to a 10 percent drop in the price of imports and a 5 percent drop in the price of domestic output. Projections are compared for the years 1983 to 1997 under this scenario and under a base-run assumption of unchanged policies. By 1992, the author concludes, imports of textiles and clothing would be 7 percent and 5 percent higher, respectively, due to the abandonment of the MFA. By 1992, domestic output of textiles and clothing could be 4 percent and 1-2 percent lower, respectively, than the base-run figures. The effects of liberalization on unemployment were estimated to be minor. For example, employment in the clothing industry in 1992 is expected to be 5,000 less than in the base case (but employment in the base case itself is expected to be nearly 100,000 less in 1992 compared with 1983). Based on 1982 consumption, gains in consumer surplus are estimated to range from £455 million to £950 million for falls in retail prices of 5 percent and 10 percent, respectively, depending on the price elasticity of demand.

Several studies quantify the extent of protection in the textile and clothing industries by examining the value of quota rights in such low-cost suppliers as Korea, Taiwan Province of China, and Hong Kong. Jenkins (1980) measures protection to the Canadian textile and clothing industries under the MFA by calculating quota charges on 16 products imported from these countries. He finds that the tariff equivalents ranged from 24 to 74 percent, with an average of 40 percent. With regard to welfare and distribution effects of protection on consumers and producers, he finds that in 1979 consumers paid approximately Can$470 million to protect the textile industry, and the net loss to the Canadian economy was approximately Can$107.5 million. The incremental net loss due to the bilateral quotas was Can$86 million.

Using a similar method, Cable (1983) estimates the tariff and quota premium as a percent of total landed price for several clothing categories exported from Hong Kong to selected EC countries in 1981. These range from 29 percent for parkas exported to Germany to 68 percent for knitted jerseys exported to the same country. Hamilton (1984) estimates that the average ad valorem tariff equivalent of the MFA restrictions in several European countries is 18 percent, which is similar to the average tariff rate. The combined trade barriers average around 38 percent. The tariff equivalent of the MFA varies markedly between importing countries, with Sweden the highest (31 percent) and Italy the lowest (7 percent).

c. Steel

The complexity of EC policies for this industry makes it difficult to assess their impact; although the implications of the EC crisis cartel for competition policy have been intensively discussed, little quantitative analysis of the policy's overall impact is available. In contrast, the focus of U.S. policy on border protection has made its impact relatively easier to model.

Estimates of the effects of trade restrictions in the U.S. steel sector vary widely because of the different assumptions and methods used in the various studies. A notable study by Crandall (1982) examines the effects of the U.S. voluntary restraint arrangement (VRA) of the early 1970s and the Trigger Price Mechanism (TPM) of the late 1970s. He concludes that the VRA reduced imports by 15-23 percent and the TPM cut them by 40 percent. Average import price increases were estimated at 6-8 percent in the case of the VRA in 1971/72, and 9-12 percent as a result of the TPM in 1979. The output effects were relatively small (about 3 million tons for both types of measures), suggesting that trade measures were ineffective in generating additional demand for steel, compared with a macroeconomic stimulus working through higher investment or higher consumer sales. The TPM maintained 8,800-12,400 steel jobs (2-3 percent of industry employment) that would otherwise have been lost.

U.S. steel companies and their foreign rivals have been the main beneficiaries of protection. Crandall estimates that steel producers received $370-640 million a year extra in rents on existing assets as a result of the TPM in 1979; of these rents, 43-56 percent accrued to foreign producers. This highlights the implicit compensation for foreign producers built into certain forms of restrictions. The OECD (1984) study comments that, paradoxically, U.S. protection may have strengthened foreign rivals, notably in Japan, but also in Europe; protection has probably increased the profit margin on Japanese steel sales in the U.S. market by at least 10 percent, or about $200 million a year, equivalent to half of Japan's annual expenditure (the world's highest) on steel research and development.

The U.S. Congressional Budget Office (1984) studied the effects of a five-year, 15 percent global quota on steel imports proposed in the U.S. Congress (H.R. 5081 and S.2380). The CBO model estimated that the average price of steel consumed in the United States would rise by 10 percent, steel consumption would decrease by 4-5 percent, domestic steel shipments would rise by 4-5 percent, and industry employment by 6-8 percent. The quota would transfer $1.7-4.5 billion to the domestic steel industry in pre-tax profits, and $1.9-2.3 billion to foreign steel producers (assuming the U.S. Government did not try to capture this sum by auctioning off import licenses). However, the resulting losses in employment and output and the rise in prices in steel-consuming industries would offset the benefits to the steel industry. The effects of the quota would be particularly injurious to steel-consuming export industries, especially as U.S. steel prices were already 20 percent above world prices. If foreign suppliers retaliated by restricting a similar value of U.S. exports, the net effect on U.S. employment and output would be negative and substantial. Finally, the quota would entail efficiency losses of $0.9 billion per year. It would cost consumers (outside the steel sector) $4.3-5.9 billion per year (in 1983 dollars). The study concluded that there was little prospect that the proposed quota would reverse the secular decline in the steel industry, since it did not address the underlying factors that have conditioned this decline.

Following announcement of the actual steel decision, the CBO estimated that the expectation of a limit of steel imports to 18 1/2 percent (20 percent including semifinished steel) of the U.S. market would raise domestic steel prices by 7 percent.

d. Electronics

A recent econometric analysis by the OECD secretariat of U.S. restrictions on imports of color television receivers from Japan, Korea, and Taiwan Province of China indicates that the 1977 OMA with Japan had no significant effect on the U.S. import demand or supply for this product, mainly because of the strong expansion of imports from nonrestricted sources. However, the pattern of imports was affected. Japan's share of U.S. imports fell from 90 to 50 percent during 1976-78, while Korea and Taiwan Province of China increased their share from 15 to 50 percent between the third quarter of 1977 and the fourth quarter of 1978.

The extension of the OMA to Korea and Taiwan Province of China in 1979 had a significant impact on both import volumes and prices. First, U.S. import unit values were, on average, 4-8 percent higher in 1979 than they would have been in the absence of restrictions. The restrictions allowed a sharp increase in the markup in U.S. import prices over wholesale prices in the exporting countries, with Japanese producers, in particular, gaining high rents. While Japanese domestic prices for color television receivers continued to decline, the Japanese export price index for this product rose by 17 percent in the first nine months of 1979, compared with a 1 percent increase in 1978 and a 10 percent decline in 1977. Second, U.S. wholesale prices for color receivers were, on average, 4-5 percent higher in 1979 than would have been the case in the absence of restrictions; this increase appears to have been fully passed on to U.S. consumers. Third, the U.S. import volume in the first three quarters of 1979 was 45 percent lower than predicted by the OECD model. Finally, there would have been 1,000-1,500 fewer jobs in the U.S. television industry in 1979 in the absence of restrictions. "Saving" each of these jobs cost U.S. consumers over $60,000 a year. A considerable part of the employment "gain" was due to the creation of job opportunities by Japanese firms in areas where color televisions had not been assembled previously, while employment at existing plants continued to decline.

The OECD study notes that, due to the lifting of import restrictions in 1982, the color television industry is one of few that have benefited from genuinely temporary protection in recent years. U.S. firms sought to reduce costs by accelerating the transfer of labor-intensive operations to low-wage countries, and the larger firms diversified their activities and sought new growth areas in the electronics industry, mainly in the sale of computer terminals and microcomputers. At the same time, heavy investment in the United States by Japanese firms (the major gainers from protection) made the restrictions largely irrelevant.

Comparing the U.S. restrictions with the EC VER on Japanese VTRs, the study notes that the U.S. OMA left the increase in prices to the vagaries of the market, while the EC agreement explicitly stipulates (in addition to quantities) minimum prices; the EC measures may be equivalent to the price effect of a 130 percent ad valorem tariff. The study conjectures that the EC restrictions could induce Japanese VTR producers to use the "rents" accruing to them to invest in "products of the future," such as digital and high-resolution televisions, further undermining, over the medium to long run, those producers whom the restrictions were intended to protect.

IV. Agricultural Trade Policies

1. Overall developments 1/

Following several years of decelerating growth, the value of world agricultural exports declined by 9 percent in 1982 to $212 billion. In 1981-82, agricultural markets were characterized by marked declines in international commodity prices. In 1983, world agricultural exports were relatively stagnant. An improvement in commodity prices occurred in the second half of 1983 and continued at a slower pace in the first half of 1984, but prices softened subsequently. Agricultural production and trade data, based on the FAO, are presented in Tables IV-1 through IV-9.

1/ For details of the institutional and legal framework governing agricultural policies in major trading nations, see SM/82/136, Suppl. 1 (7/21/82), pp. 37-70. As in that survey, the focus of this section is on the main temperate zone and competing zone agricultural products in which OECD countries dominate.

The agricultural situation in OECD countries continues to be characterized by a tendency for supplies to exceed effective demand from all sources. The problem of surpluses, which in the past had assumed serious proportions mainly for dairy products and sugar, has now become apparent in practically all commodities.

Technological progress and government policies, including domestic price support policies, have been largely responsible for inducing rapid increases in production, although other factors, such as weather conditions, have also played a role. At the same time, the demand for agricultural products in the OECD countries has shown slow growth, and export demand from developing countries has been constrained by slow growth and balance of payments difficulties. The general situation of overproduction is reflected in high stocks and in pressures on prices, on farmers' incomes, and on government budgets. It has led to more demands for government intervention and to greater resort to measures which impede or distort trade. International trade frictions in agriculture have increased.

Motivated primarily by rising budgetary costs, several countries have begun to reassess their agricultural policies. Various measures have been taken, including price and production restraints and incentives to set aside acreage. The steps taken so far are positive and encouraging, but have been limited in relation to the magnitude of the problems. Even the changes implemented, however, have occurred against the background of strong opposition from affected producers, highlighting again the entrenched and complex nature of protectionism in agriculture.

In an examination of agricultural markets, in late 1984 the OECD Committee for Agriculture noted that the prospects for a significant expansion in world demand for agricultural products were not bright. In these circumstances, the Committee called on OECD countries to increase efforts to contain surpluses. It pointed out the desirability of a strategy for overall production orientation to ensure that measures were effective and that the burden of adjustment was not transferred from one agricultural subsector to another. Such a strategy needed to be flexible and based increasingly on market mechanisms. More consistent national objectives for domestic policies needed to be accompanied by greater harmonization of policies at the international level. International cooperation was essential in order to improve disciplines in agriculture and adherence to agreed rules.

a. United States

Developments in agriculture in the past few years have been characterized by rapid increases in production, induced to a significant extent by the operation of domestic support programs. Agricultural exports declined (by 11 percent each year in fiscal 1982 and 1983), as the appreciating dollar reduced external competitiveness, at the same time as demand in traditional markets in developing countries contracted, owing to their balance of payments difficulties and, in some cases, to favorable harvests. By 1983, stocks had risen to their highest levels since the 1960s. Net expenditures of the Commodity Credit Corporation (CCC) shot up from $3.8 billion in fiscal 1980 to $18.8 billion in fiscal 1983 (Table IV-10). As a percentage of federal government net budget outlays, they rose from 0.66 percent to 2.36 percent over this period. In fiscal 1984, CCC net expenditure declined significantly to $7.3 billion, but are estimated to rise sharply in fiscal 1985 to $15 billion.

Three features of the government's response to these developments may be noted. First, measures were taken to reduce surpluses and expenditures by reducing or freezing domestic support or target prices (dairy, tobacco, wheat, cotton, corn, rice), and through programs designed to reduce or divert acreage under production. Further, a reassessment is under way of the affordability of domestic support programs. The 1981 Farm Act was formulated against the background of an inflationary environment and expectations of continued high inflation, which did not materialize; moreover, the impact of rapid technological advances on productivity may have been underestimated. A new Farm Bill is scheduled for discussion in the U.S. Congress in 1985. While the detailed proposals are not yet available, the Administration's general objective is to seek increased reliance on market mechanisms in the conduct of domestic agricultural programs.

Second, the United States intensified efforts to improve discipline in the conduct of international trade in agriculture, particularly with regard to competition in third markets and the extent of export subsidization by the European Community, and also with regard to foreign market access, including in the Japanese market. Toward this end, the United States has pressed for bilateral and multilateral consultations, including in the OECD and the GATT, and has also made increased recourse to the GATT's dispute settlement mechanism.

Third, the United States has made increased use of export market programs, mainly with a view to reducing its stocks, but to some extent also to match subsidized exports by foreign competitors in third markets. Many of these programs have existed for a number of years, but the intensity of their use has varied. Exports under government-financed programs (P.L. 480 and U.S. AID), together with commercial exports with export payments assistance (CCC sales at reduced prices) averaged about one half of the value of total U.S. agricultural exports in the late 1950s and early 1960s; this proportion declined to 5 percent during 1976-80, and further to less than 4 percent in fiscal 1983. On the other hand, the use of credit sales has increased. CCC credit sales (under GSM-5, GSM-101, GSM-102, and blended credit programs) declined from about 8 percent of the value of total U.S. agricultural exports in 1971-75 to 5 percent in 1976-80, but rose to about 13 percent in fiscal 1983. Under the GSM-5 program, the CCC makes direct, short-term export credit loans; in 1984, the interest rate charged borrowers was set at 1.5 percent above rates paid by the U.S. Treasury on 52-week Treasury bills. Under the GSM-101 program, operative from 1979 to 1981, the CCC provided credit guarantees against noncommercial risks. In 1981, commercial risk was added to the guarantee through GSM-102, which replaced GSM-101. Under GSM-101 and 102, short-term credit is provided through commercial institutions at financing costs set by U.S. banks. The blended credit program, begun in October 1982, uses GSM-5 direct credit and GSM-102 commercial export credit guarantees. The credit is blended on a ratio of a minimum of four parts government-guaranteed credit (GSM-102) to one part interest-free direct government credit (GSM-5). In fiscal 1983, blended credits were directed principally to developing countries to purchase U.S. wheat, rice, corn, vegetable oil, soybean meal, and cotton. In fiscal 1984, blended credits were authorized for countries such as Morocco, Tunisia, Algeria, and Egypt, to purchase wheat and wheat flour.

Exports with CCC credit sales amounted to around $4 1/2 billion in fiscal 1983, of which $1.0 billion was under the blended credit program. Other measures included long-term sales agreements with certain countries, and a few barter agreements.

b. European Community

Agricultural policies are conducted under the framework of the Common Agricultural Policy (CAP). Tables IV-10 through IV-16 present information on the CAP. Implementation of the CAP and technological improvements have induced rapid increases in domestic production. Self-sufficiency ratios have increased steadily over the past decade. During 1980-83, they reached or exceeded 100 percent for most commodities except maize, fresh fruits, and sheep and goat meat, where they ranged from 73 to 85 percent (Table IV-11). The export of surpluses over domestic demand has necessitated substantial export "restitutions" (subsidies), because world prices have generally been well below domestic prices. Over the past decade, the Community has significantly increased market shares abroad in several products, including sugar, dairy products, wheat, and meat. However, the Community remains the largest world importer of agricultural products; such imports largely comprise agricultural raw materials, fruit and vegetables, and natural textile fibers.

The cost of domestic supports and export restitutions under the CAP have led to marked increases in budgetary expenditures on agriculture. Expenditures under the Guarantee section of the European Agricultural Guarantee and Guidance Fund (EAGGF) rose from ECU 11.3 billion in 1980 to ECU 15.9 billion in 1983; in 1984, they are estimated at ECU 18.4 billion (Tables IV-10 and IV-12). Such expenditures declined from 69 percent of the overall Community budget in 1980 to 60 percent in 1982, but rose to over two thirds in 1984. The Guidance section of the EAGGF accounts for around 3 percent of the overall Community budget.

Rising budgetary expenditures on agriculture have been a source of concern, and have stimulated discussions on changes in the CAP. Over the past several years, some measures have been taken with a view to restraining production, reducing surpluses, and controlling the growth of budgetary expenditures. However, these proved inadequate in relation to the magnitude of the adjustment required. Consequently, debate on the reform of the CAP intensified during 1983-84, and became linked with discussions to expand the total size of the Community budget.

The discussions resulted in the adoption of a set of measures commonly referred to as the CAP "reform." The main features of the agreement were (i) a more realistic price policy; (ii) restoration of a single market by dismantling the monetary compensatory amounts (MCAs); 1/ (iii) control of milk production through production quotas; (iv) extension of the principle of guaranteed thresholds (already applicable to cereals, rape, processed tomatoes) to new products (sunflower, durum wheat, dried grapes); (v) rationalization of aids and of premiums for various products; and (vi) compliance with Community preference.

The average level of common agricultural prices (the intervention price or equivalent price) was reduced by 0.5 percent in 1984/85 in ECU terms, compared with increases of 4.2 and 10.4 percent, respectively, in the previous two years; prices were reduced for most commodities, and price increases decelerated for others (Tables IV-15 and IV-16). In terms of national currencies, there was an increase in prices in 1984/85 averaging 3.3 percent, compared with increases of 6.9 and 12.2 percent, respectively, in the previous two years. The 1984/85 measures envisaged a reduction in prices in real terms on an overall basis. The increase in national currencies ranged from 1.5 percent for Denmark to 17.6 percent for Greece. Price reductions in national currencies (of less than 1 percent) were effected for the Netherlands, the United Kingdom, and the Federal Republic of Germany.

In order to eliminate positive MCAs, a new green ECU has been introduced which, in practice, is pegged to the deutsche mark. This avoids the emergence of new positive MCAs for Germany, but may create negative MCAs in other countries if the deutsche mark is revalued, thereby making room for CAP prices in national currencies to rise for other members. As an "exceptional" measure, Germany was allowed to compensate for the dismantling of its positive MCAs through fiscal measures. VAT payments by German farmers were lowered by 5 percent for two years and 3 percent for the subsequent three years. Details of the sectoral measures are given below. Along with the reform measures, the Community is seeking to restrict imports of certain cereal substitutes.

With regard to the overall budget, the Community has decided to increase its amount of "own" resources by increasing the VAT ceiling from 1 percent to 1.4 percent from 1986; this aims, in principle, at accommodating the envisaged accession of Spain and Portugal and providing the Community with resources to expand its activities in the nonagricultural areas. In view of the concern of some member states, particularly the United Kingdom, that the availability of

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1/ MCAs refer to border taxes and subsidies used under the CAP on intra-Community agricultural trade in order to avoid immediate adjustment of common agricultural prices in each member country's currency when the currencies of member countries fluctuate against each other. "Green rates" are the rates of exchange between the unit of account used in agriculture and the national currencies. For further details, see Anjaria, et al. (1982), p. 34.

additional resources could dilute the incentive to contain agricultural expenditures and reform the CAP, it has been agreed in principle that the growth in EAGGF Guarantee expenditures will be kept below the rate of increase of total expenditures. This principle has not yet been formally adopted as a Council decision.

The combination of price restraints and production controls reflected the Community view that it was not feasible to rely wholly on the price mechanism to bring about adjustment; for a significant cutback in production, reductions in support prices would have to be so large as to be politically unacceptable.

The recent measures to reform the CAP are expected to slow the growth in production and in surpluses. They are a positive and courageous step in the right direction; their vigorous implementation, followed by additional steps in the future, should help tackle the problem of overproduction in the medium term.

In the event, unusually favorable weather conditions and increased yields brought about record harvests in 1984, which raised output of cereals (by 22 percent), sugar beet (13 percent), potatoes (19 percent), oil seeds (34 percent), and durum wheat (59 percent). Production of milk declined by an estimated 2 percent.

c. Japan

Japan's agricultural policy has remained essentially unchanged in the past several years. Tables IV-10, and IV-17 through IV-19 present data on Japan's agricultural sector. Rice accounts for about 35 percent of farm output, and the price of rice is supported at levels three or four times higher than world prices. The price support program for rice has contributed to increased production costs for most other agricultural products and has necessitated protection of other agricultural sectors. While high degrees of self-supply have been achieved for rice, dairy products, vegetables, meat, and fruits (Table IV-17), the global food self-sufficiency ratio has declined to about 50 percent in terms of caloric intake, owing to a sharp reduction in the self-sufficiency ratio for grains and livestock feeds; this development reflected severe constraints on available arable land and rapid growth in demand.

The agricultural sector is basically protected in four ways: (1) direct payments from the budget--i.e., subsidies that do not affect the price of the commodity; (2) restrictions on quantities supplied to consumers through import quotas managed by state trading; (3) domestic price support measures; and (4) charges on imports that raise domestic prices and improve the competitive position of domestic producers. Although import duties and levies are important, especially in the beef sector, protection is provided largely through the first three instruments. About 78 percent of the value of Japan's agricultural production was subject to price support in 1982. The cost of price support programs has declined continuously from ¥881 billion in 1979 to ¥697 billion in

1983 (Tables IV-10 and IV-18). In the same period, their share in total budget allocation to the agricultural sector also declined continuously from 30 percent to 23 percent. The cost of price support for rice accounts for two thirds of the total agricultural support program.

The product coverage of quantitative import restrictions has been progressively reduced to 22 items at present. Import quotas now mainly cover meat, certain milk and milk products, dairy products, citrus fruits, wheat, barley, and rice. In addition to these formal controls, Japan's food distribution system is sometimes viewed by trading partners as constituting an informal import barrier. Most food products are distributed to consumers through long intermediary chains closely bound to traditional domestic sources of supply (Houck, 1979). Procedures for issuing licenses for imports subject to quantitative restrictions have also been said to have an adverse impact on foreign suppliers.

In consideration of trading partners' concerns, Japan has included certain agricultural goods in its five market-opening packages. Tariff reductions were included on 15 agricultural items in the May 1982 package, 60 items in the December 1982 package, 3 items in the October 1983 package, and 32 items in the April 1984 package. 1/ After the United States lodged a complaint with the GATT against Japanese import controls on 13 agricultural products, 2/ and after subsequent bilateral discussion under GATT Article XXIII, Japan agreed to liberalize 6 agricultural products 3/ in April 1984. In response, the United States agreed to suspend the GATT procedure for two years. Separate agreements were reached on imports of citrus products and high quality beef. Following negotiations with Australia, the government announced its intentions regarding total imports of beef in October 1984.

d. Other countries

The Canadian agricultural sector is largely export oriented. The major agricultural exports comprise grains and oilseeds, in which Canada is very competitive. There have been no major changes in the framework of agricultural policies in the past two years. Various agricultural products (butter, cheese, chickens, turkeys, and eggs) are subject to

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1/ Resulting in a reduction in the average tariff on the relevant items from 19.4 percent to 16.8 percent, and from 14.5 percent to 11.8 percent in the May and December packages, respectively.

2/ Including milk and cream products, processed cheese, dried leguminous vegetables, preserved oranges and tangerines, starches, groundnuts, canned beef and pork, grape sugar and caramel, fruit puree and paste, canned pineapple and fruit pulp, noncitrus juices, ketchup and tomato sauce, and other food preparations containing sugar, such as TV dinners.

3/ Hi-test molasses (raw material for production of monosodium glutamate), prepared or preserved product of pig meat or offal, fruit purees and paste (except for citrus, pineapple, peach apple, and grape), fruit pulp, other food preparations containing added sugar, and tropical fruit juices.

a domestic support program through the Agricultural Stabilization Board (ASB). The ASB supports the prices of these commodities at not less than 90 percent of the previous five-year average market or base price, taking into account cash cost increases.

In the dairy sector, compulsory production quotas are complemented by the basic producer prices. The difference between the producer price and the world market price is met partly by a coresponsibility levy on producers, but largely by the budget. Expenditure on the dairy industry accounts for around one third of the federal agricultural budget. To guarantee the proper functioning of the domestic support program, import tariffs, supplemented by quantitative restrictions, apply to all dairy products except butter. Cheese import quotas have been set at about 20,000 tons, equivalent to around one tenth of domestic output; 60 percent of the cheese quotas are assigned to the European Community.

In addition to products subject to stabilization, controls are applied to meat imports under the Meat Import Act of February 1982. In 1984, Canadian producers filed a complaint about subsidized beef imports from Ireland and Denmark. The Anti-Dumping Tribunal found insufficient injury from imports of "like" products; the question of like products was raised as European exporters had been shipping slaughtered milk cows as manufacturing meat. As a result of an arrangement between the Canadian and U.S. governments in 1983, U.S. exports of beef and veal to Canada were limited to 10.4 million kilograms, while Canadian exports to the United States were limited to 58.9 million kilograms. Canadian exports were lower by an estimated 9-18 million kilograms, relative to what they would have been in the absence of the arrangement.

Around four fifths of exports of wheat and barley are to state trading countries and are channeled through the Canadian Wheat Board to purchase agencies in these countries under long-term contracts. Long-term agreements with China and the U.S.S.R. provide for minimum amount commitments. In the past several years, there have also been long-term agreements with Algeria, Brazil, Jamaica, Japan, Mexico, and Poland. The actual sales contracts are negotiated for periods of six months, with contract prices generally in line with U.S. market prices.

Australia is an important exporter of wheat, wool, sugar, meat, and dairy products. There have been no significant changes in agricultural policy in the past few years. While the overall level of assistance to the agricultural sector is low, certain individual sectors are supported through a wide range of measures, such as discriminatory pricing arrangements, import restrictions, adjustment assistance programs (including concessional credits and tax concessions) and other programs (including government contributions to stabilization funds and a local content scheme). Discriminatory pricing arrangements may raise commodity prices above world prices or hold them below world prices.

Discriminatory pricing arrangements currently operate for certain dairy products, sugar, wheat, 1/ rice, dried vine fruits, other fruits, and eggs. In some years, these pricing arrangements resulted in transfers from producers to consumers. The average effective rate of protection of agricultural products has generally been less than 10 percent, but increased sharply in 1982/83 to 16 percent, partly due to climatic factors. The effective rate of protection is likely to have declined in 1983/84. Restrictions are sometimes placed on domestic production in order to limit the output increases resulting from higher returns. In cases where domestic prices are maintained above world prices, imports are usually excluded or their prices raised through tariffs or other forms of restrictions.

2. Dairy products

Since 1980, production of dairy products has outpaced commercial demand, large stocks have accumulated, and prices in international dairy trade have fallen. According to the FAO (1984), government expenditures on milk price support in the developed market economy countries increased to $9 billion in 1983.

World production of milk, at some 500 million tons, reached a new record level in 1983. The increase was largely attributable to expansion of output by the EC, which, with one quarter of world output, is the leading producer of dairy products, and by the U.S.S.R., which has been the largest importer in recent years. International trade in dairy products declined and stocks continued to increase; in particular, stocks of butter rose sharply, due to a virtual doubling of stocks in the EC.

The gap between international prices and the minimum prices for dairy products established under the GATT's International Dairy Arrangement (IDA) was steadily reduced during 1983-84. In 1984, the EC announced special sales of 200,000 tons of surplus butter (mainly to the U.S.S.R.), at prices some 40 percent below the minimum level of $1,200 per ton established under the IDA. At a special meeting held by the GATT Committee of the Protocol Regarding Milk Fat, the EC expressed the view that, because of the age of the butter to be sold, its sale price would have to be lower than the IDA minimum. The International Dairy Products Council found that the envisaged sales were not consistent with the provisions of the IDA. The EC requested a derogation under Article 7 of the Protocol, but some countries (e.g., the United States) did not agree. In mid-December 1984, the United States notified the GATT Director-General of its decision to withdraw from the IDA within 60 days, because it considered that the EC's decision to proceed with the special sales had rendered the Arrangement meaningless.

1/ A guaranteed minimum price is fixed on 95 percent of the average of estimated net returns for the subject season and net returns in the lowest two of the preceding two seasons. Domestic prices for wheat are based on the export price with a margin (of the order of A$20 per ton) to cover additional costs of servicing the domestic market.

a. United States

The domestic program supports the milk price received by farmers through purchases by the CCC of butter, nonfat dry milk, and cheese. The Agriculture and Food Act of 1981, passed at a time of large CCC purchases, used a set of triggers relating the minimum support level to the size of CCC purchases. This was a major departure from traditional price support policy under which price changes were tied directly to parity. 1/ As long as large CCC purchases continued, the support prices were specified in dollar terms, with the 1981-82 price set at the 1980-81 level of $13.10 per cwt, and modest increases thereafter.

Concern over continued surpluses and rising expenditures led to legislation in 1982 which froze support prices for two years and provided for deductions from milk producers' marketing receipts to partially offset rising government costs. The 1983 Dairy and Tobacco Adjustment Act lowered the minimum price support level from $13.10 to $12.60 and allowed for further $0.50 reductions in support on April 1 and July 1, 1985, if net government purchases in the succeeding 12 months were projected to be above 6 billion or 5 billion pounds, milk equivalent, respectively. Based on current purchases, these reductions appear likely. The 1983 Act also provided for the first time for a milk diversion program.

Since 1979-80, net CCC expenditures on dairy price support and related programs have exceeded $1 billion annually (Table IV-20). In the 1982-83 marketing year, net expenditures were a record $2.6 billion, about 13 percent of farms' total cash receipts for milk and cream, or an average of about $13,000 per commercial dairy farmer. Net expenditures were lower in 1983-84, but still substantial ($1 1/2 billion), and are expected to remain at this level in the current marketing year.

In 1983, the CCC purchased the equivalent of 16.8 billion pounds of milk (12 percent of total milk marketed), exceeding total CCC removals during 1973-77. Even though donations of dairy products under government food distribution programs have been expanded in recent years, government stocks stood at over 17 billion pounds (milk equivalent) at the beginning of 1984, representing more than 7 weeks of commercial use of all milk and dairy products.

At September 1984 exchange rates, U.S. domestic dairy prices were about the same as domestic prices in most major dairy producing countries with price support programs, but two to three times higher than world market prices. Import controls have been used for many years to prevent disruption of the domestic support program. Quotas exist for imports of milk products in various forms, for 12 categories of cheese, and for chocolate.

1/ The U.S. Department of Agriculture defines the parity price as the commodity price that will pay for the same goods, taxes, labor, etc., as in the base period 1910-14.

In 1981 and 1983, barter agreements were concluded with Jamaica involving an exchange of CCC-owned commodities (dairy products and, in 1983, grains) for Jamaican bauxite; the transactions, valued at $13 million and $34 million, respectively, were effected in 1982 and 1984. In the past several years, the CCC has made direct sales of dairy products, valued at world market prices but below CCC's acquisition cost, to a number of countries.

b. European Community

The tendency for Community milk deliveries to rise at a significantly higher rate than the increase in normal internal consumption and in export demand has been a feature of the milk sector since the CAP's earliest days. Dairy products currently account for about one third of EAGGF (Guarantee) expenditures on crops; dairy program expenditures (costs of intervention and export subsidies) account for 15 percent of the value of Community production of milk and milk products.

The earliest measures to restrain production were concentrated on voluntary actions to reduce output by premiums to producers for dairy cow slaughter or conversion to beef production. In 1977, a flat-rate coresponsibility levy was introduced on producers' milk deliveries. In 1982 and 1983, production targets were adopted in the form of guarantee thresholds; if exceeded, price increases for the milk sector in the subsequent year would be subject to specified "abatement," i.e., a reduction in prices from the levels that would normally have been granted (which did not necessarily imply actual price reductions). In the event, these measures failed to contain overproduction.

In mid-1983, the Commission proposed adoption of more effective measures to control milk surpluses. It suggested a 12 percent reduction in milk support prices, or the introduction of a production quota system. The Council agreed to introduce quotas for a period of five years beginning 1984/85. The target price (in ECU) for 1984/85 remained unchanged, in contrast to increases of 2.3 percent and 10.5 percent, respectively, in the previous two years.

The national quotas were to be calculated from the 1981 deliveries plus 1 percent, except for Ireland and Italy, for which the guaranteed quantity would be that for 1983 deliveries. Taking account of internal consumption and the scope for exports, the Council agreed on a guaranteed final quantity of 98,363,000 tons. As a transitional measure, it approved a total quota of 99,235,000 tons for 1984/85. It also created a "Community reserve," enabling additional quotas of 335,000 tons to be assigned to Ireland, the United Kingdom (Northern Ireland), and Luxembourg. The Council also agreed that, when the quantities added to the reserve were distributed, Ireland would enjoy priority treatment so that the quantities available for that country would not be reduced in future years. As a counterpart to the flexible arrangements for 1984/85, the coresponsibility levy was raised from 2 percent to 3 percent.

The national quotas are distributed among the various regions of each member state, either on the basis of individual quotas (granted to each dairy farmer) or on that of collective quotas (granted to a dairy). Each member state remains free to choose one or the other arrangement, provided that the formula applied is the same for all farmers in a given region. An individual member state may, therefore, operate both systems in different regions.

Quota overruns entail penalty levies of 75 percent (for individual quotas) and 100 percent (for collective quotas). Special arrangements have been made for dairy farmers who operate development plans and young farmers who have started farming since 1981. In view of adjustment difficulties, the Council renewed the Community's direct aid to small dairy farmers for two years at an unchanged level of ECU 120 million. It will be financed from the 3 percent coresponsibility levy.

Implementation of the milk quotas is difficult because of the large number of producers involved. By end-1984, a number of problems, such as the transferability of quotas, still needed resolution, and collection of levies was delayed. Nevertheless, indications are that, on an overall basis, milk output is likely to fall in 1984/85, although it is still uncertain whether the aim of a 4.25 percent decline will be achieved. Over the medium term, it is estimated that adherence to quotas would reduce surpluses to around 15 percent of production, compared with the current 18 percent.

The EC has granted special access for New Zealand butter since the United Kingdom became a member. Access was reduced gradually from 165,000 tons in 1973 to 83,000 tons in 1983. In 1984, the Community decided to guarantee access for a further five years, with a reduction in quantities to 79,000 tons in 1986; quantities have not yet been determined for the remaining period.

c. Japan

Japan's dairy production has increased rapidly under government subsidies and protection. The Livestock Industry Promotion Corporation (LIPC) is entrusted with the purchase and sale of butter, condensed milk, and powdered skimmed milk. The difference between the guaranteed price to farmers and the basic marketing price of milk for manufacturing is subsidized from the government budget through the LIPC. The guaranteed price is determined on the basis of estimated costs of efficient producers. Quantitative controls on imports of dairy products other than natural cheese contribute to maintaining domestic market prices for dairy products at a level several times that of world prices.

In the early 1980s, the increase in dairy production, coupled with a slow growth in demand, resulted in dairy product surpluses. In 1981, Japan held consultations with New Zealand that led to a "voluntary" cut of about 10 percent in New Zealand's exports of compound butter to Japan over the following three years. At the same time, the annual rate of increase of guaranteed prices for processed milk was held back to less than 0.5 percent during 1982-84, leading to a slight decline in subsidy payments. The production of dairy products is now broadly equivalent to 100 percent of self-sufficiency levels, with minor imports of butter and powdered skimmed milk.

3. Grains

World production and exports of grains (wheat and coarse grains) are largely concentrated in developed countries in the temperate zone. North America accounts for more than 60 percent of world exports of wheat, and the United States for about two thirds of world coarse grain exports. The developing countries account for the major part of world imports of wheat, whereas the developed countries are the major importers of coarse grains. State trading nations are important importers of both wheat and coarse grains.

World output of wheat continued to rise strongly in 1982/83-1983/84. International trade in wheat declined in both years, partly reflecting better harvests in some importing countries, and balance of payments difficulties in many developing countries. World stocks of wheat have risen strongly in the past three years, and international wheat prices have tended to fall. In 1983-84, world trade in coarse grains tended to increase at the same time as production declined, leading to a fall in stocks and a strengthening of international prices.

a. United States

The price support program is implemented through a nonrecourse loan and purchase program. 1/ Tables IV-21 and IV-22 present data on the wheat programs. The loan rate rose in 1981 and 1982, but declined in the 1983 and 1984 crop years. In addition to price support, a number of programs are in operation, with objectives such as reduction of official stocks, or farm income distribution.

Under a program introduced in 1973, deficiency payments are made to farmers when farm prices fall below a target price, with the maximum payment rate equal to the difference between the target price and the CCC loan rate. The program aims to support income without affecting the market price. The Agricultural Programs Adjustment Act of 1984 lowered the target price for wheat from $4.45 to $4.38 per bushel for 1984 and 1985, and required farmers participating in the wheat program to cut back total wheat acreage by at least 30 percent, consisting of a 10 percent paid diversion and a 20 percent unpaid acreage reduction.

1/ Under the nonrecourse loan program for grains, farmers are offered loans for their crops at specified price support levels, with the crops serving as loan collateral. Farmers have the option of repaying their loans and redeeming their crops or, alternatively, of not paying the loans and transferring title to the crops to the U.S. Government. The CCC also purchases wheat and feedgrains to implement the U.S. food aid programs; the P.L. 480 program, under which U.S. wheat may be sold overseas for local currencies, is quite important in this regard.

Under the farmer-owned grain reserve (FOR), established in 1977, in return for loans and annual storage payments, farmers agreed not to market their grain for an extended period (3-5 years), unless the average farm price reaches a specified level.

Since 1970, direct cash payments have been limited to $50,000 per crop per person, and participation in set-aside programs has become mandatory for eligibility for direct payments or loan programs. A new and more specific acreage reduction program (ARP) was introduced in 1981. Since 1982, there has been a 15 percent ARP for wheat in which the diverted land had to be put in an approved conservation program. In 1983, a payment-in-kind (PIK) program was introduced for wheat (as well as for cotton, feedgrain, and rice). PIK payments are made to farmers in exchange for agreeing to idle up to 50 percent of their acreage base. The PIK program proved very popular, partly because it was not subject to the $50,000 cash limit. It also proved to be costly (the imputed value of PIK entitlements in 1983 was $1.94 billion) and has been terminated for wheat.

Direct payments under the wheat programs were as low as $97 million in 1979/80, but reached $3.3 billion in 1983/84, with PIK accounting for 60 percent of the total. Direct payments, including PIK, were over 35 percent of the farm value of 1983/84 production and nearly 67 percent of the returns above cash expenses. Prior to PIK, direct payments were much smaller--less than a tenth of the farm value of production in 1981/82 and 1982/83--but they still accounted for over a fifth of the returns above cash expenses.

Since the United States is the largest exporter of wheat, the domestic loan rate supports international prices. A higher loan rate may encourage other wheat exporting nations to raise their production. Foreign exporters have expanded wheat production 54 percent since 1975 and they have more than doubled exports. The strong dollar has exacerbated the effects of U.S. price support programs on exports. The U.S. Foreign Agricultural Service estimates that, from 1975/76 to 1983/84, the U.S. loan rate expressed in local currencies rose 166 percent in the United States, but 275 percent in Australia and 227 percent in Canada.

In 1983, an export payment was made to U.S. wheat millers under an agreement between the United States and Egypt that provided for the commercial sale and delivery of flour equal to 1 million metric tons of wheat to Egypt. The agreement stipulated that wheat flour would be purchased from U.S. millers on a tender basis at a suggested price of $155 per metric ton (compared with U.S. wheat flour prices of $250-$260 per ton), with 77.5 percent of the purchase price eligible for financing under the GSM-102 credit guarantee program. The value of this export payment was $103.5 million.

With regard to other grains, the 1984 Agricultural Programs Act froze the target price for corn at $3.03 per bushel in 1985 ($0.15 lower than the price dictated by the 1981 Farm Act). If the corn carryover level is projected to exceed 1.1 billion bushels on September 30, 1985, an acreage cutback of 5-20 percent must be provided through a combination of acreage reduction and paid diversion. The target price for rice was also frozen (at $11.90 per cwt. compared with $12.40 in the 1981 Farm Act), and provision was made for acreage cutback.

b. European Community

A guarantee threshold production level of 121 million tons of cereals has been established for 1984/85. If actual production (defined as the average of the actual in the most recent three years) exceeds the threshold, the subsequent year's support price will be reduced by 1 percent for each 1 million tons in excess, with a ceiling of 5 percent on the price reduction. This may be partly offset by adding 1 percent to prices for each 1 million tons of imports of cereal substitutes in excess of 15 million tons. The maximum 5 percent price decline is relative to the price that would normally have been granted. The 1984/85 threshold may be exceeded by 8 million tons, as average production is estimated at 129 million tons. Imports of cereal substitutes did not exceed 15 million tons, so no adjustment for this factor is necessary. In accordance with the formula, prices in 1985/86 must be reduced by 5 percent; since the "normal" price increase has not been decided, it is not yet possible to determine whether actual support prices for cereals will be reduced.

Following the U.S. complaint in the GATT about wheat flour subsidies by the EC, the EC voluntarily limited its exports of wheat and wheat flour to 14 percent of the world market in 1982 and 1983. As production continued to increase, Community stocks rose to 8-9 million tons by the end of 1983. In 1984, the Community may have exceeded its self-imposed export limit, as a result of a decision to prevent further stock accumulation in the face of increasing cereal output. World wheat prices have been declining, partly reflecting the appreciation of the U.S. dollar, in which they are set. This has enabled the EC to increase exports in 1984 without increasing export restitutions in ECUs.

High domestic prices of cereals have induced a rapid increase in Community imports of cereal substitutes (such as corn gluten feed and manioc) for use as animal feed. Manioc imports are controlled by quantitative restrictions. In 1982, the EC negotiated a voluntary restraint agreement with Thailand, limiting the latter's manioc exports to the EC until 1986; at the same time, the EC provides assistance to Thailand for agricultural diversification. There is also a GATT quota on manioc, mainly utilized by Indonesia, and a quota for non-GATT members, mainly China. As part of the CAP reform proposals, the EC is seeking an unbinding of its GATT-bound tariff on corn gluten feed, and a limit on imports of corn gluten feed which are mainly supplied by the United States, and, to a smaller extent, by Brazil. The Community proposed to allow U.S. imports of up to 3.3 million tons at the current tariff level, and to impose a variable import levy, equal to that on cereals, on imports of corn gluten feed exceeding this level. However, bilateral negotiations with the United States have thus far been unsuccessful.

The EC took countermeasures in 1983 in response to the subsidized sale by the United States of cereals to Egypt, a traditional Community market. To win back part of the Egyptian market in common wheat flour, the Commission decided to pay a special refund to Community exporters in addition to the ordinary export refund, for a limited period, for a quantity of 400,000 tons of flour.

c. Japan

Japan implements a price support program for grains to increase its self-sufficiency, and for sociocultural reasons. Its import policy is also guided by the need for security and stability of grain supplies. The government buys rice from farmers at a guaranteed price determined on the basis of production costs, commodity prices, and other economic conditions to ensure broad self-sufficiency in the production of rice. Rice is resold to wholesalers at a lower price, determined to stabilize the consumers' household economy. Producer prices for rice have risen somewhat faster than other guaranteed prices (an average of 1.7 percent during 1982-84). Increases in producer prices are generally passed to the consumer. Government rice subsidies have declined by one third from 1979 to 1983, but nevertheless remain the largest expenditure items in the agricultural budget. Production of rice is broadly equivalent to domestic consumption, and Japan does not normally export rice, except in certain cases in the form of food aid. Realizing the potential for excess production due to a decrease in domestic consumption of rice, the Japanese authorities have expressed their intentions to undertake adjustments in order to bring production in line with demand.

Since feedgrains provide the basis for the economy's pig, poultry, and cattle industries, imports of maize, sorghum, and other grains are permitted liberally. However, imports of wheat and barley, which are produced domestically, are subject to global quotas, despite the low level of self-sufficiency (13 percent in 1982). In recent years, wheat imports have remained stable at 5.5 million tons, and barley imports at about 2 million tons.

As in the case of rice, producer prices for wheat and barley have consistently been much higher than the import prices. The Food Agency of the Ministry of Agriculture, Forestry, and Fisheries buys virtually the entire production of wheat and barley, and resells it at substantially less than producer prices. The resulting deficit is financed from the consolidated budget. The cost of protecting domestic producers rose from ¥84 billion in 1980 to ¥113 billion in 1982, mainly because of a significant increase in domestic production of wheat and barley; support prices for wheat have remained unchanged since 1982.

c. Australia

Australia is an efficient producer of wheat. However, there is considerable government intervention in wheat production and marketing, involving the operation of a price stabilization fund, price setting arrangements, statutory monopoly control of domestic and export marketing, other assistance measures from government, and import controls. The Australian Wheat Board is the sole marketer of wheat domestically, and of wheat and flour overseas. During most of the 1970s, government intervention in the wheat industry resulted in negative effective protection, but effective rates of assistance of 5-11 percent were provided during 1980/81-1982/83.

According to new regulations in effect since October 1984, the guaranteed minimum price (GMP) for standard quality wheat (ASW) is set annually at 95 percent of the average of estimated net returns for the subject season, and net returns in the lowest two of the preceding three seasons. Government guaranteed differentials are applied to other qualities of wheat, based on expected returns relative to ASW. An interim first advance representing a substantial share of the estimated GMP is paid on delivery. A second advance payment is made when the final GMP is fixed. Any difference between the GMP and the final actual return for a season is met by the government, which has not made any such contribution since the 1972/73 season. Wheat for human consumption is sold at an administered price determined quarterly on the basis of the average of AWB's export price for the forward quarter and the last quarter, plus a margin to cover additional costs to the AWB of servicing the domestic market. Wheat for domestic stockfeed purposes may be sold directly to users by growers and is not subject to a minimum price arrangement.

A large proportion of exports is made under long-term arrangements. In response to sales on longer credit terms by major suppliers, Australia recently extended credit of up to two-three years to a limited number of markets. The financing of such credit was borne directly by the AWB, without government involvement.

4. Meat

Developed countries account for two thirds of meat production and over three quarters of world trade. World meat output accelerated in 1983, but world trade and international prices declined.

a. United States

While meat production is not promoted through a domestic support program, the import of meat is restricted. U.S. legislation passed in 1964 and amended in 1979 provided for quotas on the importation of fresh, chilled, or frozen beef, veal, sheep meat, and goat meat when annual imports were estimated to exceed a trigger level defined as

110 percent of an adjusted base quota. 1/ There have been no import quotas since 1979. However, whenever it appeared likely that the trigger level might be reached, the United States avoided imposing import quotas by negotiating voluntary restraint arrangements with exporting countries. Voluntary restraint arrangements with Australia and New Zealand were in effect in the last quarters of 1982 and of 1983. No restrictions or voluntary export restraints were imposed in 1980, 1981, and 1984. The operation of the U.S. Meat Law during 1965-84 is presented in Table IV-23.

b. European Community

Output and exports of meat have increased in recent years. CAP expenditures on meat rose from ECU 1.3 billion in 1982 to an estimated ECU 2.4 billion in 1984. In 1984/85, beef animal support prices were reduced by 1 percent (in ECU), compared with an 7.9 percent increase in 1983/84. At present, there are no production limits on meat. However, the Council has agreed, in principle, to introduce a guarantee threshold production system if meat surpluses become a major problem. The introduction of milk quotas has contributed to the rise in beef production in 1984, probably by some 100,000 tons, because of increased slaughtering of dairy cows. The Community currently has 700,000 tons of beef in public intervention stores, some 300,000 tons more than a year ago.

Domestic production of sheep meat is around 720,000 tons. Imports of sheep meat are restricted by voluntary export restraints negotiated with certain countries in exchange for lowering the 20 percent GATT-bound tariff to 10 percent. The major suppliers are New Zealand, Australia, and certain South American countries. Actual imports from these sources have recently been lower than the 320,000 tons allowed. There are also subceilings on imports into France and Ireland.

The domestic market for bovine meat is protected by a system of variable import levies, and few imports enter under the normal regime. There is a GATT-bound global quota of some 50,000 tons of frozen beef and veal, with a 20 percent tariff. This quota has effectively been

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1/ The adjusted base quota is equal to a basic quota of 1,204,600,000 pounds multiplied by two factors--growth and countercyclical. The growth factor, defined as the ratio of 3-year moving average of domestic meat production to 10-year average meat production, 1968-77, tends to increase the allowable import level in line with the long-run trend in domestic meat production. The countercyclical factor, defined as the ratio of 5-year moving average per capita supply of domestic cow beef to 2-year moving average per capita supply of domestic cow beef, tends to reduce the trigger level during the liquidation phase of the U.S. cattle cycle when supplies are likely to be abundant. The countercyclical adjustment factor has the potential of being particularly prejudicial to those meat exporters whose cattle cycles coincide with the U.S. cycle since their access to the U.S. market could be reduced at the time of the liquidation phase of their cycles.

applied on a bilateral basis through detailed product specification in a manner which ensures that particular amounts can be imported only from particular countries. There are, in addition, a series of preferential regimes. Under the Lomé Convention, 50,000 tons are allowed levy-free entry into the EC, provided that the exporter levies an equivalent export tax. In addition, "balance sheet" arrangements were put in place during the Tokyo Round negotiations. At that time, the EC had been in deficit for certain cuts of meat, mainly for the canning industry. An agreement was therefore made to evaluate the import requirements annually with the parties to the arrangement, and to fix an annual import quota. As the EC has been a surplus producer since 1979, these arrangements have created internal difficulties; thus far, however, they have been continued. For 1985, under "balance sheet" arrangements, 50,000 tons of beef and veal for processing are allowed, mainly from Uruguay, Argentina, Australia, and New Zealand. Also under the balance sheet system, 190,000 head of young male calves for fattening are allowed, mainly from Yugoslavia, Hungary, Poland, and Romania. There is also a preferential quota for "Hilton" beef (29,800 tons for 1985), mainly from the United States, Canada, and Argentina. Altogether, preferential quotas have totaled between 350-400,000 tons in recent years, compared with Community exports of 800,000 tons.

c. Japan

Japan produces about 70 percent of its consumption of beef and veal. Policy is directed at ensuring a certain target income support to the domestic livestock sector. The Livestock Industry Promotion Corporation conducts purchase and sales operations of bovine meat in order to maintain market prices within a predetermined range. When wholesale prices exceed the intended range, the LIPC increases the sale of imported and domestic beef. If wholesale prices fall below the minimum price, the LIPC withdraws domestic beef from the market for storage. Beef imports are subject to a global import quota that is broken down by type of beef. The LIPC conducts the purchase and sales operations of most imported beef in order to stabilize demand and supply, as well as prices. Imports are auctioned to domestic distributors, subject to the predetermined minimum price, at a premium over import prices (c.i.f.) of some 50 percent. The profits are allocated to a special fund to assist the domestic livestock industry.

The United States supplies virtually all imports of high quality beef, while Australia supplies the preponderance of other types of beef. Under the MTN, Japan liberalized its global import quota from 92,000 tons in 1977 to 135,000 tons in 1982/83. Following bilateral consultations with the United States, Japan liberalized high quality beef imports from 16,800 tons in 1979/80 to 30,800 tons in 1983/84. Further consultations with the United States led to new understandings in April 1984 for additional liberalization of high quality beef imports to 58,400 tons by 1987/88--an annual average increase of 6,900 metric tons. After negotiations with Australia, the Japanese government announced its intention regarding the evolution of global imports of beef in November 1984.

According to the announcement, global beef imports will increase from 141,000 tons in 1983/84 to 177,000 tons in 1987/88, with increases of about 9,000 tons each year, including an annual increase of 2,100 tons for the type of beef supplied by Australia. Thus, Australia's share in Japanese beef imports, which declined from 75 percent in 1980/81 to 66 percent in 1983/84, is likely to decline further.

5. Sugar

World trade in sugar expanded in 1981-82, mainly because of large imports by China and the U.S.S.R. Trade declined by an estimated 5 percent in 1983, as these countries reduced purchases and output increased in other importing developing countries. Negotiations to renew the International Sugar Agreement have been unsuccessful, and it currently operates as a cooperation agreement without economic provisions.

a. United States

About two thirds of the sugar consumed in the United States is produced domestically, with a farm value of $1.53 billion in the 1982 crop year, equivalent to 2 percent of the total value of all principal crops.

In December 1981, against the background of falling world market prices of sugar, a domestic price support program was reintroduced for the 1982-85 crops of sugar beets and sugarcane. The program established a domestic support price for raw cane sugar of US¢16.75 per pound, with scheduled per-pound annual increases to not less than US¢17, US¢17.5, US¢17.75, and US¢18 during 1982-85. The domestic support price is to be achieved through the implementation of nonrecourse loans by the CCC. However, it has been the CCC's aim not to acquire sugar stocks under the program. Accordingly, a market stabilization price (MSP) has been announced that is the sum of the domestic support price and specified costs. Import controls are used to raise the price of imported sugar to the level of the market stabilization price. 1/

In May 1982, the import fee necessary to maintain the market stabilization price reached its maximum statutory limit, and a quota system was reintroduced. The global annual quota was fixed at 2,800,000 short

1/ The instruments of import control are import fees (in addition to existing, but quite low, tariffs) and import quotas. The flexible import fee, quite similar to a variable import levy, is equal to the difference between the domestic support price adjusted for freight, insurance, and related domestic charges, and the sum of the average spot (world) price and the applicable import duty. The use of quotas and fees is subject to certain statutory limitations. The import fee may not exceed 50 percent of the world (spot) price. The import quota levels may not exceed 50 percent of the quantity imported during a representative period. Import duties are subject to legal ceilings (e.g., US¢2.8125 per pound, raw value).

tons during October 1982-September 1983, and raised to 3,050,000 tons for the subsequent year. Largely to offset the effect of continuing replacement of sugar by nonsugar sweeteners (especially thick fructose corn syrup), the global quota for the period starting September 1984 was lowered to 2,550,000 short tons, and the quota period was extended by two months to end-November 1985. Within the global quotas, country quotas were established according to historical trade patterns, with traditional suppliers (Australia, Brazil, the Dominican Republic, and the Philippines) accounting for more than half of the total allocation. The relative country shares remained unchanged in the past few years, with the exception of a reduction in the allocation to Nicaragua and a reallocation of the difference to El Salvador, Honduras, and Costa Rica.

The direct effects of the U.S. sugar price support program on U.S. sugar producers are substantial. The difference between the world price (f.o.b. Caribbean, converted to a New York basis) and the actual U.S. domestic price of raw sugar represents the premium of the U.S. market to the world market due to import restrictions. During October 1982-September 1983, this premium is estimated to have averaged US¢12.5 per pound, raw value. The premium of the 1982/83 crop of 5.9 million tons yielded domestic sugar growers and processors an estimated $1.5 billion. The direct budget costs were negligible, as the CCC acquired no sugar stocks. The effects on consumers are difficult to estimate; high sugar prices also affect prices of other products, especially other sweeteners. A U.S. Department of Agriculture estimate, assuming full pass-through of cost increases, suggests that the US¢12.5 per pound premium attributable to the U.S. sugar price support program cost U.S. consumers of industrial and nonindustrial sugar and sugar substitutes about $3 billion per year.

b. European Community

Following rapid increases in sugar production in the late 1970s, large surpluses developed, the export of which necessitated substantial export restitutions. This created pressures on the budget, and also led to frictions with other sugar-exporting countries, who felt that the Community's sugar policy was depressing international prices.

In July 1981, the Council defined the Community sugar policy for a period of five years. This provided for a continuation of the domestic production quota system, and for the implementation of a coresponsibility levy in accordance with the principle that producers should be fully responsible for the costs of disposing of sugar produced in excess of Community consumption (other than preferential imports from the ACP countries, which are financed by the EAGGF). 1/ A levy of 30 percent

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1/ Under the system, "A" and "B" production quotas are established. "A" quotas are equivalent to estimated domestic demand. "B" quotas are determined as a proportion of the "A " quotas (determined in 1981-82 at 23.5 percent), and are eligible for export subsidies. Sugar produced in excess of these quotas is called "C" sugar, for which there is no intervention or export refunds.

is applied on the B quota. A coresponsibility levy of up to 2 percent of the intervention price is applied on all A and B sugar. If the proceeds of this levy do not cover the cost of refunds, a supplementary levy of up to 7.5 percent can be applied on the B quota retrospectively.

Between 1981/82 and 1983/84, sugar acreage and production declined by 18 percent and 27 percent, respectively. The Commission has attributed these developments to the operation of the production quota regime and the coresponsibility levy.

In 1981/82, in view of low world prices, and to take account of concerns of trading partners, the Community initiated a policy of maintaining large stocks. In 1982/83, Community producers carried over 1,083 million tons of C sugar to the following marketing year. The Commission limited export commitments in 1982/83 to the same level as in 1981/82, i.e., 5.2 million tons of quota on C sugar. Stocks of sugar in the EC have continued to remain high. Target prices for sugar were kept unchanged in 1984/85.

In 1978 and 1982, Australia, Brazil, and a group of ten sugar exporting countries made three separate complaints in the GATT against the EC's sugar policy, two of which were examined by GATT panels. The panels did not find the EC to be in breach of Article XVI of the GATT, as it was not demonstrated that the EC had acquired an "inequitable" world market share; they found that the EC policy had contributed to depressing world prices, but did not hold it to be solely responsible. Although the EC was not obliged under the GATT to take remedial action, it offered to cooperate with trading partners through bilateral consultations.

c. Japan

Japan's domestic sugar industry is fairly small, supplying about 30 percent of domestic needs in 1983, compared with 20 percent in 1979. Under the impact of price support schemes, domestic production has increased at about 3.5 percent per year, while domestic consumption has stagnated. Imports declined from 2.4 million tons in 1979 to 1.8 million tons in 1982.

A sugar price stabilization law was introduced in 1965 to protect the domestic industry and to prevent excessive fluctuations in prices for refined sugar. In order to support the price of domestic sugar, the Japan Raw Silk and Sugar Price Stabilization Agency purchases domestic sugar from sugar millers at a price based on the minimum price to be guaranteed to growers, which is based on their production costs, plus the cost of manufacturing. The Agency subsequently resells the sugar into the market at a price corresponding to the price of imported sugar as fixed by the Agency. Generally, the buying price of the Agency is about twice as high as the selling price.

The price of imported sugar is stabilized through a system of variable levies or rebates, to maintain the price within a range fixed by the agency. If the price of imported sugar falls below the floor price, the agency imposes a variable levy, part of the proceeds of which are transferred to the Sugar Price Stabilization Fund. Conversely, the Fund pays a rebate to importers when import prices exceed the maximum. In recent years, import prices have been below the minimum price. In 1983, import prices (c.i.f.) were only 50 percent of domestic wholesale prices. Part of the agency's surplus from its operational transactions with imported sugar is used to subsidize the domestic producer price scheme. The remaining amount is subsidized by the consolidated budget of the government; budgetary subsidies have shown a slightly declining trend, from ¥31.9 billion in 1979 to ¥28.6 billion in 1983.

6. Fats and oils

Fats and oils account for 4 percent of world trade in agricultural products. Developing countries account for a major part of world production and for two fifths of world exports. Following a decline in 1981, world production rose during 1982-83. Available data indicate that world export values declined in 1981-82. International prices were generally weak.

a. United States

The United States is an efficient soybean producer and the world's largest exporter. The farm value of soybeans is over $12 1/2 billion (Table IV-24). This sector is relatively free of direct government regulations such as production or acreage restrictions. However, production levels are affected, if only indirectly, by support programs for other crops. Support prices were introduced in 1977 and retained in the 1981 Farm Act, but were consistently established below market prices. The Act requires a support price equal to 75 percent of the simple average of prices received by farmers over the preceding five marketing years--excluding the high and low years--with a minimum level of $5.02 a bushel. This formula is inoperative until the simple average is over $6.69 (the formula-determined price would have been $4.74 a bushel in 1983).

The 1981 Farm Act covers the peanut support program for the 1982-85 crops. There is a two-tier price system. Peanut producers are subject to poundage quotas with output up to the quota level being supported by the higher price. Additional output is eligible only for the lower support price, and is subject to marketing controls (including controls on exports to Canada and Mexico). The price support program is supported by import restrictions in the form of import quotas and high import tariffs.

In order to reduce the cost of the peanut program to the government, the national poundage quota was decreased over time. It declined from 1.68 million tons in 1978 to 1.2 million tons in 1982, and is scheduled to be reduced to 1.1 million tons in 1985. The quota support price was increased under the 1981 Act to $550 per ton from $455 per ton in 1981, and should increase over time in line with production costs, but by no more than 6 percent annually. The price support for nonquota peanuts is based on the crush value for peanuts, i.e., oil and meal prices, and was $185 per ton in 1984.

b. European Community

The Community is 70-80 percent self-sufficient in olive oil. Rape seed, sunflower seed, soybeans, and olive oil are covered by the Community's common regulations, but the regime applicable to oils is different from that applied to other agricultural products. Deficiency payments are made to producers to maintain the target price for olive oil. Imports of oils are subject to an import duty of 10 percent. Olive oil imports are subject to variable import levies. In 1984/85, the system of production guarantee thresholds was extended to sunflower seed; such a system was applied to rape seed in previous years.

In October 1983, the Commission proposed the introduction of a tax on oils and fats, which has not been accepted by the Council. This issue may be reassessed in connection with the envisaged accession of Spain and Portugal. At present, Spain levies high tariffs on imported vegetable oils and fats. If these were reduced to Community levels, increased imports could create a problem of surpluses for olive oil. The oils and fats tax proposal was viewed with concern by trading partners, particularly the United States, as the tax could reduce consumption and thereby affect imports of soybeans.

c. Japan

Japan's imports of fats and oils are generally free of restrictions. A tariff is imposed on seed oil, but oilseeds are imported free of duty in order to encourage the domestic crushing industry. Japan attaches great importance to secure sources of imports; this has been attempted through an informal allocation of the domestic market to numerous foreign suppliers. In the case of soybeans, in which Japan is about 5 percent self-sufficient, a system of deficiency payments, similar to the one applicable to grains, is used to protect domestic producers. There have been no significant changes in the fats and oils sector in recent years.

7. Wine

In the European Community, for quality wine the CAP only prescribes regulations for production, and exercises quality control. Orientation prices are established for table wine, and the policy entails intervention in the market by withdrawing quantities for distillation and by carrying stocks. The trends in consumption and production have diverged increasingly, and wine surpluses have developed. Total consumption of wine has declined by 0.75 percent per year, while total production has increased by 1 percent per year. Since 1976, the area under production has declined by 10 percent, but productivity has increased and production has not fallen. The EC makes restitution on exports to a limited number of countries (Norway and Sweden). If imports of wine into the EC are priced below its reference price system, a "countervailing" duty is applied.

Medium- and long-term plans for the wine sector in the Community are to continue the reduction in the area under production. Also, the regulations for the production of quality wine are to be reviewed in order to induce reduced yields per hectare. Short-term measures under consideration include a change from the present voluntary distillation to obligatory distillation of 10 percent of production, at 65 percent of the orientation price. The implications for the wine sector of the envisaged accession of Spain and Portugal are under discussion.

In 1984, the EC reduced to zero the special levy on imports of U.S. wine into the EC, originally imposed because U.S. wine did not meet certain EC standards; the measure was designed to reduce trade frictions on wine. EC exports to the United States have increased rapidly. U.S. wine producers recently filed a subsidy complaint against the EC, but the USITC found no injury. The 1984 U.S. Trade and Tariff Act allows, for two years, the inclusion of grape growers in the definition of the wine industry for purposes of AD and CVD petitions. The EC has complained to the GATT that this aspect of the U.S. legislation is inconsistent with GATT rules, which allow ADs and CVDs and the investigation of injury only to "like" products. The U.S. Act also requires the USTR to identify trade barriers to U.S. wine exports and to consult with trading partners on their removal; the President is empowered to retaliate against unfair foreign practices on wine. The EC has been concerned about the concept of sectoral reciprocity implied by the U.S. legislation.

8. Cost of protection

The economic effects of agricultural protection are well documented. Persistent high domestic price support levels can lead to overproduction and underconsumption of agricultural output in the protecting country, as well as distortions in resource allocation. Protection may also reduce output, exports, and employment in agriculture and agro-based industries of efficient foreign producers in both developed and developing countries. Traded volumes may be significantly reduced, contributing to instability in international markets.

a. Price distortion effects

In order to provide insights on how protection has changed over time, as well as the effects of protection on price variability, Webb (1984) examines changes in world and domestic prices (in nominal terms) of major trading countries for selected agricultural commodities over the past 15-20 years. In the case of wheat, prices in the EC were found to be generally above world prices, and did not appear to have responded at all to the rapid price increases in 1973-74, or to the subsequent price declines in 1975-77. Argentine prices were found to rise somewhat with world price increases, but Argentine export taxes appear to have kept the actual gains of producers from reaching their potential, at least until 1977. The price movements in the United States, Canada, and Australia closely tracked the movement of world prices. Broadly similar results were obtained from price data for corn, with EC prices remaining above world prices and exhibiting less variability than those in the United States, Argentina, and South Africa.

The same study found that, in the case of rice, more than in any other market, there has been a tendency toward growing protection among a few important traditional importing countries. The prices received by Japanese and Korean rice producers, which were relatively close to the world price in the early to mid-1960s, rose dramatically thereafter, both in absolute terms and relative to the world price. Producer prices in Japan rose from 150 percent of the world price in 1960-62 to between 350-400 percent in 1980-82. While the rice price increases in Korea were an example of the growing tendency toward agricultural protection in some newly industrialized countries, the example of Pakistan--where prices remained below the world price and did not respond to the large world price movements of 1972-76--suggests that, in many other developing countries, negative producer support policies exist. Finally, data on sugar prices reveal the high degree of protection accorded to producers in Germany, France, and the United States during the last two decades. Price variability reveals the differences in the type of protection that was afforded in the United States and EC member countries. The greater price variations in the United States stemmed from the fact that policy was designed mainly to provide a price floor to producers, while, in the EC, protection was also geared to domestic price stabilization.

Data provided by the Japanese Ministry of Agriculture, Forestry and Fisheries indicate that, in 1983, nominal protection coefficients were above 4 for wheat and rice, above 2 for butter and sugar, and above unity for meat and oranges (Table IV-19). In the United States, domestic prices for grains (except rice) and meat have generally tracked world prices (Table IV-25), but they have been substantially higher than world prices for dairy products and sugar.

A study by T. Kugo (1982) compares 1981 food prices in Tokyo and in other major world cities. While sensitive to the rate of exchange used, the study brings out the sharply higher beef and milk prices in Tokyo compared with other cities; for beef, prices were up to five times more than in New York, and double those in London and Paris. A study by Hayami and Honma (1983) found that the ratio of the cost of agricultural price supports to the value of domestic agricultural production in Japan rose from 15 percent to 46 percent between 1955 and 1980. Costs to Japanese consumers were estimated at about $0.5 billion in 1955, $4.2 billion in 1970, and $20.5 billion in 1980.

Various studies using effective rates of protection reveal that these can differ substantially from the nominal rates of protection. Sampson and Yeats (1979) estimated protection to EC producers by the variable import levies on grain imports in 1969-70; they found the ad valorem tariff equivalent of these levies to be 52 percent of border prices, and the average effective protective rate to be 127 percent. Jabara and Brigida (1980) found that the effective levy varied among EC members, due to border taxes and subsidies resulting from the system of Monetary Compensatory Amounts (MCAs). Inclusive of MCAs for the period 1970-78, protection offered by the levy was equivalent to an ad valorem tariff of 62 percent in Germany and 57, 41, and 17 percent, respectively, in the Netherlands, France, and the United Kingdom. Furthermore, during 1972-74, for most grains in Germany, effective rates of protection were over 50 percent higher than nominal rates, and in France they were over 40 percent higher. A study by Jabara (1981) compared nominal effective rates of protection for grains in Germany and France during 1972-75, when EC variable levies were at their lowest level in 15 years, and found effective rates to be 30-350 percent higher than nominal rates of protection.

b. Budgetary costs

The budgetary impact of the Common Agricultural Policy (CAP) is examined in a study by Josling and Pearson (1982). Using 1980 as a base year, the authors calculate that, if agricultural prices are raised in line with inflation rates of EC members (i.e., prices are maintained in real terms), the proportion of total EC revenue taken up by the obligatory costs under the CAP will rise to 105 percent in 1985. If prices are adjusted to fully compensate producers only in the country with the lowest inflation, this proportion will be 71 percent in 1985. Finally, if the pricing policy only serves to protect a member state from decreases in nominal prices (implying decreases in real terms), the proportion declines to 40 percent. As spending on surplus disposal increases with the size of the surpluses, the rates of growth of agricultural production and consumption are key variables in the calculations. Although sensitive to world price assumptions, changes in world prices do not appear to have a dominant effect on the budget.

c. International trade effects

A study by Anderson and Tyer (1983) analyzes the international effects of the CAP using a dynamic model of world demand and supply for five commodities: wheat, coarse grain, rice, meat of ruminants (cattle and sheep), and meat of nonruminants (pigs and poultry). The study indicates that, while EC grain and meat policies raise the level--and reduce the instability--of prices within the EC, they depress world prices by about 15 percent, increase world price instability by 30-100 percent, reduce world trade in grains and meats by about one fifth and two thirds, respectively, and reduce welfare substantially, both in the EC and in the major grain and meat exporting countries; however, benefits accrue to the food deficit countries, including the developing countries as a group.

The same study investigates implications of alternative hypothetical scenarios. First, if the EC embarked on a policy of only a slight degree of sustained reductions in domestic food prices (a 2 percent annual reduction is assumed), the welfare gains to the EC and other food exporters could be considerable by 1990. Second, should the EC introduce a 2 percent levy on wheat production, increase consumer prices by 4 percent, and use the gain in revenues to finance increased export subsidy payments, it would increase its exports and self-sufficiency by 1990, with all the negative effects on its own and other countries' welfare, without any additional funds from the EC budget. Finally, should the United States retaliate against EC export subsidies by granting a 15 percent subsidy to U.S. wheat exports, other countries as well as the EC and the United States would be adversely affected; in particular, the U.S. Treasury would sustain a heavier burden than the EC by maintaining the subsidies.

Based on 1980-81 data, a study by Paarlberg and Sharples (1984) estimates the effects on U.S. agricultural exports of liberalizing the EC grains policy. World wheat prices would rise by 8 percent, and domestic EC prices would fall. As a result, EC production would be reduced by 8 percent, and net EC exports of wheat would fall by about 6 million tons. The United States and other exporters would sell an additional 1.4 and 0.8 million tons, respectively. Because world market prices would rise, other importing nations would reduce purchases by 4 million tons. In value terms, EC export earnings on wheat would fall by $1.2 billion, and export earnings for the United States and other exporters would rise by $1 billion and $700 million, respectively. Finally, the cost of imports to other countries would increase by $500 million. Liberalization of protection for coarse grain would have effects similar to that for wheat. EC coarse grain prices would fall by 25 percent, and consumption and imports would expand. World grain prices would rise by 4 percent, and net EC imports would expand from 5.8 million tons to 20.5 million tons and cost an additional $2.5 million. U.S. exports of coarse grain would rise significantly, as would those of other exporters, although to a lesser extent. A reduction in imports of other importing countries, as a result of the increased world market price, would offset over half the increase in EC coarse grain imports. The study also investigates the effects on the United States of a liberalization by Japan of its rice policy. This would have increased U.S. exports of rice and wheat by $20 million and $30 million, respectively, in 1980.

Coyle (1983) examines the trade impact of a full liberalization of the Japanese beef market. Assuming constant world prices, liberalization would raise Japanese consumption and import volumes of beef by 89 percent and 189 percent, respectively, by 1990. The large expansion is attributable to the large population, and to the limited potential for increasing domestic production in Japan. Liberalization would also reduce imports of pork (by 40 percent) and chicken (by 22 percent), which are beef substitutes, and those of feed grains to Japanese livestock (by 20 percent). However, the decline in Japanese demand for feed grains would be roughly offset by increased demand in the United States and Australia, in order to increase beef production for export to Japan. The study suggests that liberalization of the Japanese beef market would primarily provide a stimulus to trade between Australia and Japan.

V. Some Issues Affecting Developing Countries

1. Trade trends

Over the past decade, the economies of the developing countries 1/ have become increasingly integrated with the world economy. Between 1973 and 1983, developing countries' share in world exports increased from 19 percent to 25 percent, and their share in world imports rose from 18 percent to 25 percent (Tables V-1 and V-2). Data on the importance of trade in developing countries' economies are less conclusive. The ratio of exports to GDP rose during 1963-83 in two fifths of the developing countries surveyed, but declined in a roughly equivalent number of cases, with declines most frequent among African countries (Table V-3). The ratio of imports to GDP rose in the large majority of cases (Table V-4). Developing countries' exports rose by 15 percent annually in value terms during 1973-83, compared with 12 percent for world exports as a whole. Their exports to other developing countries grew more rapidly than to industrial countries. Nevertheless, developing countries gained market shares in both areas--from a share of 20 percent to 25 percent in industrial countries, and from 22 percent to 31 percent in developing countries. Industrial countries remained the most important markets for developing countries, accounting for 63 percent of total exports in 1983.

Export performance varied over the period 1973-83. After a rapid increase during 1973-81, the value of developing country exports declined in 1981-83 because of declining sales of oil and oil products, and, to a lesser extent, lower sales of other primary products. As a result, the share of developing country exports in world exports declined by 3 percentage points between 1981 and 1983. In contrast, developing countries' exports of manufactures held up relatively well during 1981-83, growing by 3 percent annually against a decline in world exports of manufactures of 1.5 percent. Over the period 1973-83, the share of developing countries in world exports of manufactures increased from 7 percent to 12 percent.

While developing countries' exports of manufactures continued to be concentrated to a significant extent in the traditional sectors, there was also some diversification toward other products (Table V-5). Fully one third of the increase in developing countries' exports of manufactures between 1973 and 1982 came from engineering products. Clothing, textiles, and other consumer goods together accounted for another one third of incremental exports of manufactures. Overall, developing countries captured about 13 percent of the increase in world exports of manufactures. Non-oil developing countries accounted for about 12 percent of the increase in world exports of manufactures. Export growth shares of non-oil developing countries 2/ were above this average in

1/ Except when otherwise specified, the present section utilizes GATT data and definitions (see Explanatory Note).

2/ Detailed information is not available for oil exporting countries.

clothing, textiles, other consumer goods, and other semimanufactures (45, 28, 22, and 15 percent, respectively), and lower than the average in steel, chemicals, and engineering products (10, 8, and 8 percent, respectively). However, the low shares of market growth for the latter sectors is explained by the low starting points; indeed, growth rates were the highest in these sectors.

The experience of individual developing countries and country groupings varied widely. Under the impact of increasing oil prices, the value of oil exporting countries' exports grew by 17 percent on average during 1973-83, while non-oil developing countries' exports grew by 15 percent. Exports of the major exporters of manufactures 1/ grew at roughly the same rate as that of non-oil exporting countries as a whole, while the subgroup of major Asian exporters of manufactures showed stronger export growth than non-oil developing countries as a whole--16 percent, compared with 15 percent. Developing countries in Africa generally experienced slower rates of growth (10 percent during 1973-83).

The share of developing countries in world imports increased from 18 percent in 1973 to 26 percent in 1981, before falling back to 25 percent in 1983, owing to a compression of imports during 1981-83. Developing countries' imports of manufactures grew less rapidly than their imports of primary products. Industrial countries remained by far the major suppliers of developing countries, although their share declined from 67 percent in 1973 to 58 percent in 1983. However, the importance of developing countries as markets for the industrial countries increased; they accounted for 18 percent of industrial countries' exports in 1973, 26 percent in 1981, and 23 percent in 1983.

2. Trade policies of developing countries

a. Overview

The diverse historical and economic backgrounds and recent economic performance of the large number of developing countries complicate an overall assessment of trade policies. Some developing countries (e.g., many Latin American countries) have historically maintained highly protective trade regimes, some from the 1930s, while other countries (e.g., Malaysia and many African countries) inherited relatively liberal trade regimes at independence. Their growth process and development strategies have varied, depending on factor endowments and national policies. In the postwar period, development plans implemented by a large number of developing countries were aimed at growth from an agrarian or raw material-producing economic base. In many countries, protection was introduced and is maintained as a major policy instrument of industrialization.

1/ The World Economic Outlook classification includes: Argentina, Brazil, Greece, Hong Kong, Israel, Korea, Portugal, Singapore, South Africa, and Yugoslavia; export data in this paragraph are based on IMF, Direction of Trade Statistics, various issues.

For the purposes of this paper, the staff carried out a survey of the restrictive systems of 35 developing countries, based on information available in the Fund, 1/ with special emphasis on the stance of trade policies--in particular, tariff and nontariff trade barriers. These countries account for 50 percent of the trade (exports plus imports) of all developing countries. Information available to the staff on certain aspects of trade policies in developing countries, in particular on statutory tariffs, is often fragmentary or out of date. In addition, data on effective rates of protection, which reflect the combined effects of tariff and nontariff barriers on domestic value added, are available only for a few countries, and then usually not in consistent time series form. Nevertheless, developments in the countries surveyed provide a broad picture of the stance of trade policies in developing countries.

(1) *Tariffs*

Statutory rates of tariffs are generally higher in developing countries than in industrial countries, typically ranging from zero to very high maximum rates; maximum rates of 100 or 150 percent are not uncommon. A study prepared by the UNCTAD secretariat (1983) indicates that the structure of tariff protection in developing countries is broadly similar to that in industrial countries. Products such as tobacco and beverages, textiles, and certain foodstuffs, are subject to above-average duties, while fuels, chemicals, metals and metal products, and minerals and mineral products, are subject to below-average tariffs. Tariffs may vary less widely among product groups in developing countries than in developed countries, possibly reflecting the higher average level of tariffs in the former.

A GATT study (1984) illustrates the height of tariff barriers in the clothing and textiles sectors. Of the 21 developing countries surveyed, the combined average tariff level for the two sectors was less than 10 percent in one case (Singapore), ranged from 10-25 percent in 3 cases (Israel, Yugoslavia, Malaysia), from 25-50 percent in 6 cases (Tunisia, Korea, Mexico, Argentina, Spain, Philippines), and exceeded 50 percent in 11 cases (Thailand, Taiwan Province of China, Sri Lanka, Peru, Pakistan, Nigeria, Morocco, India, Egypt, Colombia, Brazil). In another tabulation, ratios of import duties collected to total imports were calculated for 58 developing countries: the average duty rate was less than 10 percent in one third of the countries, in the 10-20 percent range in half of the countries, and exceeded 20 percent in the remaining countries (Table V-6). 2/

1/ Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Egypt, El Salvador, Guatemala, Ghana, Hungary, Hong Kong, India, Indonesia, Ivory Coast, Jamaica, Jordan, Kenya, Korea, Liberia, Malaysia, Mexico, Morocco, Nigeria, Pakistan, the Philippines, Romania, Sri Lanka, Sudan, Singapore, Thailand, Turkey, Zaire, Zambia, and Yugoslavia. Where appropriate, references are occasionally made to countries outside this group.

2/ By way of comparison, the ratio of collected import duties to total imports averaged 2.4 percent for OECD countries in 1980.

Available information for a few countries seems to indicate that statutory rates of tariffs are generally substantially higher than the average rate of duties collected (Table V-7). About half of the countries for which data are available had average statutory rates in excess of 40 percent. In two fifths of the cases, average duties collected amounted to less than 15 percent of statutory rates. In Brazil, for example, the average statutory rate in 1983 was 79 percent, compared with 5 percent actually collected. Other countries show a lesser degree of divergence. A large proportion of imports is sometimes exempted from tariffs or allowed to enter at reduced rates under a variety of schemes. Some countries allow imports of raw materials and intermediate inputs intended for export production to enter duty-free under a "drawback" scheme (e.g., Brazil, Korea, Yugoslavia). Similar privileges may be extended to specified projects, in some cases to attract foreign investment or to promote investments in priority sectors or regions (e.g., Brazil, Cameroon, Gabon, Thailand).

In addition to protection of domestic industry, tariffs also play an important role in many countries as a source of government revenue. Smaller economies, and developing countries in Africa, often depend heavily on revenues from tariffs (Table V-8).

Under the GATT, a contracting party provides assurance of market access to trading partners by agreeing contractually not to apply tariff levels in excess of rates specified in its schedule of concessions. The extent to which a country's tariff schedule is "bound"--i.e., included in the schedule of concessions--places limits on its legal ability to raise tariffs without compensating its trading partners. For the major industrial countries, up to 100 percent of the tariff schedules are GATT-bound. For developing countries, the proportions are much lower. For the 12 developing contracting parties for which information is available, the proportion of tariffs bound ranges from 0.2 percent to 35.2 percent (Table V-9).

The combination of high statutory tariffs with substantially lower actual average tariffs may have implications for the certainty of trading partners' access to a developing country's market. Importation of items with high statutory rates may occur only at lower actual rates when the items are partially or totally exempted from the statutory tariff. The criteria for granting these duty remissions or exemptions may then have effects similar to those of a "nontariff" barrier. Changes in the restrictiveness of tariff policy may reflect changed criteria for duty exemptions, rather than amendments to the legal tariff schedule.

Tariffs are used as the main instrument of protection in relatively few developing countries. Of the 35 countries surveyed by the staff, only 6 relied heavily on tariffs as the main instrument of trade policy.

(2) Nontariff barriers

Developing countries frequently use nontariff barriers (NTBs) as the main instrument of protection. According to an UNCTAD secretariat estimate, nontariff volume controls apply to 71 percent of all product groups for the 27 developing countries surveyed, while price controls apply to a further 2 percent. (The corresponding figures for developed countries were estimated at 23 and 8 percent, respectively.) Developing countries seem to use a narrower range of NTBs than developed countries, the most important ones being total prohibition (10 percent), quotas and discretionary licensing (21 percent), and automatic import authorization 1/ (38 percent).

The frequency of the incidence of nontariff measures in developing countries is borne out by the information available in the GATT (Tables I-3 and II-4). The GATT provisions on balance of payments restrictions are the most frequently invoked justification. 2/ Nontariff measures other than quantitative restrictions have been notified for more than 40 developing countries. They include government aids, government procurement restrictions, state trading practices, surcharges and similar taxes, and border tax adjustments.

A reason often advanced by developing countries for their relative preference for quantitative restrictions is that such restrictions have a more direct and predictable effect than tariffs on the level of imports. Where trade policy is directed toward import substitution, restrictive import licensing may be used to ensure that shortfalls in domestic production are quickly compensated for by additional imports to meet residual needs. Where quantitative restrictions are used for balance of payments purposes, the level of restrictions can be speedily adapted to foreign exchange requirements. In contrast, tariff changes often must be approved by the country's legislative assembly. Quantitative restrictions may be considered a more flexible instrument to regulate the composition of imports, say, between "essential" and "luxury" goods. In the context of regional arrangements, nontariff measures may selectively provide preferential treatment to imports from other regional partners. Nontariff restrictions are also related to industrial licensing policies and laws on inward private foreign investment. Finally, developing countries may, in some cases, apply quantitative restrictions rather than raise tariffs in order to avoid the income distribution effects of higher tariffs.

1/ Automatic import authorizations serve to monitor import transactions and may, in certain cases, have the aim of facilitating subsequent specific actions to regulate prices and volumes.

2/ Countries notifying quantitative restrictions to the GATT include Argentina, Brazil, Chile, Colombia, India, Indonesia, Korea, Nigeria, Pakistan, the Philippines, and Yugoslavia. These countries also consult in the GATT Committee on Balance of Payments Restrictions (see section II).

Exchange restrictions, which fall outside the scope of this report, are also often used to restrict imports. In many countries, foreign exchange budgets are the basis for the central bank's approval of all import transactions. The economic effects of such exchange restrictions may be indistinguishable from pure trade measures.

(3) Effective rates of protection

The overall level of protection is best measured by the effective rate of protection (ERP), which measures the degree of protection accorded to the value added in domestic industries, taking account of both the degree of protection of inputs into the production process and of the final output. The nominal rate of protection only takes into account the protection of the final product by measuring the excess of prices in the domestic market over those in international markets. Generally, for a given level of nominal protection, the lower the protection of inputs to an industry, the higher the degree of ERP; conversely, if the inputs to an industry are heavily protected, the ERP of the industry could be low, even though the nominal protection may be high. Available estimates of ERPs in the manufacturing sector are contained in Tables V-10 to V-12. The staff found only a few estimates of ERPs for the period after 1980.

The estimates support the notion that effective rates of protection of developing countries' manufacturing sectors are often high relative to those in most industrial countries. 1/ In Table V-10, available estimates of ERPs are grouped in five ranges for three periods, from the 1950s to the mid-1960s, from 1966 to 1972--both periods characterized by a favorable international environment--and the period since the first oil crisis. In the two first periods, average ERPs of 50 percent and above were not uncommon. Information for the period since 1973 is less comprehensive. Table V-11 shows additional information on the ERP estimates. The tables should be interpreted with great care because of the lack of continuity of data and the differences in methodology for many countries. However, it may be tentatively concluded from the limited evidence available that effective protection in manufacturing did not increase markedly after the first oil shock, despite the balance of payments difficulties experienced by developing countries in this period. Among the countries with lower average post-1973 ERPs are Brazil, Mexico, the Philippines, and Sri Lanka. Average ERPs increased following the first oil shock in Argentina, Colombia, Korea, and Nigeria.

The data in Table V-11 should be interpreted in the light of ERPs' sectoral dispersion. Generally speaking, a larger dispersion of ERPs will lead to a greater distortion across sectors. Insufficient data on a comparable level of aggregation is available to assess whether the degree of variability changed, for example, whether individual sectors

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1/ In 1981/82, Australia--whose effective rates of protection of the manufacturing sector are high by industrial country standards--had an estimated average ERP of 26 percent.

succeeded in securing greater protection following the oil shock. Statistical analysis across all these time periods of data aggregated to the level of 28 sectors indicates a positive correlation between the average level of protection of manufacturing and the standard deviation of ERPs of individual sectors from the average (Chart V-1).

Table V-12 shows the degree of protection by industrial sectors, and the changes over time for certain countries. In some developing countries, the low average effective rate of protection may have involved negative or very low levels of protection for traditional and dominant industries, combined with a very high overall level of protection for most manufacturing sectors. In Argentina, for example, food processing and leather products received low or negative protection in the late 1960s. In the mid-1960s, Korea had relatively high levels of protection for electrical machinery, transport equipment, and professional goods, but a negligible overall level of protection. Relatively high levels of protection exist in the food and textiles and clothing-related industries in many developing countries shown in Table V-12. Electrical machinery and transport equipment are also heavily protected in most of the countries. In many countries, the high level of effective protection of production for the domestic market introduced a bias against production for exports.

Developing countries' industrialization strategies often resulted in the introduction of a bias against agricultural production. Several countries are adjusting agricultural policies in order to redress this bias. A recent study by Tyers and Anderson (1984) indicates that, in certain developing countries, trade policy is being used to increase protection of domestic agricultural production.

b. Recent developments

Developing countries often resort to both trade and payments restrictions, making it difficult to identify the incidence and effects of trade policies per se on these countries. Another complication in arriving at an overall assessment for a group of countries is the difficulty of choosing a relevant timeframe. Taking the "restrictive system" to include both trade and exchange restrictions, information collected for this survey shows that, in trade-weighted terms, 1/ about one third of the sample increased their reliance on restrictive measures between 1978 and 1983 (including Argentina, Brazil, Hungary, Mexico, the Philippines, and Nigeria). A slightly higher proportion of the sample (including India, Korea, Malaysia, Pakistan, Singapore, Thailand, and Turkey) liberalized their restrictive systems, while no significant change in overall restrictiveness was discerned in the remaining one fifth of countries surveyed. The survey did not take into account the degree of tightening or liberalization. The tightening of restrictive

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1/ Calculated as the ratio of trade (exports plus imports) of countries which increased their reliance on restrictive measures to total trade of the countries surveyed.

systems occurred mainly during 1981-83, in response to balance of payments pressures. In 1984 and early 1985, several countries (e.g., Brazil, Hungary, Argentina, Mexico, Morocco, and the Philippines) that had intensified restrictions for balance of payments reasons began to ease them again. 1/

(1) Tariffs

Tariffs have rarely been the main instrument of change in the overall stance of trade policies in developing countries. Of the 16 countries that increased trade barriers during 1978-83, only 3 used tariffs as the main instrument. Chile eliminated major nontariff trade and exchange restrictions in 1973, and gradually reduced tariffs to a uniform level of 10 percent by mid-1979. Starting in 1982, tariff policy became increasingly restrictive--most recently, with the generalized tariff increase in mid-September 1984, to a uniform rate of 35 percent. The authorities have announced a scheduled rollback to a uniform level of 25 percent by June 1986. Given the absence of significant nontariff trade restrictions, the Chilean trade system is one of the simplest developing country trade regimes. Sri Lanka has relied mainly on tariffs to implement its trade policy since the tariff reform of 1977. A large number of tariff increases, covering some 600 products, were introduced during 1978-82. In 1983, there was a general tariff increase of about 5 percentage points for most imports. In Liberia, tariff policy since 1980 has been directed at reducing the scope of exemptions; statutory rates, on balance, have not changed.

In several countries, tariff barriers were also increased to a limited extent to support a general increase in the use of restrictive measures or to offset liberalization in other areas. In Brazil, surcharges were increased substantially in 1977 and minor modifications were made over the 1978-83 period; nevertheless, because of the increase in tariff exemptions, the ratio of collected tariffs to imports did not increase. In 1984, the tariff structure was reorganized and the surcharges were eliminated, leading to a reduced statutory level of tariffs from 79 percent in 1983 (including surcharges) to 51 percent at end-1984. Mexico implemented a limited increase in the tariff level during 1978-82, but did not raise tariffs further in response to the balance of payments pressures of 1982-83. In Kenya, tariffs were increased on a large number of items in 1981, and were raised by 10 percent across the board in 1982. Across-the-board reductions in tariffs at varying rates in 1983 left the tariff structure moderately higher than in 1978.

1/ In a few countries, the liberalization of the restrictive system was carried out solely through the exchange system (e.g., Zaïre). More detailed information on the main developments in restrictive practices is given in various issues of the Annual Report on Exchange Arrangements and Exchange Restrictions.

Tariff policy was made more liberal in five of the countries surveyed. Korea, as part of a major tariff reform, reduced average tariff rates from 22.6 percent in 1983 to 20.6 percent in 1984. Thailand increased the use of tariff exemptions under the Investment Promotion Act from 1980; import duties on various items were also reduced in 1980, 1982, and 1983. The effects of these measures were partly offset by a 10 percentage point increase in the import surcharge on certain items in October 1984. Malaysia reduced average tariff rates moderately by reducing or eliminating duties and surcharges on 150 food items and raw materials, and by reducing duties on certain durable consumer goods in October 1981, and on certain electrical and electronic goods in 1982. In 1980, Singapore, which has traditionally maintained a liberal trade regime, abolished duties for a number of items, including foodstuffs, clothing, television sets, and footwear, and further reduced tariffs for a wide range of other commodities.

(2) Nontariff barriers

In the early 1980s, countries relied mainly on nontariff trade barriers or exchange measures as a response to balance of payments pressures. In Colombia, major categories of imports were transferred from the freely importable list to the import licensing regimes in several stages during 1982-84. Certain provisions for countertrade arrangements were introduced in February 1984, and certain imports were prohibited in April 1984. In Nigeria, many items were shifted from open general license to specific licensing during 1982-84, and the scope of outright prohibitions was increased.

In some other countries, nontariff measures that had been tightened during 1978-83 were partially liberalized in 1984 and early 1985. Argentina introduced an "ad hoc" licensing scheme with effect from April 1982, and an advance deposit scheme in May 1982. A foreign exchange allocation system introduced in October 1983 was eliminated at the end of December, when the import licensing system was reformed. Consumer goods and industrial inputs for which close substitutes were considered to be amply available domestically were prohibited. Capital goods and industrial inputs, and inputs for the pharmaceutical and health sectors, were made subject to discretionary licensing following a review procedure. Other imports were licensed automatically. In January 1985, the import licensing system was further reorganized, entailing a slight liberalization. In Mexico, there was a relaxation of import licensing from 1978 to mid-1982, but, from mid-1982 until late 1983, import licensing was tightened sharply in response to balance of payments pressures, and most imports were made subject to prior licensing. More recently, in line with the improved balance of payments position, import licensing has been liberalized somewhat.

In a few countries, the rollback of measures introduced during 1978-83 was virtually completed in 1984 and early 1985. For example, in Hungary, import licenses, which had been granted automatically, became subject to discretionary approval in September 1982, leading to a substantial tightening of import controls. The system was subsequently liberalized in stages, and reverted to the pre-1982 level of restrictiveness on January 1, 1985. In Brazil, the major changes in the restrictive system were the introduction of a global import program in 1981, the expansion of the list of items subject to prohibition and the tightening of national similarity requirements in September 1982, and the introduction of a comprehensive foreign exchange budgeting system in August 1983. Several minor measures also had the effect of reducing imports. Most of these measures were eliminated in late 1984, and the trade system reverted to broadly the position in effect before the balance of payments crisis.

Six of the eleven developing countries 1/ that liberalized their trade systems during the period under review mainly reduced their reliance on nontariff trade barriers (combined, in some cases, with a liberalization of exchange measures). The liberalization in India, Jamaica, Korea, Pakistan, and Turkey is described in section VI. In Malaysia, several items were removed from the list of items subject to quantitative restrictions and licensing requirements during 1979-81. In some countries, liberalization has focused on the exchange system.

(3) Countertrade

While countertrade arrangements were previously applied mainly in trade with centrally planned Eastern European countries, the use of countertrade arrangements in trade with or within developing countries appears to have increased in recent years. 2/ The main reasons given by countries resorting to countertrade arrangements are foreign exchange difficulties and improved access to foreign markets for certain primary and manufactured products. A recent estimate (Banks, 1983) suggests that countertrade arrangements may account for as much as 5 percent of world trade.

Most countertrade arrangements are concluded between private enterprises and/or government trading organizations without any requirement being imposed by the government to that effect. A large number of such arrangements have been reported, involving, inter alia, Brazil, Colombia, Indonesia, Iran, Iraq, Jamaica, Jordan, Malaysia, the Philippines, and Thailand. Only a few countertrade arrangements have been concluded as a result of a declared government requirement. Since January 1982, the government of Indonesia may, at its option, require all foreign firms

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1/ Liberalization by Thailand is referred to in section V.1.
2/ These arrangements take a variety of forms, but basically entail a barter or quasi-barter arrangement between private firms and/or government entities such as foreign trade organizations, by which the seller is obligated to accept specified goods or services from the buyer as partial or total settlement. Arrangements may cover several years; for example, in buy back arrangements the seller, in return for sales of equipment and technology, may undertake to purchase, over a period of time, a specified amount of products originating from the original sales.

bidding for government-sponsored construction or procurement projects to agree to fulfill a counterpurchase obligation. Bidders for projects that include counterpurchase requirements must submit a letter with their bids agreeing to purchase and export the equivalent of the contract's value in selected Indonesian products (f.o.b.) during the life of the contract. The scheme was modified in September 1983 to permit assignment of the countertrade obligation to third parties, including those currently importing from Indonesia, subject to official review and approval. In February 1984, Colombia introduced legislation requiring countertrade arrangements as compensation for imports of 30 products, including tractors, whiskey, typewriters, and computers, among others. In 1984, Ecuador introduced minimum financing or, alternatively, barter requirements for imports. Countertrade arrangements usually involve trade between developing countries; they occasionally also involve trade between industrial and developing countries.

The Executive Board reviewed countertrade arrangements in 1982 in connection with the review of bilateral payments arrangements, 1/ and developments in countertrade practices imposed by Fund members are discussed in recent issues of the Fund's Annual Report on Exchange Arrangements and Exchange Restrictions. Countertrade practices may entail many of the undesirable restrictive and discriminatory practices traditionally associated with bilateralism. 2/ In the context of its reviews of restrictive systems, the staff has paid particular attention to whether countertrade arrangements involve restrictive and discriminatory exchange measures subject to Article VIII.

The subject of countertrade has recently received attention in the GATT. A report prepared by the GATT secretariat in early 1984 concluded that countertrade as such is not contrary to the GATT, but that ". . . governmental measures that require, stimulate, or take the form of countertrade, or that react to countertrade, can be inconsistent with obligations under the General Agreement or the codes." 3/ In discussing the report, some GATT members pointed out that the recent increase in countertrade constituted a movement toward bilateralism and toward primitive, expensive, and discriminatory business methods, while others maintained that countertrade might be unavoidable when there were no other means of financing transactions. It has been estimated that

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1/ "Review of Bilateral Payments Arrangements, 1976-81" (SM/82/169, 9/17/82).

2/ Some of the more common and serious disadvantages encountered in countertrade arrangements are (1) a limited choice of products or services that are available for trading at internationally competitive prices, (2) poor quality of goods, (3) the difficulty of marketing products that are not directly consumed by the buyer, especially when the seller places geographical or commercial restrictions on the marketing of products, and (4) a higher product cost resulting from payments of commissions or fees to the middle men handling sales of products, and from bridge financing that may be required owing to long delivery dates.

3/ GATT document CG.18/W/80 (3/30/84).

the additional costs arising from the need to discount goods taken in countertrade, which reflects the marketability of the goods concerned, may range from 2-3 percent for certain high grade minerals and commodities to 25-30 percent for low-quality manufactured goods and machinery. 1/

c. Prospects

The staff survey indicates that, although some countries intensified restrictions for balance of payments purposes in 1982 and 1983, many of these measures are being reversed. In several countries that have begun to liberalize their trade policies in recent years, there is a growing realization that high levels of protection may encourage costly import substitution and ultimately discourage economic growth and development. Several studies have established a strong relationship between export performance and growth for middle income countries, for sub-Saharan Africa, and for individual countries (such as Brazil and Korea), for both the pre- and post-1973 periods. 2/ Table V-13, taken from Krueger and Michalopoulos (1984), shows the average annual rates of growth of real export earnings and real GNP for selected developing countries for the periods 1960-73 and 1973-81, grouped according to the trade strategy adopted. The data illustrate that countries with relatively "balanced" trade incentives achieved relatively more rapid rates of growth of exports and real income. A study by Balassa (1983) also indicates that, in the post-1973 period, economies where incentives were not biased against exports succeeded in maintaining higher GDP growth, before, during, and after the external shocks of 1973-75 and 1979-81, even though they faced quantitatively larger external shocks.

An important consideration in developing countries' liberalization efforts is to offset the bias against exports arising from protection of the domestic market by liberalizing imports of raw materials and capital goods for export production. Also, measures have been taken to eliminate redundancies and simplify trade systems in order to reduce distortions. Nevertheless, in many developing countries, serious distortions and inefficiencies remain. 3/ In particular (as pointed out by Krueger and Michalopoulos, 1984), restrictive systems that provide automatic or quasi-automatic protection tend to rigidify market shares, reduce incentives for lowering costs and adopting new technologies, and create a higher cost structure that is passed on to the export sector. Efforts to achieve export-led growth may thus be frustrated.

In those instances where the negative effects of high levels of protection are recognized, an important issue for policymakers is the speed with which trade liberalization can be implemented. The feasibility and effectiveness of significant and early trade liberalization would depend

1/ U.K. Department of Trade and Industry (1984), p. 10.
2/ For example, A.O. Krueger (1983); B. Balassa (1982); M. Michaely (1977); and C. Michalopoulos and K. Jay (1973).
3/ There are a few notable exceptions, such as Hong Kong and Singapore.

on the strength of complementary domestic policies, in particular fiscal and exchange rate policies. The possibility of establishing a specific and credible medium-term program for trade liberalization is illustrated by Korea's liberalization program. 1/ A five-year program, supported by appropriate macroeconomic policies, envisages substantial but gradual import liberalization and comprehensive tariff reform. The current average tariff rate is 21 percent. Tariffs in eight industrial sectors were reduced from a range of 18.8-48.5 percent in 1983 to a range of 19.1-38.9 percent in 1984. The subsequent stages envisage further reduction of the tariffs in these sectors to a range of 14.7-20.0 percent in 1988 (Table V-14). About 15 percent of items in the tariff nomenclature will be freed from specific approval requirements under the import liberalization plan, raising the import liberalization ratio to 95 percent by 1988 (Table V-15). The number of items to be liberalized in 1987 and 1988 has been announced; the actual items to be liberalized will be announced a few years in advance, in order to give domestic manufacturers enough time to adapt to greater competition from imports. With a view to safeguarding domestic industry against surges in imports, the liberalization plan allows for temporary increases in tariff protection; this has been used for a limited number of items (adjustment duties were imposed on 14 of the 350 items liberalized in July 1984).

The pursuit of appropriate domestic financial policies, including pricing policies, forms an essential ingredient in the success of the trade policy objectives. Adjustment efforts of Fund member countries undertaken under comprehensive financial programs can thus provide both domestic producers and trading partners a clear signal of the commitment of the authorities to sustained and substantive trade liberalization.

3. Trade measures affecting developing countries

a. Overview

Trade barriers in industrial countries have been relatively high in a few sectors of particular interest to developing countries where they have an existing or clearly emerging comparative advantage, such as textiles and clothing, footwear and other leather products, steel, and certain other manufactures. Some developing countries are also producers of temperate zone agricultural products, trade in which largely takes place under restrictive and protectionist trade policies. As noted in sections III and IV, industrial countries have increasingly broadened nontariff measures in these sectors and extended them to developing countries. In the textiles and clothing sector, restrictions are directed specifically at the developing countries--and have been progressively tightened--while trade among industrial countries has remained generally free of nontariff restrictions. More recently, trade measures are being introduced increasingly in other sectors such as automobiles, consumer electronics, and high technology. While the latter may not have a significant direct impact on the majority of developing

1/ See also section VI.3.

countries, they nevertheless entail adverse indirect effects by increasing distortions, introducing uncertainties, and reducing global efficiency. Perhaps more importantly, they constitute a potentially serious problem for developing countries' longer term development and growth prospects.

b. Tariffs

Although nominal tariff rates have been reduced substantially under successive GATT rounds to an average of about 5 percent for imports of manufactured products (excluding oil) into OECD countries, the reductions have not been as significant on products of interest to the developing countries as this average suggests. After the Tokyo Round, tariffs on clothing imports averaged about 19 percent, those on footwear and travel goods averaged 13.5 percent, and on textile fabrics about 12.5 percent. 1/ The structure of tariffs in industrial countries creates an additional problem in the form of "tariff escalation." Numerous studies show a pronounced general tendency for tariffs to increase or escalate with the degree of processing of the product. Therefore, the effective rates of protection on processed goods are higher than nominal rates, thus impeding the development of higher value added industries in developing countries. 2/

On the other hand, a prominent feature of industrial countries' trade policies toward developing countries is the extension to them of tariff preferences under the General System of Preferences (GSP). Imports from beneficiary countries covered by the GSP scheme increased from $4 billion (27 percent of dutiable imports) in 1972 to $55 billion (31 percent of dutiable imports and 62 percent of non-oil dutiable imports) in 1980. 3/ As noted by the Commonwealth Secretariat (1984), a number of studies show that the GSP scheme has had a significant impact in trade terms, but that various factors tended to limit the benefits.

The coverage of the GSP scheme is limited by the exclusion of certain sensitive products from the preferential regimes in some countries. The "sensitive" textiles and clothing sectors, whose products represent about 17 percent of all industrial tariff lines, account for over one half of industrial products excluded from all GSP schemes taken together. 4/ The exclusion of sensitive products from preferential

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1/ GATT and OECD estimates of import-weighted tariffs of the United States, Canada, Japan, Austria, Switzerland, and the Nordic countries.

2/ According to Melvin and Wilkinson (1968), the overall ratio of effective to nominal rates based on 1962 data was 1.72 percent for the United States, 1.56 percent for the EC, 1.79 percent for the United Kingdom, and 1.82 percent for Japan. See also the Commonwealth Secretariat (1982), pp. 47-49.

3/ In 1980, a further 42.3 percent of total imports entered free of MFN duty (OECD, 1983).

4/ OECD estimate.

treatment, while inputs into their production may be subject to reduced or zero tariffs, may well increase their effective rate of protection. Also, the impact of the GSP is reduced by provisions in the schemes of some countries for graduation of products of more developed producers, when sufficient competitiveness has been demonstrated, and by limits on the share of total imports of a particular product that can be imported at preferential rates from a single supplier. In part as a result of these provisions, and also because, in certain cases, preferential treatment was not requested, only half of eligible imports received preferential treatment in 1980.

The EC has gradually increased the coverage of its GSP scheme, 1/ and has applied special preferential treatment for the least developed countries since 1979. During 1981-84, 24 agricultural items were added to the list receiving preferential treatment (334 items at present), and GSP rates were reduced on 146 items; no products were removed. In 1980, 56 percent of agricultural imports from beneficiary countries were covered by the GSP or other preferential schemes (Table V-16); in addition, MFN-bound duty-free items accounted for 17 percent of agricultural imports from beneficiaries. Industrial GSP items enter duty free (except for Greece). Industrial products, other than textiles and steel, are divided between sensitive and nonsensitive items. In principle, all items are subject to ceilings or quotas, but imports of nonsensitive items are usually only subject to surveillance. In 1984, the list of sensitive items included 132 items subject to individual beneficiary country ceilings at the Community level, or quotas at the EC member level. The 1985 scheme is estimated to allow an increase of preferential imports of 5 percent. In 1980, 59 percent of imports of non-oil industrial products from beneficiary countries were covered by the GSP scheme or other special preferences; in addition, MFN duty-free bound items accounted for 35 percent of non-oil industrial imports from beneficiaries.

The EC also extends trade preferences to 63 African, Caribbean, and Pacific (ACP) countries under the Lome Conventions. Virtually all exports from ACP countries enter the Community duty free. Tariff preferences are also extended to the Maghreb 2/ and Mashraq 3/ countries.

Japan has gradually improved its GSP scheme since its introduction in 1971. 4/ The list of beneficiaries includes 122 countries, with special provisions for 34 least developed countries since 1980. In 1981, the GSP scheme covered 17 percent of agricultural imports from GSP beneficiaries; in addition, bound MFN duty-free items accounted for 20 percent of agricultural imports from beneficiaries (Table V-17). The Japanese GSP scheme covers most industrial products; the main exclusions are certain textile, clothing, leather, and footwear items. In 1981,

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1/ GATT document COM.TD/W/407/Corr. 1 (8/1/84).
2/ Algeria, Morocco, and Tunisia.
3/ Egypt, Jordan, Syria, and Lebanon.
4/ GATT document COM.TD/W/410 (8/17/84).

45 percent of imports from beneficiaries were covered by the GSP scheme, and 37 percent of imports were accounted for by bound duty-free items. Ceilings were established for all 201 industrial product groups covered, and were increased annually according to an established formula. As part of its market-opening measures, Japan expanded GSP access for industrial products by 55 percent with effect from fiscal year 1984/85. A further increase of 8 percent was announced in December 1984 for fiscal year 1985/86. GSP treatment may be suspended for a beneficiary of GSP imports if the beneficiary exceeds a certain percentage of the ceiling set for each product; with effect from fiscal year 1984/85, this ceiling was reduced from 50 percent to one third, but remained unchanged in absolute terms.

The U.S. GSP scheme provides duty-free treatment for 3,053 items out of a total of 4,840 MFN dutiable items. 1/ Between 1979 and 1983, 200 items, covering approximately $1.1 billion in imports, were added to the scheme, while 10 items, covering $0.3 billion, were excluded. Certain products (textiles and clothing subject to textile agreements, watches, import-sensitive electronic articles, import-sensitive steel articles, certain footwear articles, and certain glass products), are mandatorily excluded from the GSP scheme.

In 1980, 20.8 percent of total non-oil imports from GSP beneficiaries were eligible for GSP treatment (Table V-18). An additional 30.6 percent of non-oil imports from beneficiaries were accorded MFN-bound duty-free treatment. Data for 1982 indicate that, by then, the share of non-oil imports from beneficiary countries covered by the GSP scheme had increased to 34.2 percent; slightly less than half of these were accorded GSP treatment. As a result of a review of the system, a "graduation" principle was introduced in 1980 according to which the President could "withdraw, suspend, or limit duty-free treatment" for the more developed beneficiaries for products in which they had demonstrated competitiveness, in order to provide increased opportunities for the less advanced developing countries.

Imports of a product from a given country are normally excluded from preferential treatment if, in the previous year, imports exceeded competitive need limits ($57.5 million in 1984) or 50 percent of total imports of that product. In recent years, this rule, and other modifications to the system, have led to a gradual increase in the number of products excluded in the annual reviews. When the scheme was extended for a further eight and a half years from January 1985, it was made somewhat more restrictive by envisioning the introduction of lower competitive-need limits (25 percent or $25 million) for certain products from specified countries. The Trade and Tariff Act of 1984 contained authority to revise and extend the scheme, and also required that certain discretionary considerations related to market access be taken into account when making GSP determinations which might reduce the scope for preferential treatment. In the context of the Caribbean Basin Economic

1/ GATT document COM/TD/W/401 (5/23/84).

Recovery Program established in 1983, the United States extended duty-free treatment to Caribbean country products, with the exception of textiles and apparel, footwear, petroleum, leather apparel, and canned tuna fish, for a 12-year period.

A study by UNCTAD (1983) shows that tariffs of developing countries themselves present significant barriers to exports of certain products of interest to developing countries. Based on a sample of 27 developing countries, the study shows that these countries imposed a weighted average tariff of 33.8 percent on developing countries' imports, while developed countries' imports faced an average tariff of 28.3 percent. 1/ The tariff structure is fairly similar to that of industrial countries.

c. Nontariff barriers

The incidence of nontariff measures applied by developed countries is relatively high in sectors where developing countries have an actual or potential comparative advantage. As mentioned above, clear examples are provided in the textiles and clothing, leather and footwear, and, more recently, in the iron and steel sectors. This is supported by Table V-19, based on the UNCTAD data base on trade measures, which shows that the proportion of tariff lines subject to price and volume restraints imposed by 17 developed countries are concentrated in the foodstuffs, footwear, textiles, and clothing sectors; the incidence ranges from 25-50 percent, compared with a range of 7-11 percent for mineral products, chemical and allied sector products, wood and wood articles, papermaking material, machinery, and mechanical appliances, optical, photographic and cinematographic equipment, and miscellaneous manufactured articles. UNCTAD estimated that developed countries imposed volume-restraining trade measures affecting 23.2 percent of their imports from all sources, and price controls affecting 7.5 percent of imports. 2/ Cline (1984) estimated, on the basis of measures in effect from the late 1970s to 1981, that the proportion of the market for manufactured goods imported from developing countries affected by nontariff barriers ranged from 24 to 31 percent in the five major EC countries, and from 28 to 43 percent in Japan, Canada, and the United States. 3/ Many of

1/ These averages were obtained by weighting the MFN rates for 31 product categories by the shares of these categories in the total exports of developed, socialist, and developing countries. UNCTAD (1983), p. 9.

2/ A given nontariff barrier may affect only part of a product group. In addition, a measure may be directed at specific imports in the context of antidumping or countervailing measures. According to the UNCTAD definitions used here, volume measures include tariff quotas, seasonal restrictions, total prohibition (for trade as well as health, sanitary, wildlife, censorship, etc., reasons), conditional prohibition, quotas, discretionary licensing, automatic import authorization. Price controls include variable levies, antidumping and countervailing duties, control of the minimum price level, and price investigation and surveillance.

3/ Estimates based on the frequency of trade measures should be interpreted with some caution; see section I.4.c.

the more recent restrictions apply directly to some of the major developing country exporters of manufactures. According to an OECD estimate, the proportion of exports to the OECD countries by four Asian major exporters of manufactures 1/ that was subject to nontariff trade restrictions rose from 21 percent in 1980 to 31 percent in 1983. 2/ It is estimated that 40 percent of Brazil's exports of manufactures to the United States, the EC, Canada, Australia, and Chile were exposed to nontariff restraints in 1983 (Table V-20).

The ratio of Korea's major exports subject to nontariff trade measures abroad is estimated to have increased from 35 percent in 1981 to 42 percent in 1982 (Table V-21). Exports most affected were footwear, silk, and textile products. In 1983, it was estimated that $6.3 billion of exports to 19 developed countries were subject to nontariff measures in foreign markets (40 percent of total exports to these countries). Quantitative restrictions accounted for the majority of the nontariff trade measures facing Korea (Table V-22). The shares of restricted exports were higher for Korea's exports to Japan, the United States, and Canada than for the EC and Australia (Table V-23). In all cases, the majority of restricted items was found in the textiles and apparel sectors. Tables V-24 through V-27 indicate the types of nontariff restrictions presently applied to selected developing countries. 3/

Exports of developing countries are also hindered to a significant extent by nontariff measures of other developing countries. Developing countries supplying some of the larger developing countries were particularly affected by the payments difficulties in partner countries; in response, some of them tightened their own nontariff barriers. In some cases, imports from partners in a regional integration scheme among developing countries were excluded from the scope of new restrictions.

d. Impact on developing countries

It is difficult to assess the impact of protectionism on developing countries, since factors such as foreign demand conditions and supply constraints in their own economies play an important role in their export performance. Also, since some trade measures were implemented recently, their full effect on developing countries may be difficult to discern immediately. In the past decade, developing countries' exports of manufactures to industrial countries have held up relatively well. Nevertheless, the drift toward protectionism has obliged those most seriously affected by foreign restrictions to diversify the commodity and country composition of their exports, and has distorted the pattern of trade among developing countries. For example, a study by Hughes and Newbery (1984) suggests that a number of middle-income countries, e.g., the Philippines, Thailand, Chile, Malaysia, and Peru, have been relatively successful in their export performance compared with the major

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1/ Korea, Taiwan Province of China, Hong Kong, and Singapore.
2/ The 1983 projection is calculated using 1980 trade weights.
3/ Table V-28 shows similar information for New Zealand.

exporters of manufactures which were more affected by protectionist measures. They suggest that developing countries which were relatively less exposed to protectionist measures on industrial products (e.g., Mexico and Argentina) succeeded in achieving higher growth rates for exports to OECD countries than for exports of manufactures to other countries. On the other hand, those major exporters of manufactures most exposed to protectionist measures on industrial products (Hong Kong, Taiwan Province of China, Korea, Singapore, Brazil) diverted a large share of their exports to non-OECD countries.

There is also evidence that, in the absence of trade restrictions, exports of developing countries in the restricted sectors would have expanded faster. Examples of this are found in the studies on the textiles and clothing sectors, and in sectors where country-specific restraints have been introduced (e.g., footwear, consumer electronics). 1/ A recent study on Korea concluded that, in the absence of intensified restrictions under MFA III and other recently intensified restrictions in the iron and steel, footwear, and consumer electronics sectors, Korea's exports would have been $1 billion, or roughly 4 percent, higher in 1984. 2/ Kirmani, et al. (1984) have investigated the impact of eliminating tariff and nontariff barriers in four OECD markets (Canada, the European Community, Japan, and the United States) in seven selected sectors (meat, cereals, sugar, textiles, clothing, steel, and footwear) on the exports of a geographically distributed sample of ten developing countries undertaking adjustment programs with Fund financial assistance, either at present or in the recent past. The exercise is of an illustrative nature, based on partial analysis with certain simplifying assumptions, and its results must therefore be qualified accordingly. The results indicate that the trade liberalization assumed could lead to an increase in their combined exports, in real terms, of 5-10 percent, depending on the strength of supply response. The authors thus conclude that improved market access could contribute significantly to export performance and hence to the adjustment efforts of developing countries. Additional studies of the effects of protection and liberalization are given in section I.4.d.

While the adverse effects of restrictions on foreign market access may be felt immediately for countries with existing production capacities, a significant impact on growth prospects of other developing countries may also be felt in the longer run. As developing countries successfully acquire the skills and know-how to exploit markets in higher value-added products, they may find that possibilities of specialization and diversification are impeded by existing protectionist measures. Also, investors facing uncertainty of market access may be deterred from investment in new export-oriented activities for fear that, once capacity has been installed, they may also be affected by new protective measures. Thus, the allocation of resources according to comparative advantage is impeded, with the attendant consequences for overall efficiency and economic growth.

1/ See section III.8.
2/ GATT document, BOP/246/Add. 1 (10/17/84).

The 1984 OECD study cited earlier similarly suggests that the pressures for extending the country and product coverage of restrictions may be so strong as to inhibit the future scope of further shifts in the product composition and destination of developing country exports. The recent conclusion of arrangements to limit developing countries' market shares in the U.S. steel market illustrates this point.

VI. Fund Surveillance and Programs

1. Introduction

This section reviews the coverage of trade policy issues and developments in the 119 Article IV consultations concluded in 1984, and describes the trade policy content of 143 stand-by and extended arrangements approved in the period January 1979-August 1984. The increased emphasis on trade issues in Article IV consultations derives from the Executive Board consideration in September 1982 of the staff paper "Developments in International Trade Policy" (SM/82/136, 7/12/82), and Board discussions of Fund surveillance. Fund programs have included a trade policy element for several years. In some major recent programs, trade liberalization has been emphasized as an objective in the context of the more widely felt need to encourage balance of payments adjustment through a policy mix relying on structural change toward a more open and externally oriented economy.

2. Article IV consultations

a. Overview

In the 1984 surveillance review, the following suggestions on improving the trade coverage of Article IV consultations were made by the staff and broadly endorsed by Directors: (1) inclusion of assessments of the impact of protection on domestic adjustment; (2) greater emphasis on the impact of members' protectionist measures on its trading partners; (3) reporting on the impact of protectionism abroad on the consulting country; (4) more analysis of specific trade issues; and (5) coverage of protectionist measures adopted in the framework of regional arrangements in the report for the individual member. 1/ In the Article IV consultations conducted in 1984, the staff has sought to improve its coverage of trade issues on the basis of the Executive Board discussion of surveillance. In addition, the staff has sought to provide quantification of trade measures in the consultation reports.

Particular efforts have been made to improve the coverage and assessments of trade policy developments in Article IV consultations with the major trading nations, based on two main considerations. First, a relatively small number of countries account for a substantial portion of world trade, and their actions have a proportionately greater impact

1/ SM/84/44 (2/15/84), p. 24.

on the trade of other countries and on the openness of the world trade system as a whole. 1/ Second, trade policy formulation is, in practice, a highly interactive process in which the sectoral trade measures of one major country tend to be emulated by other major trading countries. Article IV consultations can serve as a useful vehicle for bringing to bear the international view on trade policy formulation in the major trading nations.

Exchange and trade restrictions can be close substitutes for each other. Assessments of the openness of the economy and of the appropriateness of the country's exchange rate policy take into account both exchange and trade restrictions. In that sense, the external sector policy discussions cover trade policy with all countries in the context of Article IV consultations.

As already indicated, surveillance of trade policy developments has received renewed emphasis in GATT discussions in the past three years. The GATT secretariat recently established a trade policy division to gather information on trade measures for each GATT member. This should ease the Fund staff's task in pinpointing important trade measures and policy developments. Apart from frequent contacts between the GATT secretariat and the Fund staff through the Fund's Geneva Office and the Exchange and Trade Relations Department, area department staff members periodically stop over in Geneva for brief informal discussions on trade matters before or after an Article IV consultation with a major trading nation. These contacts have been very useful, particularly as they give the area department staff concerned an opportunity to obtain a first-hand impression of relevant GATT-related issues in an individual Article IV consultation. In the presentation and analysis of trade matters in Fund reports, the focus has been on the economic impact of the stance of trade policy, rather than on the legal status of individual measures under the GATT. 2/

b. Summary of improvements

In order to assess the degree of improvement in trade policy coverage, the staff conducted a broad review of a large number of reports on Article IV consultations concluded in 1984. A more detailed review was conducted for 17 major trading nations. These included the Group of Ten members, 2 other industrial countries, and 5 of the non-oil developing countries, each of which is included in the world's top 25 exporters and

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1/ For example, some 60 percent of world exports are accounted for by the top 10 trading nations (9 OECD countries and Saudi Arabia). On a broader definition, 80 percent of world exports originate in the top 25 trading nations, including 10 developing countries.

2/ Only the CONTRACTING PARTIES (and not the GATT secretariat) can interpret the consistency of a measure under the General Agreement. There are sometimes divergent views among contracting parties on whether certain measures are legal or illegal, and on the techniques for liberalizing trade with respect to the two categories of measures.

accounts for at least 1 percent of world trade. Table VI-1 summarizes the main features of the trade coverage of Article IV consultation reports for the main consultation reports surveyed.

In general, for the major trading nations, all consultation reports featured some assessment of the overall stance of trade policy. In the majority of cases, reference was made in the description or the assessment of trade issues to available quantified assessments of the trade policy stance. About one half of the reports on the major countries included some coverage of the implications of trade measures on domestic adjustment, the balance of payments, and trade flows, although quantification of the impact was not extensive. Discussion of the impact of trade actions on trading partners was focused on countries where recent major developments in trade policies raised the possibility of adverse effects on the economies of foreign suppliers. Sectoral developments, and the treatment of issues such as subsidies, were featured in cases where information was available and the sector or issue was of special concern for the national economy or for international trade.

For members of the European Community, discussion of the member's stance on the common commercial policy was featured when the member had initiated, or was likely to be particularly affected by, certain developments and trade measures at the regional level. In a number of instances, major Community members were called upon in the staff reports to press for a liberal Community-wide trade policy stance.

The trade policy discussion varied considerably among the staff reports for the smaller industrial countries. In a few cases, the impact on a member of foreign protectionism was stressed, while, in some other countries, the impact of the country's own trade policies on its trading partners was highlighted.

In the staff reports for most developing countries, the impact of protectionism was quantified in very few instances, other than those falling within the category of major exporters. Four cases discussed the impact of foreign trade restrictions on a member, while one case featured the impact of membership in a regional association on trade. The impact of the U.S. Caribbean Basin initiative was discussed in another case. Three of the four discussions of foreign restrictiveness related to foreign restrictions on textile imports, while the fourth referred to the problem of foreign restrictions on the country's copper exports. However, the vast majority of consultation reports for the developing countries did not specifically discuss issues such as the effects of foreign protectionism on the member and on its trading partners. Moreover, in most of these consultation reports, the external trade environment facing the developing country, including the trade policies of trading partners, were assumed as a given.

3. Trade policies in Fund programs

a. Overview and "standstill"

Fund programs typically are geared to the establishment of a viable balance of payments in the medium term and of conditions contributing to the achievement of sustainable, noninflationary growth. The promotion of an open exchange and trade system is an important objective incorporated in the Fund's Articles, and is also reflected in the content and design of Fund-supported adjustment programs. A restrictive trade and payments system may be viewed both as a symptom of underlying balance of payments disequilibrium and as a factor hindering structural adjustment and efficient resource allocation.

A necessary condition for establishing an open exchange and trade system is the pursuit of an appropriate exchange rate policy, which normally receives high priority in Fund programs. In many cases, the exchange and trade systems are so closely interlinked that liberalization of the trade system is neither feasible nor effective unless it is preceded or accompanied by reduced reliance on exchange restrictions, where such reliance is significant. Quite apart from jurisdictional matters, this factor explains the high and immediate priority accorded in Fund programs to corrective measures on the exchange rate and exchange restrictions relative to the priority attached to trade liberalization. From a broad perspective, domestic and external measures which promote balance of payments adjustment also help establish conditions favorable to trade liberalization, even if the adjustment program does not directly address the issue of trade liberalization. Typically, reversal of trade restrictions which had been introduced to contain balance of payments problems is a priority objective in formulating the trade content of Fund programs.

In the period 1979-August 1984, 143 stand-by and extended arrangements were approved. All Fund programs incorporate as a performance criterion a standard clause under which purchases will be interrupted if the member imposes new--or intensifies existing--restrictions on imports for balance of payments purposes. The economic rationale for this provision is the need to avoid "solving" balance of payments problems through trade restrictions. From the viewpoint of the trade policy content of Fund programs, as a minimum, a sort of "standstill" on trade restrictions is provided.

There has been remarkable adherence to this "standstill" provision in Fund programs during the approximately six years under consideration. There were only a limited number of serious violations, most of which were accompanied by nonobservance of other performance criteria in a situation where the program as a whole was off-track.

b. Overview of trade liberalization

As regards policies on trade liberalization included in Fund programs, the experience in Fund programs has varied considerably. Using a broad criterion of whether trade liberalization was mentioned as an objective in the program, about half of all programs and two thirds of EFF programs included trade liberalization during the period under review (Table VI-2). The policy content ranged from substantial liberalization put into effect during the program period to general intentions to liberalize trade when feasible, with little expectation that measures would be instituted during the program period.

Perhaps a more meaningful criterion for assessing the trade policy content of programs is whether the program contained specific measures to liberalize trade. Three types of situations were identified. First, in cases where the trade system was considered relatively liberal at the outset of the program, or the administration of trade restrictions was relatively liberal, trade liberalization was not considered necessary or at least did not warrant priority, and the program did not include specific trade liberalization measures. Approximately 30 percent of all programs fell into this category. Second, in cases where balance of payments and/or external debt problems were acute, trade liberalization was considered unfeasible or warranted less priority than measures on the exchange rate and exchange restrictions. Another 30 percent of all programs fell into this category (about one third of these contained general intentions to liberalize trade as conditions allowed). Third, there were programs containing specific trade liberalization measures; these accounted for two fifths of all programs and about half of EFF programs (Tables VI-2 and VI-3).

Of the programs containing specific trade liberalization measures, 23 programs (16 percent of all programs) included such measures as performance criteria for purchases from the Fund, and monitoring relied overwhelmingly on the review clause (Table VI-4). This reflected the general difficulty of formulating and assessing trade measures in quantitative terms. In 13 of the programs containing other specific trade measures, these were expressed as intentions on the part of the authorities and were not considered very significant, nor presented as a central element of the program. Excluding these cases, and taking account only of significant trade liberalization measures contained in the programs (irrespective of whether they constituted performance criteria), about 30 percent of all programs had a trade liberalization policy content in the strict sense.

Some countries (e.g., Korea) initiated the process of major trade liberalization before the Fund program was formulated, and continued the process during the program period; the trade liberalization became an integral and important part of the economic policies under the Fund program without necessarily being subject to performance criteria. In other cases, e.g., where a major tariff reform study was to be undertaken to provide the basis for rationalizing and liberalizing the trade system, a performance criterion was not warranted.

The overwhelming focus of the specific trade liberalization measures was on import restrictions (Tables VI-4 and VI-5). Trade liberalization typically involved relaxing, streamlining, or dismantling the import licensing or quota system, rationalizing the import tariff structure, reducing the dispersion of tariffs, and lowering the average rate of tariff protection. In a number of countries, the programs called for replacing quantitative import restrictions with a more efficient tariff system. Several programs called for reduced export subsidies or a review of the system of export incentives (Argentina, Brazil, Ghana, India, Mexico, Pakistan, Peru, Turkey, and Uruguay). Other measures consisted of improving the administration of trade restrictions, or of dismantling import deposit schemes.

Implementation of the specific liberalization measures was generally good, with over three fourths of the measures being fully or partially implemented (Table VI-6). In most cases where the measures were not implemented, other aspects of the program were also under strain, as indicated by at least one nontrade-related performance criterion being broken, and purchases interrupted (Table VI-7).

c. Case studies

This subsection describes the trade policy content of selected programs in which trade liberalization played an important role.

(1) Hungary (SBA 12/8/82; SBA 1/13/84)

In September 1982, in response to balance of payment pressures, temporary measures were put in place to restrict imports. Imports of several primary products were made subject to restrictions, and imports of component parts became subject to a 20 percent surcharge. In addition, all applications for import licenses were made subject to discretionary approval.

The 1982 and 1984 stand-by arrangements called for an elimination of these trade restrictions. The restrictions were eased in 1983 and early 1984. The proportion of imports subject to quotas was reduced by about 20 percent each in 1983 and 1984, while importers handling large and frequent transactions were exempted, effective January 1, 1983, from the discretionary individual licensing requirement, subject to prespecified quarterly limits relating to 1981 imports. 1/ The import licensing system was eased further in 1984 by setting the company-specific reference limits for the first six months of the year rather than quarterly and by raising the limits by 14.4 percent, on average, relative to the first half of 1983. In addition, effective April 1, 1984, the import surcharge was eliminated. The remaining quotas were eliminated at the end of December 1984.

1/ Except for imports of capital goods, for which licenses remained subject to individual approval.

(2) India (EFF 11/9/81)

The extended Fund facility program envisaged that import restrictions, which were mainly for the purpose of protecting domestic industry, would be reduced--especially with regard to raw materials and intermediate and capital goods--and export incentives increased during the program period. The objectives of the changes to be introduced were to improve efficiency, and promote exports by easing access to imports and foreign technology and reducing import formalities.

On the import side, measures implemented in 1982/83 consisted of built-in increases in the value of automatic licenses (which allow free imports of automatically permissible items up to the value of the license); new provisions made for imports of more heavily protected items (in limited permissible and nonpermissible items); enlarged coverage of imports under Open General License (OGL); increased access to foreign technology by expanding provisions for import of capital goods even if comparable goods were available from domestic sources. Measures designed to simplify import procedures were also introduced.

On the export side, measures implemented included the relaxation of industrial regulations relating to capacity, location, and monopoly controls for the export sector; the provision of tax and other concessions to 100 percent export-oriented units located outside free trade zones; special incentives for the development of large trading houses; and the establishment of an Export-Import Bank. The financial position of the export sector was also strengthened by the effective deployment of exchange rate policy.

A liberalization of imports was also included in the 1983/84 program under the EFF. The intended measures, if applied to the previous year's (1982/83) import values, would, by themselves, have increased allowable imports (other than petroleum, fertilizers, edible oils, and food grains) by 12.5 percent. The total value of the various licenses issued, plus Open General License (OGL) imports (with the same exclusions), were projected to increase by 30 percent in 1983/84. The relaxation of import controls in the least restrictive categories (about 20 percent of items covered by the import system) meant that, by the beginning of the 1983/84 program, the licensing system for these items was no longer an effective restraint. Contrary to the trade liberalization moves, some measures were taken to increase restrictions on imports in 1983/84--mainly higher import duties on several items. However, their impact on protection of domestic industries was outweighed by the liberalizing effects of the other measures, which included: (i) substantial expansion of the coverage of OGL imports; (ii) establishing new OGL facilities for units exporting 100 percent of production and for nonresident Indians returning home; (iii) raising the effective value of import replenishment licenses for exporters (REP) and automatic licenses by 20 percent, when imports are carried by Indian vessels; (iv) raising the entitlement for REP licenses by 10 percent for exports to new markets or of new products and for those shipped by Indian vessels; (v) establishing a one-window clearance for automatic imports of capital goods and technology; (vi) increasing the flexibility in the use of REP licenses; and (vii) raising the limits on free imports of capital goods and technology against REP licenses and allowing importers to use REP licenses transferred to them for this purpose.

(3) Jamaica (EFF 4/13/81; SBA 6/8/84)

The main restrictive feature of Jamaica's import regime was the existence of import licensing requirements. The progressive elimination of import licensing requirements was a basic objective of the extended Fund facility program, which was largely completed as scheduled. In FY 1981/82, the measures adopted with respect to import restrictions were (a) the flexible issuance of so-called "no funds" import licenses (which did not give rise to a claim on official foreign exchange), including the automatic issuance of such licenses for imports of raw materials, spare parts, capital goods, and basic foods. Other measures adopted were (b) the elimination of import licensing requirements for imports of goods not banned or restricted for the protection of local industry, and financed from "Special Retained Accounts" for foreign exchange established for this purpose; and (c) the automatic issuance of licenses for imports financed by the Export Development Fund. Also, a systematic reduction of quantitative import restrictions--with their replacement, when deemed necessary, by temporary tariff increases--started in February 1982 under a program developed as part of a structural adjustment loan from the World Bank. As a first step, on February 1, 1982, 64 items out of a total of close to 400 were removed from the restricted list without any compensatory tariff increases.

In November 1983 and March 1984, the Government dismantled the quota and licensing system for all imports save a small range of non-essential and low priority goods. Goods subject to licenses now fall into two groups: items on the restricted list, and low priority goods amounting to $97 million or 12 percent of non-bauxite/non-oil imports; and imports of basic food financed under concessionary financing programs of donor countries amounting to $162 million. The aggregate of goods which may be imported without licence was 73 percent of the 1982 value of the non-bauxite/non-oil imports. The 1984 program calls for removal of the remaining items on the restricted list within two years, according to a schedule agreed with the World Bank.

(4) Kenya (SBA 6/15/80; SBA 1/8/82; SBA 3/21/83)

Import liberalization was a central element of the three stand-by arrangement programs during 1980-83. The liberalization strategy for a gradual replacement of quantitative restrictions on manufactured imports with a system of higher tariffs, with the view that tariffs would eventually be reduced and subsidies to exports eliminated.

The liberalization process started in 1981, with the introduction of new import schedules that classified imports by order of priority. Items of high priority included in schedule 1 were to be automatically licensed by the Ministry of Commerce. Items in other schedules were either freely importable once authorization by the regulatory agency had been granted, or subject to quotas. A further liberalization was carried out in the first half of 1982 with the transfer of 20 percent of items from the controlled schedules to the liberalized schedules. However, due to severe balance of payments pressures, occasioned in part by an attempted coup in August 1982, the utilization of schedules was eased.

A new import system was introduced in June 1983. Under the new system, two schedules were established under which licenses are granted virtually automatically. One group contains items largely of high priority for production, while the other contains some important items such as petroleum products and fertilizers, which are freely importable only by approved importers. It was estimated that these two groups were equivalent to about two thirds of expected total import demand in 1983. Two additional import categories, containing about 30 percent of expected demand, are subject to allocations which aim at meeting a high proportion of expected demand. Importers receiving allocations for these categories may import any item on the list. A final group, which includes largely low-priority consumer goods (about 6 percent of expected import demand), is subject to quotas. Items in the more restricted categories were grouped into segments which would be shifted, automatically, as the level of the gross reserves of the central bank improves. In June 1984, over one quarter of the items in the more restricted categories were transferred to the less restricted ones.

(5) Korea (SBA 3/3/80; SBA 2/13/81; SBA 7/8/83)

Korea started liberalizing its trade system in mid-1978. As a result, the ratio of imports included in the automatic approval list to all basic items in the Customs Cooperative Council Nomenclature (CCCN) increased from 54 percent in May 1978 to 68.5 percent at the end of 1979, and tariffs were reduced.

Although the liberalization process slowed between 1980 and 1983, owing to balance of payments pressures, the automatic approval list of imports was expanded further, raising the proportion of nonrestricted categories of import in the total to 77 percent in 1982. Tariffs were also reduced on a large number of imports including foodstuffs, chemical and metal raw materials, and some machinery.

In late 1983 and early 1984, the authorities announced and began to implement a five-year plan of import liberalization and a comprehensive tariff reform. Under the import liberalization plan, about 1,200 items would be freed from import restrictions during 1984-88, raising the import liberalization ratio to 95 percent by the end of the period. The government also announced a list of 352 items being liberalized in 1984, and a list of 543 items scheduled for liberalization in 1985 and 1986.

The advance announcement of the liberalized items is designed to provide domestic manufacturers with adequate time to adapt to greater competition from imports. To further smooth the adjustment process, tariffs on certain liberalized items have been raised temporarily; the authorities have announced that these tariffs will be reduced over a 3-5 year period.

The tariff reform aims to eliminate excess protection, reduce the dispersion of tariff rates, and lower tariffs on raw materials. Under the tariff reform program, tariff rates will be reduced on 700-2,300 dutiable items in 1984 and on nearly 1,000 items by 1988; the average tariff rate would fall from close to 23 percent in 1983 to less than 21 percent in 1984 and to 17 percent in 1988. Tariff rates will be concentrated in a range of 5-50 percent in 1984, and a range of 5-30 percent by the end of 1988--before the reform, they were as high as 150 percent. Duty rates on most imports of raw materials have already been reduced from 10-30 percent to 5-10 percent. The authorities have also announced that they will reduce nontariff barriers by ensuring that enforcement of regulations is focused on their original purpose (i.e., protection of public health, safety, and national security).

(6) Mauritius (SBA 5/18/83)

During 1980-82, in response to a sharp deterioration in its balance of payments position, Mauritius significantly tightened its import controls, mainly through import prohibition and other quantitative restrictions. Under the 1983 stand-by arrangement, Mauritius moved to liberalize its trade system. This involved lifting import restrictions on 22 commodities, changing effective prohibitions for 28 other commodities to import quotas, and removing quantitative restrictions on goods subject to import duties of 30 percent or above. All quantitative restrictions on imports were removed by the end of 1984.

(7) Morocco (EFF 3/9/81, SBA 4/26/82, SBA 9/16/83)

Morocco implemented a substantial trade liberalization during 1981-83, after which a significant tightening of the system of import restriction occurred by mid-1983, a situation that the 1983 stand-by arrangement aimed at reversing.

The trade liberalization objectives were to rationalize the system of tariff protection granted to domestic industries in order to improve allocative efficiency, increase the availability of necessary imports for domestic industries at least cost, and increase the competitiveness and profitability of the export sector. To this end, the import program for 1981, following a period of intensified import restrictions (1978/79), provided for a transfer of a large number of items from the restricted list (list B) to the free list (list A). The share of imports on the free list rose from less than 20 percent in 1980 to 30.5 percent in 1981. A few items were transferred from the prohibited list (list C) to list B. Also, the scope of the advanced import deposits introduced in 1978 was reduced to 16 percent of import by end-1981. Meanwhile, a review of the tariff protection system was undertaken in collaboration with the World Bank, on the basis of which the authorities were expected to define their protection policy. Other aspects of the program were the implementation of a flexible exchange rate policy and significant consumer subsidy cuts.

The program for 1982 called for further liberalization of the trade system, which was effectively implemented. List A was to include 40 percent of the value of imports. Although cereals and petroleum (37 percent of total imports) were on the restricted list, their importation was authorized virtually freely. The scope of the advance import deposit was to be reduced to 4 percent of imports by the end of 1982, and to be phased out in 1983. Also, administrative procedures favoring the issuance of licenses were simplified. This move toward trade liberalization was temporarily reversed in early 1983, when the authorities, in response to balance of payments pressures, decided to expand the scope of the advance import deposit and transferred to the restricted list all imports previously included on List A. This restriction on imports was partially lifted at the end of March and mid-June 1983, when the List A share increased to 17 percent.

Subsequently, under the 1983-84 stand-by arrangement, liberalization of the trade system was accelerated. The share of liberalized products in total imports was raised to 24 percent at end-1983 and 48 percent in July 1984, which was the highest for 15 years. The prior import deposit was reduced to 15 percent of the total cost of imports in September 1983, and eliminated in 1984. Further, in the context of the Industrial and Trade Adjustment Program supported by the World Bank, the special tax on imports was reduced by 5 percentage points in January 1984 from 15 percent to 10 percent, and the maximum rate of customs duties was reduced substantially from 140 percent to 60 percent. On the export side, special customs regimes for exporters were extended or improved, export licensing was removed for all products, and the monopoly of the state marketing board on exports of processed food products was abolished.

(8) <u>Pakistan</u> (EFF 11/24/80; EFF 12/2/81)

Export promotion was one of the main objectives of the EFF program. To this end, a central aspect of the program was a reform of the import system and a phased liberalization of imports in order to remove constraints on the availability of raw materials and intermediate and capital goods, and to subject domestic production to greater external competition. The program envisioned action in three major areas by July 1, 1983. First, a full conversion was to be made to a negative/restricted import list system from the positive import list system. Under the program, the negative list was intended to consist of three categories: items banned for religious, security, or luxury consumption reasons; capital and consumer goods banned temporarily for protective reasons; and intermediate goods used mainly in the production of the capital and consumer goods banned for protective reasons. The restricted list was to consist of imports restricted to the public sector, a tied list, and certain consumer goods imports subject to quotas. However, these latter quotas were not to be so stringent as to preclude meaningful improvements in industrial efficiency. When the negative/restricted list system was put in place, all other imports were to be freely importable. Second, the proportion of domestic industry protected by bans or equivalent restrictions (initially about two thirds of domestic industry) was to be reduced to about 40 percent, with at least half of the reduction to be achieved by reducing the protection through bans afforded to the intermediate and investment goods industries. Third, a comprehensive reform of the tariff structure was to be introduced. This reform was to be based on a study of effective industrial protection undertaken by Pakistan in collaboration with the World Bank. The program envisioned that some initial actions would be taken in the first program year, while studies were undertaken to provide the basis for implementation of the more far-reaching reforms in the second and third program years.

With regard to implementation of the reforms, the conversion of the import system was introduced in the Pakistan fiscal year 1983/84. The negative/restricted list system was officially adopted; however, the positive list was also issued. The negative list was constructed basically as the mirror image of the previous positive list and contained a number of items denoted as "other" in the Pakistan customs tariff, as well as items not produced to a significant extent in Pakistan. As a result, the published negative list contained some items that fell outside of the three above categories. Moreover, the format of the negative list and use of the category "other" made the negative/restricted list difficult to use as the sole basis by which importers could determine whether or not specific items were banned or restricted. To contribute to alleviating these problems, an amendment to the 1983/84 import regulations was issued in September 1983 which aimed at reducing the length of the negative list by deleting 70 items, mostly machinery and capital goods and transport equipment. It was also clarified that the publication of the positive list was for indicative purposes only, as a guide to importers.

In the transition to the new system, the proportion of domestic industry protected by bans or equivalent restrictions was reduced to 32 percent, but this included sugar, for which a very high protective duty was implemented. In addition, a large number of SITC import items that previously were not permitted were made importable over the three years. The identification and addition of these items to the list of permitted imports facilitated the final conversion to the negative list system. Moreover, virtually all licensing ceilings were removed during the program.

With regard to tariff reform, the study of effective protection was not received until late July 1983. Thus, the comprehensive tariff reform could not be implemented by July 1, 1983, as expected under the program.

Export subsidy rates were reduced during the program period.

(9) Panama (SBA 4/28/82; SBA 6/24/83)

Panama does not maintain restrictions on payments and transfer for current and capital international transactions. Although numerous trade restrictions existed at the time of agreement, they could not be easily enforced. 1/

Considering that these restrictions constituted an impediment to a more efficient economic system, the authorities decided to undertake a comprehensive industrial policy review to determine whether the substitution of a graduated tariff for import quotas might be undertaken on a large scale. The eventual aim of the reform was to establish a low and uniform level of protection. Paralleling trade liberalization, the authorities intended to phase out gradually most price controls.

The liberalization proceeded as foreseen in the program. In the first nine months of 1983, quantitative import restrictions were eliminated on nearly one half of all the product categories subject to such restriction at the beginning of the year. The quotas that were lifted were replaced by approximately equivalent tariff protection. The remaining quotas were to be eliminated as soon as the pertinent studies of protection were completed. The timing and extent of the reduction of tariff protection were to be determined later on. 2/

(10) Philippines (SBA 2/27/80; SBA 5/25/83)

In the context of the 1980 stand-by arrangement with the Fund and of a structural adjustment loan from the World Bank, the authorities embarked on a comprehensive reform of the tariff structure and a phased liberalization of import restrictions.

Under a tariff reform program, nominal tariff rates were to be reduced from their previous average level of 44 percent to 29 percent. The reform aimed at bringing the effective rate of protection for all major economic activities within the range of 10-80 percent. The first phase of this reform involved the reduction of all peak rates (i.e., rates in excess of 50 percent) to no more than 50 percent in two stages on January 1, 1981 and January 1, 1982. These reductions were implemented on schedule. It was envisaged to further narrow the range of effective protection rates in a second round of tariff reductions after the final stages of the 1980 reform were implemented.

In August 1980, a three-year program was adopted to remove all import restrictions for balance of payments purposes to protect domestic industry. Import liberalization would initially concentrate on the 1,304 items then classified as nonessential consumer goods (NEC) and unclassified consumer goods (UC): 263 items were to be liberalized in

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1/ Due to relatively unimpeded access to the Colon Free Zone and the Canal area.

2/ As of January 1984.

1981, 610 in 1982, and 87 in 1983. The coverage of the liberalization program was to be expanded to include both NEC/UC products and, in the longer run, all imports restricted for industry protective reasons. Most of the items under the three-year program were liberalized on schedule in 1981, 1982, and 1983. However, due to balance of payments pressures, the Government did not enact the 1984 portion, covering 36 items. Further, a number of already liberalized NEC/UC items were re-restricted in 1984 and new regulations were introduced for products not restricted before.

In summary, the average tariff and effective protection rates were lowered under a five-year program of tariff reform. The Philippines persevered with a lowering of tariff rates under the first and second structural adjustment loans with the World Bank. However, quantitative restrictions were expanded as a temporary measure in the wake of the crisis in 1983.

(11) Turkey (SBA 6/18/80; SBA 6/24/83; SBA 4/4/84)

Following a major liberalization of the exchange system in the context of the 1980 stand-by program, the authorities opened the economy to foreign competition by reducing protection and export incentives. To this end, (1) the import quota list was abolished in 1981, and affected items were shifted to the licensable lists; (2) in 1982-83, several import items were shifted from the relatively less liberalized to the more liberalized list (a modest liberalization); (3) more importantly, there was an "administrative" liberalization in the form of a speedier issuance of licenses, particularly for inputs and raw materials used in export production; (4) the extension period of import licenses was increased in 1982 from 8 months to 12 months; (5) the rates of advance ("guarantee") import deposits were steadily reduced from 25-40 percent in 1979 to 1-15 percent by early 1983. On the export side, in 1982 the preferential interest rate on export credits was increased from 27 percent to 31.5 percent, and subsidies from the Interest Rate Rebate Fund were reduced in stages from 35 to 25 percent for industrial exports, and from 25 to 5 percent for other exports.

Much speedier progress toward trade liberalization was accomplished in 1983/84 than was called for by the 1983 stand-by arrangement. The import regime was considerably simplified on January 1, 1984, and import restrictions were sharply reduced. Except when explicitly prohibited or restricted, all goods may now be imported. The new import regime contains (i) a list of prohibited goods; (ii) a list of goods subject to licensing by the Undersecretariat of Treasury and Foreign Trade; and (iii) a list of goods ("Fund List") freely importable but subject to the payment of a specific tax besides customs duty. Most of the items on this list are luxury consumer goods. Imports of all goods not on these lists are freely permitted. Based on preliminary data on the value of import authorizations in 1983, about 75 percent of goods imported under special authorization (restricted imports) are now freely importable; about 70 percent of total imports in 1983 were restricted. Administrative procedures have also been simplified, although import guarantee deposits, ranging from 1 to 15 percent, remain basically unchanged. The 1984 program calls for their elimination by December 31, 1984.

Export procedures were also simplified and the number of goods subject to licensing has been narrowed. To improve resource allocation, the rate of tax rebates granted to exporters was reduced to 80 percent of their 1983 level on April 1, and to 55 percent on September 1, 1984. Meanwhile, customs tariffs rates were changed. Duties on basic raw materials now generally range up to 15 percent, those on intermediate and semifinished goods vary from 10 to 30 percent, and on finished products from 30 to 40 percent.

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