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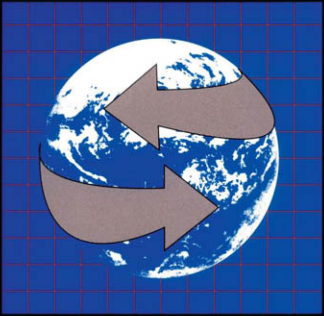
International Trade Policies
The Uruguay Round and Beyond
Volume I. Principal Issues



Prepared by a Staff Team led by
Naheed Kirmani

1994

INTERNATIONAL MONETARY FUND

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The following symbols have been used throughout this paper:

. . . to indicate that data are not available;

— to indicate that the figure is zero or less than half the final digit shown, or that the item does not exist;

– between years or months (e.g., 1991–92 or January–June) to indicate the years or months covered, including the beginning and ending years or months;

/ between years (e.g., 1991/92) to indicate a crop or fiscal (financial) year.

"Billion" means a thousand million.

Minor discrepancies between constituent figures and totals are due to rounding.

The term "country," as used in this paper, 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.

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Preface

This study reviews major issues and developments in the trade area and their implications for the work of the International Monetary Fund. It is presented in two volumes. The first provides an overview of the principal issues and developments in the world trading system; the second presents more detailed background papers on selected trade and trade-related issues. The study focuses mainly on the period 1990–93 and reflects information available as of June 1994. It follows the pattern of the Fund staff surveys prepared in 1978, 1981, 1982, 1985, 1988, and 1992.[1]

The study was prepared in the Trade Policy Division of the Policy Development and Review Department (PDR) of the Fund. The principal authors of the study are Naheed Kirmani, Division Chief; Nur Calika, Senior Economist; Richard Harmsen, Michael Leidy, and Arvind Subramanian, Economists; and Peter Uimonen, Research Assistant; they provided major contributions to both volumes of the study. Uwe Corsepius, Economist in the Fund at the time of the preparation of the study, was a major contributor to the background paper on Fund programs in Volume II. Selected sections in some of the papers in both volumes were prepared by Ali Ibrahim and Clinton Shiells, Economists; and Manmohan Agarwal, Consultant. Michael Da Costa, Senior Economist, provided input to Volume I of the study. Selected sections of some of the papers in Volume II were prepared by Filippo Cartiglia, Economist; and Rosa Alonso i Terme, Summer Intern.

To obtain information and collect views for this paper, the staff held discussions with trade and economics officials in Beijing, Bonn, Brussels (the Commission of the European Communities), Canberra, Jakarta, London, Mexico City, New Delhi, Ottawa, Paris, Tokyo, and Washington. In addition, a staff team visited Geneva and Paris for discussions with officials at the GATT, ILO, UNCTAD, and the OECD, and consulted the World Bank in Washington. The staff team was assisted by the Fund Office in Europe and the Fund Office in Geneva in some of the discussions in Europe, and by the offices of the Fund resident representative in Beijing, Jakarta, and New Delhi.

The authors are indebted to Jack Boorman, Director, and Anoop Singh, Senior Advisor (PDR) for their guidance in preparation of the study. Acknowledgment is due to numerous colleagues both in the Fund and in other national and international agencies for their willingness to exchange views and provide information, and to Professor Jagdish Bhagwati for helpful comments. The authors are grateful to the editor, Juanita Roushdy of the External Relations Department, and to Joan Wise, Lourdes Alvero, and Suzanne King-Loken for secretarial assistance. The authors alone are responsible for the study; any opinions expressed are theirs and do not necessarily reflect the views of the Fund.

[1]International Monetary Fund, *The Rise in Protectionism*, IMF Pamphlet Series, No. 24 (Washington, 1978); *Trade Policy Developments in Industrial Countries*, IMF Occasional Paper, No. 5 (Washington, July 1981); *Developments in International Trade Policy*, IMF Occasional Paper, No. 16 (Washington, second printing, 1983); *Trade Policy Issues and Developments*, IMF Occasional Paper, No. 38 (Washington, July 1985); *Issues and Developments in International Trade Policy*, IMF Occasional Paper, No. 63 (Washington, December 1988); and *Issues and Developments in International Trade Policy*, World Economic and Financial Surveys (Washington, August 1992).

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List of Abbreviations

APEC	Asia-Pacific Economic Cooperation Forum
ASEAN	Association of South East Asian Nations
CAP	Common Agricultural Policy
CMEA	Council for Mutual Economic Assistance, former
CUSFTA	Canada–United States Free Trade Agreement
ECO	Economic Cooperation Organization
ECU	European currency unit
EEA	European Economic Area
EFF	Extended Fund facility
EFTA	European Free Trade Association
EMS	European Monetary System
ESAF	Enhanced structural adjustment facility
EU	European Union
FDI	Foreign direct investment
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GSP	Generalized System of Preferences
ILO	International Labour Organization
IMF	International Monetary Fund
ITO	International Trade Organization
MFA	Multifiber Arrangement
MFN	Most favored nation
MTN	Multilateral trade negotiations
NAFTA	North American Free Trade Agreement
NTB	Nontariff barrier
NTM	Nontariff measure
OECD	Organization for Economic Cooperation and Development
QR	Quantitative restriction
REER	Real effective exchange rate
SAF	Structural adjustment facility
TPRM	Trade Policy Review Mechanism
TRIMs	Trade-related investment measures
TRIPs	Trade-related intellectual property rights
UNCTAD	United Nations Conference on Trade and Development
USITC	United States International Trade Commission
VER	Voluntary export restraint
VIE	Voluntary import expansion
WTO	World Trade Organization

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I

Overview

Open markets, alongside sound macroeconomic, structural, and social policies, are a means to "high-quality" growth (i.e., growth that is sustainable and equitable). Liberal trade policies, through their effects on relative prices and resource allocation and through exposure to foreign competition, improve efficiency, promote export growth, and enhance the economy's capacity for efficient adaptation to changing circumstances (see Appendix I).

The links between macroeconomic and trade policies run in both directions. For example, inappropriate fiscal, monetary, and exchange rate policies (including the absence of hard budget constraints on enterprises) can constrain the ability of economic agents to compete abroad. Such policies can also generate protectionist pressures. Exchange and trade restrictions are moreover equivalent measures for restraining trade so that the effectiveness of liberalization in one area can be negated by the absence of progress (or backsliding) in the other. Convertibility of the external current account can complement trade liberalization. Trade policy, in turn, can affect macroeconomic performance through its impact on fiscal balances (e.g., the revenue effects of tariff reforms), on the balance of payments (e.g., in the short term through incentives to export and import), and on the exchange rate (e.g., heavy reliance on trade restrictions can amount to overvalued (effective) exchange rates).

Given the objectives of the Fund to contribute to high levels of employment and growth and the balanced expansion of trade, and in view of direct and indirect linkages with macroeconomic and structural policies, trade policy developments have an important bearing on the Fund's work. The Fund has a keen interest and stake in maintaining open markets; market access is especially important for the success of adjustment efforts of members undertaking Fund-supported programs. The Fund can help ensure the attainment of macroeconomic stabilization by its policy advice and support of members' appropriate monetary, fiscal, and exchange rate policies—including current account convertibility. This would provide a propitious environment for the first-best assignment of trade policy to improve resource allocation and reap the benefits of international specialization.

Recent Developments

The international trading environment came under considerable strain in 1990–93. Although trade policy developments were mixed, five were prominent. First, under the Uruguay Round, countries were engaged in the most ambitious multilateral trade negotiations (MTN) in history; but discussions were difficult and protracted, which in turn added to trade tensions and undermined confidence in multilateralism.

Second, the trend toward regional integration intensified, partly reflecting frustration with the multilateral process, but in the main motivated by the political and economic imperatives of regional partners; fears of the emergence of warring trade blocs did not materialize, but the perception that they might added to prevailing uncertainties.

Third, unilateral (or "autonomous") trade liberalization was relatively limited among industrial countries but was the hallmark of the reform efforts of many developing countries and economies in transition as disenchantment with interventionist approaches prompted them to intensify moves to outward-oriented market strategies; this, in many instances, strengthened the export capacities of these countries and increased their integration into the world economy.

Fourth, protectionist pressures and trade frictions persisted, and escalated in some areas. This occurred against the background of slow growth and high unemployment in major trading nations, delays in concluding the Uruguay Round, and new competitive challenges emanating from globalization and the dynamic trade performance of some developing and transition economies. Resort to bilateral[1] and unilateral approaches to trade disputes intensified at the same time as disputes brought to the General Agreement on Tariffs and Trade (GATT) also increased. Notwithstanding increasing trade frictions, resort to nontariff measures did not increase in industrial countries. Nonetheless, subsidies remained high, voluntary export restraints (VERs) continued, and increasing attention was given to the efficacy of setting import targets (i.e., "voluntary import expansions" (VIEs)), for example, in trade with Japan. Equally, a disturbing upward trend was witnessed in the use of trade remedy laws, especially antidumping, as an instrument of pro-

[1] In this paper "bilateral" approaches refer to the use of pressures and sanctions, or both, to resolve trade conflicts with bilateral trading partners.

tection; such resort spread to developing countries, even as they liberalized their trade in other respects.

Fifth, the links between trade policies and important domestic policy objectives—for example, competition policy and better environment and labor standards—were increasingly discussed in national and international forums.

The Uruguay Round and Beyond

Under these circumstances, the conclusion of the Uruguay Round toward the end of 1993 was welcome. Not only was it a major achievement and a crucial element in world growth in the medium term, but it substantially improved the prospects for restoring the credibility of the multilateral trading system. In terms of the scope and breadth of coverage, the Round was unique among MTNs. Significant progress was made in all three areas tackled: (1) market liberalization, which could add approximately 1 percent to world real GDP ($212–274 billion) and 12 percent to world trade upon full implementation of the agreement;[2] (2) strengthening of rules and institutional structures, particularly the creation of the World Trade Organization (WTO), which could adjudicate disputes more efficiently and better restrain unilateral and bilateral approaches outside the multilateral system; and (3) integration of new areas (e.g., agreements on services and trade-related intellectual property rights (TRIPs)) and the traditional "sensitive" sectors (agriculture, textiles, and clothing) into the multilateral trading system. This last element may well be the most remarkable achievement, given the history of the Multifiber Arrangement (MFA), failure of past attempts to bring agriculture under multilateral disciplines, and the North-South differences over TRIPs and services.

With over one hundred participants with very diverse interests, it is inevitable that the Round's final results represent compromises that may not fully satisfy any one participant's original goals. Examples of concerns include (1) textiles and clothing, that exporting developing countries' own markets are not sufficiently liberalized, or that the backloaded liberalization of the MFA creates room for delaying the hard decisions on adjustment in industrial countries to the eleventh hour; (2) agriculture, that replacing quantitative restrictions (QRs) with tariffs may lead to prohibitive tariffs, or that higher food import costs may cause financing problems; (3) TRIPs, that their transition periods are too long, or that they may lead to higher prices for essential medicines with adverse effects on public health in some developing countries; (4) antidumping measures, that the codification of existing practices will not rein in their use; and (5) tariffs, that these are bound well above applied rates in developing countries, or that preferences will erode, and so forth. The extent to which these concerns materialize and the agreement's benefits are realized will be determined by the manner of the agreement's implementation.

The immediate task ahead is ratifying and effectively implementing the Uruguay Round agreement. As with any major liberalization initiative, implementation will disturb the benefits associated with the status quo (whether from protection received or preferences extended) and will entail adjustment to a new, more efficient market structure. This may involve transitional costs in specific areas for some countries and benefits for others. Preliminary analyses suggest that the Round will in general be beneficial for all countries. Given the fairly long implementation period, any transition costs are likely to be felt gradually, providing time to exploit the opportunities opened up by the Round.

Two types of transition costs identified by some developing countries stem from the erosion of preference margins and possible higher costs of food imports. Preliminary analyses suggest that the erosion of preferences is likely to be small for most African and Caribbean countries but could be more significant for some North African countries. Moreover, as tariffs come down in successive rounds, and the world economy gets increasingly integrated, reliance on preferences as a basis for longer-term export growth is not a viable strategy. Regarding food imports, the direct impact of possible higher prices is likely to be felt by those relying most heavily on commercial food imports and will depend on the extent of the rise in food prices. The Fund will need to monitor carefully members' adjustment to the Uruguay Round agreement, including its impact on their balance of payments, and help countries manage an orderly transition. The Fund and the World Bank stand ready to use their existing facilities where appropriate to address external financing and policy adjustment needs arising from implementation of the Uruguay Round. Generally, the Fund's work should continue to be supportive of, and consistent with, the agreement.

The post–Uruguay Round agenda comprises many subjects, and the list keeps growing.[3] It includes completing negotiations in key service sectors (including financial services, telecommunications, and transportation). Additional liberalization in areas such as agriculture, steel, and civil aircraft needs to be considered,

[2]In October 1994, the GATT's Director General announced that more recent analysis by the GATT Secretariat incorporating competition-enhancing effects of trade liberalization indicated that welfare gains from the Uruguay Round may be twice as high as previously estimated.

[3]The June 1994 ministerial meeting of the Organization for Economic Cooperation and Development (OECD) adopted a work program calling for additional work on trade and environment, trade and competition law and policy, and trade and employment and internationally recognized labor standards.

as distortions would remain high even after full implementation of the Round. Competition policy issues need better definition and analysis before multilateral approaches can be formulated to tackle emerging trade frictions in this area. The links between trade policy and environmental and labor policies are likely to get further attention in the future. Environmental and labor objectives are undoubtedly important and can be advanced without reliance on trade sanctions as an enforcement mechanism. Proposals to use trade restrictions to counter "eco-" or "social" dumping are conceptually weak and potentially dangerous. Developing countries fear that protectionist measures may be used against them on the pretext of securing improved standards. In general, there is concern that overloading the trade policy instrument to serve too many objectives—revenue, balance of payments, income distribution, competition policy, environment, labor standards, and human rights—could undermine the efficacy of its primary function of resource allocation.

Role of the Fund

A review of the Fund's activity in the trade area indicates that trade policy issues have featured importantly in the exercise of Fund surveillance. Further attention is likely to be given to strengthening the analysis of the effects of trade measures; the links between trade policy and other macroeconomic and structural policies, including assessment of the impact of protection on domestic adjustment; more regional analysis; and market access problems of developing countries and economies in transition. With greater emphasis on structural issues, the trade policy content of Fund-supported programs has increased significantly. Fund staff collaborate closely with the World Bank in assisting members in the design of trade reforms. A review of design issues highlights the importance of integrating trade policy with other program policies—particularly fiscal and exchange rate—and adhering to a medium-term trade reform strategy with clearly established short- and medium-term goals.

While pursuing common objectives, the Fund and the GATT have played complementary roles without significant duplication, and this should continue after the establishment of the WTO. Indeed, such collaboration is expected to be strengthened in the future. It would be important for the Fund and the WTO, at both the staff and institutional levels, to remain alert to each other's concerns, taking into account the links between macroeconomic and trade policies and the respective jurisdictions of the two institutions. The need to ensure that Fund policy advice and program design are consistent with the GATT/WTO[4] may require greater vigilance in the future, given that the scope of commitments under the Uruguay Round of common members has expanded sharply, particularly among developing countries. This may require strengthening internal review procedures, as well as intensified informal staff contacts to exchange views and information with the GATT/WTO. The collaborative relationship, including its informal and formal aspects, will evolve and develop further as the WTO is established and gains experience. Of course, better coherence and consistency of macroeconomic and trade policy at the national level is essential.

[4]The Final Act of the Uruguay Round establishes the WTO under which the GATT (1994) and other agreements and understandings are subsumed. GATT (1947) will continue to apply between those countries that do not withdraw from it. GATT/WTO is used in this paper to refer to both the GATT (1947) and the WTO.

II

Trade Policy Developments, 1990–93

During 1990–93, the growth of trade (as measured by trade volumes) outstripped the increase in real GDP, in line with the trend toward increased integration of the world economy over most of the past three decades (Chart 1). The growth of both trade and output were lower during this period than in previous decades. A contributing factor was the recession in a number of industrial countries in 1990–91 although, in contrast with the 1981–82 period, the growth in trade still exceeded that of output.

While real export growth decelerated in 1990–93 in both industrial and developing countries compared with the previous four-year period, the developing countries experienced growth rates over twice as high as those of the industrial countries (Table 1). Among the developing countries, particularly striking were the real export gains in Asia and the Western Hemisphere. Export growth in sub-Saharan Africa was negligible, although the aggregate numbers mask improvements in export growth experienced by some countries that have undertaken extensive economic reforms.

Developing countries experienced a deterioration in their terms of trade in 1990–93 (with sub-Saharan Africa witnessing the largest deterioration), although it was not as severe as in the previous four-year period. The dynamic export performance of Asia and the Western Hemisphere in 1990–93 led to a rise in the share of developing countries as a whole in world exports to about 31 percent in 1993; this was still marginally below their share in 1980 when oil exports had been more prominent.

Industrial Countries

Trade policy developments in industrial countries during 1990–93 were characterized by significant regional liberalization, limited unilateral market opening, and the continued presence (and, in some areas, escalation) of trade frictions. These themes were also recurrent in the Fund's consultation discussions and the *World Economic Outlook* over the past several years.

Multilateral liberalization under the Uruguay Round was the most prominent trade policy objective of most industrial countries during 1990–93, but negotiations were difficult and protracted. Industrial countries intensified moves toward regional trade liberalization in both Europe and North America in the context of formal regional trading arrangements. Two prominent examples were the Internal Market program (also referred to as the Single Market program) of the European Union (EU)[5] and the North American Free Trade Agreement (NAFTA) between Canada, Mexico, and the United States.[6] The Internal Market program, providing for harmonization of legislation and the elimination of barriers to trade in goods and services, capital flows, and movements of labor, is a major recent European initiative aimed at stimulating growth. Competition policies are an important component of this program.[7] Its impact on the level of real GDP is estimated to be between 2.4 percent and 3.4 percent.[8] While the Internal Market program is associated with some pockets of discrimination (e.g., import quotas on bananas, "voluntary" restraints on Japanese automobiles, and public procurement rules), trade diversion has been generally limited (less than 2.5 percent of extra-EU imports). Thus, earlier fears by third countries of a "Fortress Europe" have so far proved unwarranted.

The NAFTA provides for improved market access on a preferential basis in many sectors (agriculture, automotive, and textiles and apparel), covers areas not traditionally included in free trade arrangements (intellectual property, investment), and strengthens trade rules; supplementary agreements cover environmental and labor standards. All three countries are expected to benefit from the NAFTA, with Mexico likely to experience the largest percentage increase in real national income (up to 5 percent of GDP). Trade diversion effects

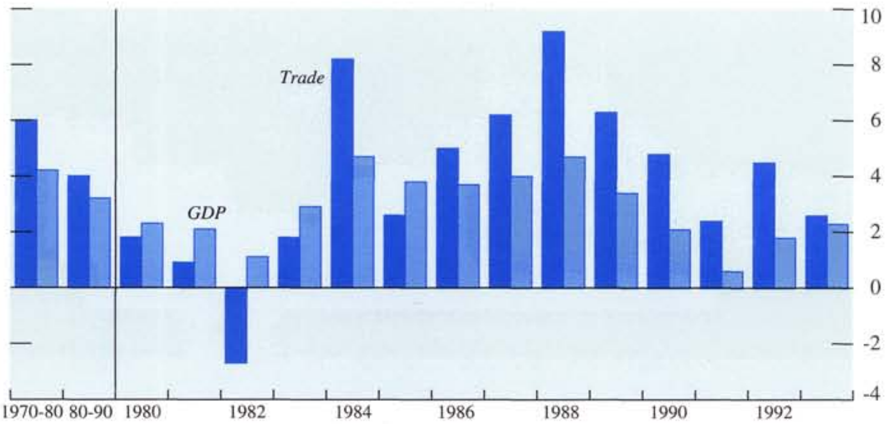
[5]The EU, which came into effect in 1993, is used in this paper to also refer to the European Community.

[6]Other formal trading arrangements involving industrial countries included the European Economic Area (EEA) together with the EU's accession negotiations with Austria, Finland, Norway, and Sweden; the European Union's association agreements with six Eastern European countries and cooperation agreements with the countries of the former Soviet Union; and similar agreements under negotiation between the European Free Trade Association (EFTA) and Eastern European countries. Under the Canada–United States Free Trade Agreement (CUSFTA), there have been three rounds of accelerated tariff cuts since 1990. Australia, Canada, Japan, New Zealand, and the United States participated with a number of Asian developing countries in the Asia-Pacific Economic Cooperation Forum (APEC).

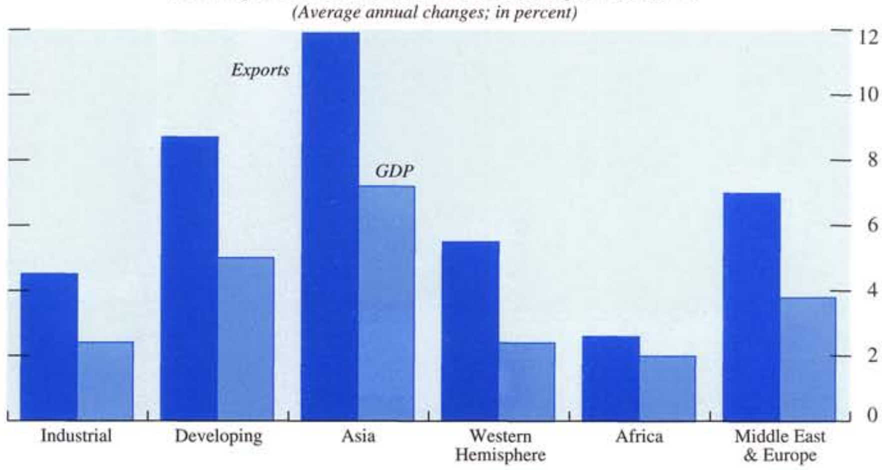
[7]Enforcement of competition rules has increasingly focused on the elimination of remaining commercial and public sector monopolies, further reductions in state aids, deregulation of private anticompetitive arrangements, and mergers and acquisitions.

[8]See Buigues and Sheehy (1993); Harrison, Rutherford, and Tarr (1994).

Chart 1. Real World Trade and GDP Growth
(Annual changes; in percent)



Real Export and GDP Growth in Selected Regions, 1986–93
(Average annual changes; in percent)



Source: IMF (1994b).

are expected to be modest (generally less than 1 percent of a country's exports to North America) but may be larger (up to 5 percent) for specific products and suppliers.[9]

Broad-based unilateral trade liberalization among industrial countries was undertaken only by Australia[10] and New Zealand;[11] promotion of transparency and public awareness of the costs of protection helped them implement trade reforms (Box 1). There were instances of liberalization in specific areas by several other countries; for example, Sweden dispensed with quantitative restrictions on imports of textiles and clothing under the MFA and moved to deregulate the agricultural sector. The EU eliminated a large number of national QRs against third countries in the context of the Internal

[9]See USITC (1993).

[10]Australia initiated a general program of unilateral trade liberalization in 1988, and a second program of phased tariff cuts commenced on July 1, 1992. With a few sectoral exceptions, the aim is to reduce most-favored-nation (MFN) tariffs on those items not already duty free to a tariff rate of 5 percent by July 1, 1996. In the sensitive area of textiles, clothing, and footwear, the highest tariff by the year 2000 will be 25 percent on apparel (down from about 47 percent), while textiles and footwear will face a maximum of 15 percent. Tariffs on motor vehicles are to be reduced to 15 percent (from just over 30 percent) by January 1, 2000.

[11]New Zealand embarked on a program of unilateral trade liberalization in the mid-1980s, with phased cuts in MFN tariffs on manufactured goods, and the elimination of most quota and import licensing restrictions. A second round of trade liberalization pursued deeper tariff cuts in 1992 and, with the exception of a few sensitive sectors, non-zero tariffs (which at present cover about 10 percent of imports) will range predominantly from 8 percent to 12 percent by July 1996.

Table 1. Export Growth and Terms of Trade

	Export Volumes		Terms of Trade		World Export Shares[1]		
	1986–89	1990–93	1986–89	1990–93	1980	1990	1993
	(Annual percentage changes)				*(In percent)*		
Industrial countries	5.8	3.2	2.6	0.9	68.1	73.6	69.4
United States	11.5	6.8	−1.2	0.2	12.0	11.8	12.6
Japan	2.1	2.3	8.5	4.8	7.1	8.7	10.0
European Union[2]	5.4	2.3	2.8	0.7	16.7	16.2	15.3
Developing and transition economies[3]	9.7	7.8	−4.0	−0.8	31.9	26.4	30.6
Africa	2.8	2.4	−6.0	−2.1	3.5	2.5	2.5
(Sub-Saharan Africa)	(2.2)	(1.0)	(−5.0)	(−3.4)	(. . .)	(. . .)	(. . .)
Asia	14.1	9.8	−0.3	0.3	8.9	13.6	17.7
(Asian NIEs)[4]	(15.7)	(11.0)	(2.2)	(0.1)	(. . .)	(. . .)	(. . .)
Middle East and Europe[5]	8.8	5.2	−8.6	−1.7	10.5	4.8	4.4
Western Hemisphere	4.6	6.5	−3.9	−2.9	5.6	3.8	4.6

Sources: International Monetary Fund, *Direction of Trade Statistics*; and IMF (1994b).

[1]World exports are from IMF, *Direction of Trade Statistics*, which excludes Albania, Bulgaria, Cuba, the former Eastern Germany, Mongolia, North Korea, and the countries of the former Soviet Union.

[2]Figures exclude intra–European Union trade.

[3]Data for regional export shares do not include figures for the Czech Republic, Faeroe Islands, Gibraltar, Hungary, Poland, Romania, the Slovak Republic, and Federal Republic of Yugoslavia; the totals for developing and transition economies do include figures for these countries.

[4]Newly industrializing economies (NIEs), that is, Hong Kong, Korea, Singapore, and Taiwan Province of China.

[5]European countries included are Cyprus, Malta, and Turkey.

Market program. In the context of its bilateral agreements with the United States, Japan liberalized (on an MFN basis) QRs on some agricultural products and coal, and reduced tariffs on selected agricultural and industrial products; it agreed (under the Structural Impediments Initiative) to take liberalization measures in areas such as foreign direct investment, deregulation of the distribution system, and stricter enforcement of competition laws;[12] and it also undertook to improve transparency and promote liberalization in government procurement in construction.

Notwithstanding closer cooperation on a regional basis, trade relations among industrial countries (and between them and others) deteriorated in 1990–93. Protectionist pressures remained strong and trade frictions escalated against a background of slow growth and high unemployment in major trading nations, and new competitive challenges emanating from globalization and the dynamic trade performance of some developing and transition economies. Initiation of GATT disputes reached an annual peak of ten in 1991/92,[13] and many others were handled outside the GATT. Trade relations were marked by bilateral and unilateral approaches to market opening. For example, during 1990–June 1993, there were 15 new investigations under the Section 301 family of U.S. trade laws.[14] Trade tensions intensified in particular with Japan, fueled by alleged difficulties of market entry and its persistent external current account surplus. With the declining importance of formal Japanese trade barriers in manufacturing, scrutiny increased of possible trade-restrictive effects of "informal" barriers and of domestic competition policy instruments. As a consequence, increased attention began to be paid to market opening through various sector-specific and other initiatives, culminating in the United States—Japan Framework Agreement of July 1993.[15] This has resulted in an ongoing debate over the economic and political efficacy of "numerical targets," "results-oriented approaches," and voluntary import expansions as instruments for market opening (see Box 2). In the particular case of the Framework Agreement, the two parties involved are agreed on the objectives,

[12]Notable among these were the Large-Scale Retail Store Law of 1990 permitting easier entry for foreign and domestic firms into the retail business and more effective enforcement of the Anti-Monopoly Act.

[13]This was in part also the result of many disputes having been held back awaiting the outcome of the Round, and of Contracting Parties beginning to clear some of this backlog after the expiration of the initial deadline for the Round in 1990.

[14]Section 301 provides authority to enforce U.S. rights under trade agreements or to respond to foreign measures considered unfair, unreasonable, or discriminatory toward U.S. commerce abroad with the threat of sanctions. The "Super 301" law expired in 1990 but was renewed by executive order in March 1994—Super 301 introduces automaticity to Section 301 investigations.

[15]This covered an array of macroeconomic and sectoral issues and encompassed previous initiatives on government procurement in computers, supercomputers, satellites, medical technology and telecommunications, and market access in the automotive and insurance sectors.

Box 1. Helping to Counter Protectionist Pressures Through Transparency

Economists agree that properly phased unilateral trade liberalization is generally in the national interest.[1] Yet resistance to trade liberalization and recurring protectionist pressures often seem to dominate public debate and ultimately influence policy decisions. The fundamental asymmetry between the costs and benefits of protection makes the pursuit of liberal trade politically difficult. The benefits of liberal trade (to consumers and industrial users) tend to be relatively nontransparent and diffuse, while the costs of liberal trade (to protected industries) are typically concentrated and transparent. Thus efforts to mobilize political resources to oppose liberalization or to support protectionist policies are often more successful than efforts to mobilize political resources to seek liberal trade policies.

Governments can play a role in helping to tip the balance of political forces in favor of trade liberalization. They can do so, in part, by helping to lift the veil of complexity that often conceals the net social costs associated with protectionist trade policies. Mobilizing political support for liberal trade can be facilitated by systematically exposing the implications of trade measures (which at times are effectively buried in the esoterica of trade legislation) and evaluating the associated costs for the economy as a whole.

Underlying the recent unilateral liberalization initiatives in Australia, for example, is an institutional base that promotes transparency and supports an economy-wide perspective in the evaluation of government policies. Of note in this regard is the role of the Industry Commission, the Government's major review and advisory body in the area of industrial economic policy, broadly defined. The Commission is an independent body whose charge is to assess prospective policy measures from a national perspective with a view to promoting a high degree of transparency in government policymaking, furthering public education, and bringing a well-informed voice to the public debate. The debate that preceded the 1988 tariff cuts was influenced by the Commission's work on effective rates of assistance, and the Commission has continued as a steady voice for trade liberalization and an effective critic of the remaining pockets of protection in Australia.

A related development at the international level is the GATT's Trade Policy Review Mechanism (TPRM) initiated in 1989 and made permanent under the Uruguay Round agreement. The TPRM process reviews individual countries' trade regimes with a view to enhancing transparency, improving adherence to GATT/WTO rules, and supporting the smooth functioning of the multilateral trading system. These reviews have become an important reference on trade policy for consumer groups, researchers, and international organizations, and over time may help to strengthen public opposition to existing and newly emerging protectionist trade measures throughout the world. In its policy advice and program design, the Fund (and the World Bank) encourages transparent exchange and trade regimes.

[1]Two well-known, but often overstated, exceptions to this prescription are those presented by optimal tariff and strategic trade theory.

although views on the means may differ. More generally, bilateral approaches can be instrumental in reducing trade or trade-related barriers—but they also risk introducing (even if unintended) elements of trade management and discrimination in practice, and thereby could undermine confidence in the multilateral trading system. Such approaches are unlikely to affect significantly the external balances, which are typically grounded in savings-investment balances.

Notwithstanding escalating trade frictions and strong protectionist pressures, governments in industrial countries managed to restrain the most serious protectionist elements. The combined resort by the EU, Japan, and the United States to nontariff measures remained essentially unchanged between 1988 and 1993 (Table 2). Nevertheless, serious distortions remained in many sectors (agriculture, steel, textiles and clothing, footwear, autos, electronics, aircraft), resort to VERs continued, and a disturbing upward trend occurred in the use of trade remedy laws, especially antidumping.

Although recent data are not available, the levels of state aid to industries have likely remained high, especially in the EU. Given budgetary pressures in most industrial countries, however, the slightly declining trend observed in the second half of the 1980s has probably continued since 1990.[16] Also, the composition of subsidies is changing, with an increased emphasis on less-trade-distortive supports such as investment in infrastructure and regional assistance.

Subsidies to the agricultural sector have continued growing since 1989, with total transfers in OECD countries associated with agricultural policies increasing from $302 billion in 1990 to $335 billion in 1993. Producer subsidy equivalents[17] for OECD countries as a whole remained practically stable during 1990–93 at about $165 billion, or over 40 percent (Table 3). These subsidies have seriously distorted markets and adversely affected efficient agricultural exporting countries. Sev-

[16]In the EU, total state aid to the manufacturing sector reached 3.5 percent of value added in 1988–90, down from 4 percent in 1986–88 (Commission of the European Communities (1992), p.10).

[17]Producer subsidy equivalents are measured by market support, direct payments, and transfers that indirectly benefit producers. Total transfers is a broader concept as it includes, in addition to producer subsidy equivalents, items such as expenditures on public stockholding not received directly by producers, subsidies to food processing and distribution, expenditures not entirely specific to the agricultural sector, etc. See OECD (1994).

Box 2. Voluntary Import Expansions

Voluntary import expansions (VIEs) refer to quantitative targets set by governments, typically in response to allegations that nontransparent market barriers impede market access. VIEs and VERs thus emphasize quantitative outcomes as opposed to trade rules as a way of resolving trade tensions. VIEs and VERs are a manifestation of managed trade, because they involve governments specifying outcomes for domestic producers that would otherwise be determined by markets. The Uruguay Round agreement on safeguards calls for the elimination of VERs and of "any other similar measures on the export or import side" that afford protection. VIEs that do not afford protection would appear not to be covered by the Uruguay Round prohibition, but this remains to be tested in the future. From the perspective of economic efficiency, the use of VIEs carries serious costs.

First, some have argued that VIEs can be distinguished from VERs, because the former could promote competition by increasing the number of firms operating in the market.[1] However, it is also recognized that the implementation of VIEs requires coordination among firms (by governments), which could lead to cartel formation and higher prices in a manner analogous to VERs.[2] VIEs may not lead to significant market opening, because typically producer groups in the exporting country will seek privileged access (excluding potential competitors) to foreign markets. The VIE-implementing country may also define the VIE narrowly to assure its implementation. The result could be some market opening, but at the expense of new entrants.

Second, VIEs are inherently arbitrary; in addition to doubts about the validity of targets, their implementation is problematic. If uncompetitive sectors are the beneficiaries of VIEs, the resulting expansion of such sectors could entail an overall loss in welfare of the VIE-seeking country; VIEs thus become instruments of "export protectionism."[3] Further, there are risks that they may not prove temporary as intended, if they come to be seen as entitlements.

Third, VIEs may become discriminatory in application, in view of pressures to appease the complaining country or industry, or both, at the expense of third parties. Bhagwati (1988) provides examples of discriminatory market opening.

Fourth, VIEs could proliferate across industries (as did VERs), because the existence of targets in one industry creates an incentive for other exporters to lobby their governments for similar deals. A global spread of VIEs would lead to market segmentation and exacerbate trade tensions between countries.

Finally, VIEs do not resolve the fundamental problem of closed markets. Improving competition policy rules and enforcement and agreeing multilaterally to eliminate regulations and discriminatory government procurement practices would be a more appropriate and effective policy response.

[1]See Tyson (1993); Bergsten and Noland (1993).
[2]See Irwin (1994).
[3]See Bhagwati (1988).

eral industrial countries introduced agricultural reforms, of which the 1992 reform of the EU's Common Agricultural Policy (CAP) was the most notable. The reform aimed most noticeably at curbing excess production of cereals by means of set-asides of arable land and reductions in guaranteed prices, with compensation to farmers in the form of a fixed payment per hectare under cultivation. These reforms are an important step toward a more market-oriented system. Nevertheless, the basic features of the CAP (minimum prices, trade protection) remain in place; and the impact on production incentives of decreases in institutional prices, which are expressed in European currency units (ECUs), was significantly reduced by the depreciation in terms of the ECU of a number of European Monetary System (EMS) currencies in 1992 and 1993. Also, the compensatory payments will inhibit reductions in the overall budgetary cost of support to the agricultural sector. New reforms will therefore be necessary in the future if further market liberalization and a reduction of budgetary costs are to be achieved.

Developing Countries

Despite continued barriers to market access in industrial countries, developing countries in 1990–93 undertook several reforms in their trade policies. Both aspects were highlighted in the Fund's consultations with members and in the *World Economic Outlook* during this period.

Developing countries accelerated unilateral trade liberalization in line with the trend toward outward-oriented strategies. Trade reforms were often part of comprehensive integrated packages that included macroeconomic and other structural reforms (including ex-

Table 2. The European Union, Japan, and the United States: Trade Coverage Ratios of Core Nontariff Measures[1]
(Percent of imports covered)

	1988	1993
Core NTMs	14.6	14.0
Quantitative restrictions	12.1	9.8
Export restraints	8.0	6.6
Antidumping, countervailing, etc.	2.4	3.7
Other price measures	1.6	1.6

Source: IMF staff estimates derived from provisional OECD data.
[1]Core NTMs include quantitative restrictions and price-based import measures.

change systems),[18] which led to increased capital flows, particularly to Asia and Latin America, and helped boost productivity and exports.[19] Trade liberalization was also pursued in the regional context.

Integration in the multilateral trading system was pursued through membership in the GATT,[20] more tariff bindings,[21] less reliance on trade restrictions allowed under GATT's balance of payments provisions (Article XVIII:B),[22] and more active participation in the Uruguay Round as compared with previous Rounds. This assisted in achieving a Uruguay Round result that took into account areas of interest to developing countries more so than before.

As QRs were abolished and tariffs were brought down, protectionist pressures increased in the more vulnerable domestic industries exposed to international competition. In some cases, governments responded by introducing minimum import price systems to sensitive sectors (especially agriculture). In others, there was increased use of trade remedy laws, particularly antidumping, and introduction or reactivation of antidumping and countervailing legislation. The use of antidumping actions increased, particularly in those countries that had significantly liberalized their trade regimes, indicating that this measure is sometimes being used in lieu of a normal safeguards instrument. Nevertheless, antidumping initiations by developing countries as a proportion of total initiations of trade remedy actions remain small.

Developing countries face a range of tariff and nontariff trade barriers in industrial country markets. Tariff escalation is a problem especially in "sensitive" sectors, such as agriculture, textiles, and apparel, and is likely to remain important in the post–Uruguay Round period. In addition, developing countries' exports face various tariff peaks (some reaching 60 percent), agricultural levies, and minimum import prices.

Regarding nontariff measures, QRs have had the most adverse effects on developing countries' exports of textiles and clothing, fish and fish products, and footwear (Chart 2). The effect of price-based measures was generally not as great, although still high in agriculture, as well as in iron and steel. Antidumping and countervailing measures, on the other hand, have intensified in recent years, affecting developing countries' exports; the number of these actions initiated has risen from 67 in 1988/89 to 136 in 1991/92 (Table 4). Subsidies to the agricultural sector in OECD countries have also acted as a barrier to developing countries' exports to the extent that they exerted downward influence on export prices and displaced exports from developing countries, or the availability of subsidized imports inhibited domestic production. Eliminating such market access barriers would improve the export prospects of developing countries and further encourage the liberalization of their trade and payments restrictions.

Table 3. Agricultural Producer Subsidy Equivalents[1]

	Annual Average 1979–86	1990	1992	1993
	(In billions of U.S. dollars)			
Australia	1.00	1.33	1.11	0.96
Austria	1.02	2.68	3.17	2.97
Canada	3.72	7.20	5.99	4.77
European Union	39.61	82.11	82.79	79.57
Finland	2.18	5.08	3.29	2.65
Japan	20.96	29.85	36.07	34.99
New Zealand	0.69	0.17	0.10	0.10
Norway	1.69	3.05	3.09	2.66
Sweden	1.68	3.15	2.74	1.92
Switzerland	2.61	5.13	4.54	4.49
United States	22.73	27.70	25.41	28.35
Total OECD	97.88	167.44	168.29	163.12
	(In percent of farm gate prices)			
Australia	10	12	10	9
Austria	31	49	55	56
Canada	28	46	38	32
European Union	37	46	47	48
Finland	56	70	67	67
Japan	64	65	71	70
New Zealand	24	5	3	3
Norway	70	75	77	76
Sweden	44	57	58	52
Switzerland	68	78	75	77
United States	21	23	21	23
Total OECD	34	42	41	42

Source: OECD (1994).

[1]Agricultural producer subsidy equivalent is assistance to producers in the form of market price support, direct payments, and transfers that indirectly benefit producers.

Economies in Transition

Trade policy developments among economies in transition were highlighted by radical transformations in Eastern Europe and the countries of the former Soviet Union toward market-oriented and more liberal trade re-

[18]In the developing countries, trade restrictions are often administered through the exchange system and exchange-based measures, including multiple exchange rates for exports and imports and exchange-based taxes and subsidies. Moves toward full current account convertibility and trade liberalization therefore often go hand in hand.

[19]See IMF (1994b).

[20]The number of developing country contracting parties in the GATT increased from 67 in 1990 to 93 in April 1994. As at the latter date, about 11 developing countries (excluding countries of the former Soviet Union and Central and Eastern European countries) were negotiating accession discussions.

[21]For example, as part of their GATT accessions, Bolivia, Costa Rica, El Salvador, and Venezuela bound their tariff schedule in the GATT at 40 percent, 55 percent, 34.5 percent, and 50 percent, respectively.

[22]GATT Article XVIII:B provides for the temporary imposition of trade restrictions to safeguard the balance of payments. Examples of countries that disinvoked GATT Article XVIII:B in the recent past include Argentina, Brazil, Colombia, Ghana, and Peru.

Table 4. Antidumping and Countervailing Actions on Imports from Developing Countries

	Cases Initiated from July 1 to June 30		Cases Outstanding at June 30	
Initiating Country	1988/89	1991/92	1989	1992
Total actions	67	136	320	443
Antidumping	58	118	233	362
Australia	8	35	14	51
Brazil	1	5	1	8
Canada	4	2	45	40
European Union	26	20	94	117
India	—	4	—	4
Japan	—	1	—	1
Mexico	4	17	6	27
New Zealand	1	12	3	18
United States	14	22	70	96
Countervailing	9	18	87	81
Australia	—	3	1	3
Canada	1	—	2	4
Chile	—	2	—	3
European Union	2	—	4	4
United States	6	13	80	67
Memorandum items				
Antidumping and countervailing actions initiated by selected developing countries[1]				
Antidumping				
Brazil	1	9	2	13
India	—	5	—	5
Mexico	17	25	26	59
Countervailing				
Brazil	—	8	—	8

Source: UNCTAD (1993).
[1]Figures are on actions on imports from all countries.

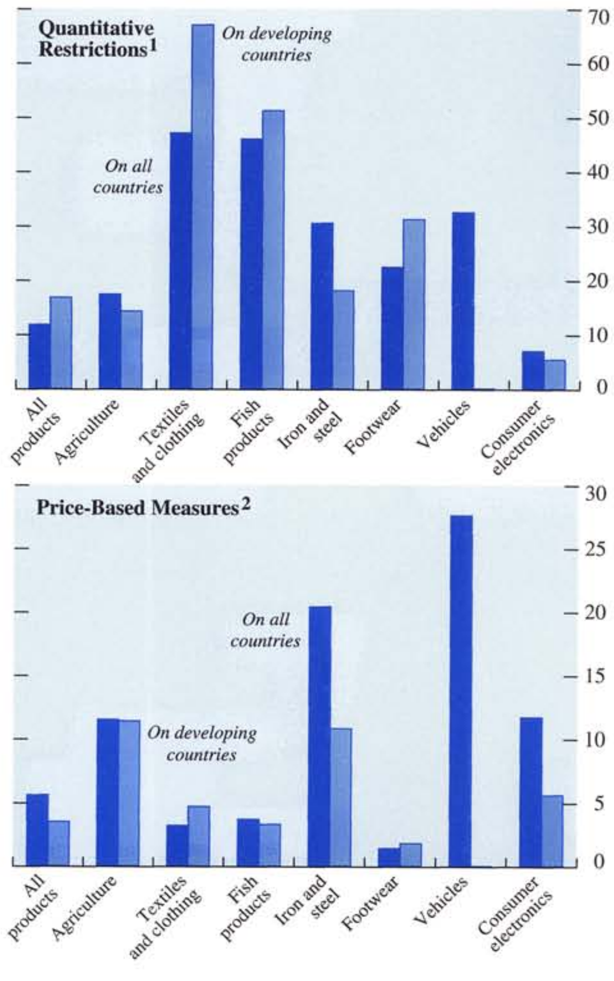
gimes and moves toward integration into the world trade system. The Fund has actively promoted these features through its surveillance and lending activities.

Elimination of monopoly control of international trade by large state trading corporations, the abolition of QRs, and the adoption of relatively low to moderate average tariffs were the priorities for reform in economies in transition. The pace and sequencing of trade reforms varied. Eastern Europe and the Baltic countries undertook the most extensive reforms.[23] Imports of industrial products were rapidly freed from QRs, except in Hungary where they were liberalized over a three-year period. QRs remained on exports of a few products whose domestic prices were not fully liberalized and on agricultural trade in some countries to control domestic supplies of foodstuffs or provide support to farmers. Tariffs on imports of agricultural goods were usually kept higher than those on manufactures. Some of these countries resorted to temporary import surcharges to deal with the difficulties of the transition, including at times real exchange rate appreciation, rising unemployment, or the need to raise revenues to curtail public sector deficits. Notwithstanding these setbacks, the countries generally kept to their reform programs. Estonia, Hungary, and the Czech Republic were particularly successful in achieving a low and relatively uniform tariff structure. Others maintained average tariffs closer to 20 percent.

The collapse of payments arrangements and large macroeconomic imbalances seriously disrupted trade in the countries of the former Soviet Union, as well as others within the former Council for Mutual Economic Assistance (CMEA) area. Although trade among the countries of the former Soviet Union remained largely free of import tariffs, payments problems and price controls severely curtailed the extent of such trade. Bilateral trade agreements and trading through state-controlled foreign trade organizations, used partly to overcome payments problems, had limited effectiveness because of increased enterprise autonomy. Lack of suitable payments mechanisms hampered enterprise trade. In trade with countries other than those of the former Soviet Union, import regimes were characterized by relatively moderate tariffs levied mainly for revenue purposes, and

[23]Eastern European countries covered in this analysis are Albania, Bulgaria, Hungary, Poland, Romania, and the Czech and Slovak Republics. Hungary had undertaken limited reforms in the 1980s. Unlike the other Eastern European countries, Albania does not have an association agreement with the EU.

Chart 2. Nontariff Measures by Industrial Countries, 1992
(Import coverage ratios)



Source: UNCTAD (1993).
[1]Prohibitions, quotas, licensing, state monopolies, VERs, MFA.
[2]Minimum prices, antidumping and countervailing duties, other measures.

limited recourse to formal import prohibitions, quotas, or licenses. A number of export QRs, however, remained because of extensive price controls.[24] Substantial distortions continued in a number of countries of the former Soviet Union because of imperfect foreign exchange markets, in part reflecting official interventions, the continued (and sometimes dominant) role of the state, and lack of an appropriate institutional infrastructure. Also, pressures for protection are likely to increase as import competition becomes more effective. This is already evident in Russia, where an increase in average tariffs from 8 percent to about 12 percent was implemented in July 1994.

The broad pattern of reform was similar, but more gradual, in the transition economies of Asia (Cambodia, China, Lao People's Democratic Republic, Mongolia, and Viet Nam). Cambodia substantially liberalized its trade regime in September 1993 with elimination of most QRs and licensing and adoption of a simplified tariff structure. In the other states, trade reform has been implemented gradually; the ending of the trading monopoly of large state enterprises and trading houses has often preceded reforms of QRs and tariffs. These countries still retain QRs on both exports and imports, and the tariff structure remains quite dispersed, although Mongolia (with a relatively uniform tariff structure and few QRs) has proceeded further with trade reform.

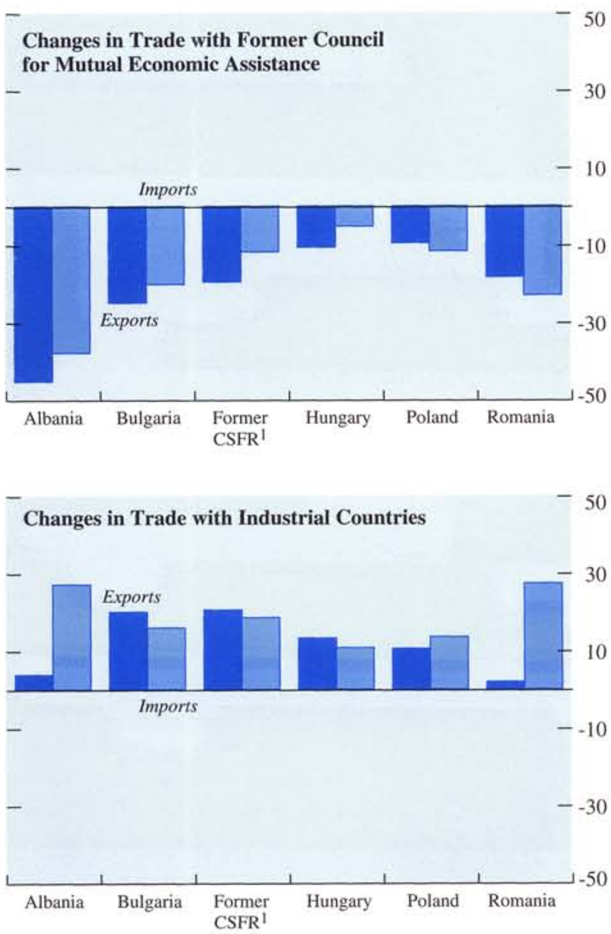
Most East European economies renegotiated their protocols of accession to GATT, or are doing so, to reflect better progress in their transformation into market economies. GATT working parties on accession were established for Bulgaria, and for many of the countries of the former Soviet Union;[25] other countries of the former Soviet Union also intend to join GATT/WTO. China's reaccession has proved time consuming, having started in 1986. Important issues regarding transparency of the trade regime and the level of GATT obligations to be assumed by China may be relevant also for the accession of some of the countries of the former Soviet Union.

Economic and political factors motivated Eastern Europe and the Baltic countries to seek integration with Western Europe. East European countries' association agreements with the EU provide for immediate elimination of tariffs and QRs on many EU imports of industrial products, and phased liberalization of others, although agriculture is mostly excluded and special provisions apply to sensitive products such as steel and textiles and clothing. The reforms and agreements are contributing to a growth of Eastern Europe's exports to Western Europe (Chart 3). The redirection of trade is leading to the establishment of new industries, many of which are labor intensive and should help improve the employment situation. The Baltic countries signed trade agreements with EFTA members and are negotiating them with the EU. The EU is likely to sign trade agreements with other countries of the former Soviet Union—partnership and cooperation agreements have been reached with Russia, Ukraine, Kazakhstan, and the Kyrgyz Republic. Central Asian republics, particularly those with oil and gas, are seeking to increase their commercial links with countries in the Middle East and some have become members of the Economic Cooperation Organization (ECO). Central Asian republics are also expanding trade with the eastern regions of China.

[24]See IMF (1994a).

[25]As of mid-June 1994, there were GATT working parties on accession for Armenia, Belarus, Estonia, Latvia, Lithuania, Moldova, Russia, and Ukraine.

Chart 3. Eastern Europe: Shifts in Geographical Trade Patterns
(Changes in shares between 1990 and 1992; in percentage points)



Source: National authorities and IMF staff estimates.
[1]Former Czech and Slovak Federal Republic, which on January 1, 1993 was succeeded by the Czech Republic and the Slovak Republic.

Regional Integration

A characteristic of the 1990s has been an increasing trend toward regional integration. This can be attributed to a variety of factors, including, for example, linkages to the Uruguay Round negotiations, fear of being excluded from emerging regional groupings, and various non-economic objectives. While the completion of the Uruguay Round may lessen some of the impetus toward regionalism, indications are that such interest—especially in the Western Hemisphere and in Europe—is likely to remain strong. Regional integration was not a major item of discussion during the Uruguay Round.[26] Many of the major regional initiatives in the recent past have been associated with outward orientation, as evidenced by the MFN liberalization that preceded or accompanied regional liberalization (e.g., in Latin America). The receptivity of the EU to broadening the reach of integration to the north and east is encouraging; it indicates that regional initiatives can transmit the forces of trade liberalization outward. The general accession clause in NAFTA and the apparent willingness of the parties to proceed with the process of admitting new members is also consistent with the view that regionalism can be a "building block" to multilateral liberalization.

While existing regional arrangements can be viewed on the whole as building blocks, unfettered regionalism is not without risk. The recent trend toward regional trading arrangements should not divert the attention of the international community from the fact that the first-best policy is MFN liberalization and the ultimate goal is global free trade. The challenge ahead is to ensure that regional initiatives are implemented in a manner that ties them securely to the long-run goal of multilateral trade liberalization, while firmly resisting those regional trading arrangements that would segment the world economy into competing trading blocs. In this regard, strict adherence to the multilateral rules governing regional trading arrangements would be a minimum requirement, and other steps not required by the multilateral rules—including, for example, liberal terms of accession and simultaneous MFN liberalization—would be highly desirable.

[26]With the exception of Japan, all industrial countries are part of at least one formal regional trading arrangement. Japan has raised regionalism as a topic for the post–Uruguay Round agenda.

III

The Uruguay Round

The conclusion of the Uruguay Round is a major achievement in international trade relations and a crucial element in promoting world trade and growth in the medium term. It arrested the deterioration in the trading environment and created a strengthened framework for future trade relations, thereby boosting business and investment confidence.

The Round provides positive outcomes in several areas, including market liberalization, strengthening of rules and institutional structures, and integration into the trading system of new and dynamic areas, such as services and intellectual property, and also traditional areas, such as agriculture and textiles and clothing that were hitherto exempted from many GATT rules. This section provides a qualitative analysis of the economic implications of the Round, based on available information at the time of preparation of this study.

In the area of market liberalization, significant benefits to income and exports will accrue to all countries because of reduced industrial country tariffs on industrial products (Table 5),[27] locking-in of unilateral tariff liberalization by developing countries through increased tariff bindings, and the elimination of "gray area measures," such as VERs and orderly marketing arrangements. At the same time, the integration into the WTO of agriculture (which has been a source of intense conflict between trading partners) and textiles and clothing will roll back pervasive governmental intervention and initiate a process of liberalization in these sectors.

Existing quantitative studies of the economic impact of the Round have focused exclusively on the static benefits emanating from market liberalization. These estimate annual real income gains globally ranging from $212 billion to $274 billion (or about 1 percent of world GDP) upon full implementation, of which some $80 billion would accrue to developing countries.[28] The final results of the Round indicate that these static benefits may have been overestimated because of optimistic assumptions about market opening to be realized by developing countries (Table 5) and about liberalization in agriculture.[29] On the other hand, the focus on static benefits significantly underestimates likely gains.[30] In any event, the studies consistently show that benefits from the Round depend on the extent of each country's liberalization efforts. To take advantage of the enhanced trading possibilities created by the Round, countries must also take supporting measures to facilitate positive supply responses.

Developing countries are expected to benefit from their own efforts at binding tariffs and making their trade regimes more transparent and rules based; they will also gain from the Round through the liberalization in their export markets of, for example, agriculture and textiles and clothing through the phaseout of the MFA, as well as from tariff cuts on products of export interest to them. Some developing countries have raised concerns about two potentially adverse effects, intrinsic to the market liberalization results of the Uruguay Round, relating to the erosion of preference margins and to possible adverse price effects on food importers. The analysis suggests that adverse effects will be limited or outweighed by gains from the Round as a whole. In any

[27]Industrial countries' weighted average bound tariffs will decline in five equal annual installments (with some exceptions) from 6 percent to 3.6 percent; the decline based on applied rates (currently averaging 5 percent) will be less.

[28]This would represent a once-for-all permanent increase in GDP. See Annex I of IMF (1994b) for a detailed discussion of quantitative estimates of the gains of the Round based on existing studies. In October 1994, the GATT Director General announced that global income in 2005 might be more than $500 billion higher than it would have been without the market-opening measures agreed in the Uruguay Round, based on preliminary work done by the GATT Secretariat. The reason for the upgrading was a new economic model that sought to capture some of the competition-enhancing effects of trade liberalization and the opportunities that it would offer for spreading fixed costs over larger markets.

[29]While developing countries have bound their tariffs and reduced bound tariffs, they have not, in most instances, reduced their applied tariffs on agricultural or industrial products as assumed by the studies. Further, the extent of liberalization in agriculture by industrial countries may have been overestimated. In addition, some studies, which were undertaken before the Round was concluded, had assumed tariff reductions different from those ultimately agreed in the Final Act.

[30]The narrow focus excludes benefits from strengthening of rules (including dispute settlement procedures), the new framework for services, and higher standards of intellectual property protection. Underestimation is also likely because many of the models neglect gains from trade due to economies of scale under imperfect competition and dynamic gains, and provide for insufficient disaggregation within manufacturing. Finally, the gains from liberalization are estimated relative to the status quo, whereas the relevant counterfactual would have to take account of the likelihood of a deterioration in the trading environment if the Uruguay Round had failed. For a detailed discussion, see Annex I of IMF (1994b). As indicated by recent analyses conducted by the GATT Secretariat, inclusion of the effects of imperfect competition leads to substantially higher estimated income gains.

Table 5. Uruguay Round Tariff Reductions on Industrial Products by Selected Countries[1]
(In percent)

	Import-Weighted Average Bound Rates Pre–Uruguay Round	Import-Weighted Average Applied Rates Pre–Uruguay Round	Import-Weighted Average Bound Rates Post–Uruguay Round
Industrial countries	6.0	5.0	3.6
Australia	20.1	10.0	12.2
Canada	9.0	4.9	4.8
European Union	5.7	5.7	3.6
Japan	3.9	1.9	1.7
United States	5.4	5.4	3.5
Developing countries			
Argentina	38.2	20.0	30.9
Brazil	40.7	15.0	27.0
Chile	34.9	15.0	24.9
Colombia	44.3	11.0	35.3
India	71.4	54.0	32.4
Korea, Republic of	18.0	7.9	8.3
Malaysia	10.0	9.1	9.1
Thailand	35.8	35.8	28.1
Venezuela	50.0	12.0	31.1

Sources: GATT; and IMF staff estimates.
[1]The figures are based on available GATT and IMF data. The table shows the average level at which tariffs were bound prior to the Uruguay Round, actual average applied tariffs prior to the Uruguay Round, and the level at which tariffs are to be bound after implementation of the Uruguay Round agreement. In cases where only a part of tariff lines is bound, average bound rates are calculated as an average of bound and applied rates.

case, the impact on individual countries would need to be monitored as the Round is implemented.

The MFN tariff cuts under the Round would reduce preference margins that beneficiaries currently enjoy under schemes such as the Generalized System of Preferences (GSP), the Lomé Convention, and the Mediterranean Agreements. A more detailed analysis, however, suggests that the erosion of preference margins is small, and smaller than suggested by MFN tariff cuts of industrial countries.[31] Furthermore, the biggest beneficiaries of preferences are the more advanced developing countries; the potential benefits to them (from MFN tariff cuts on nonpreferential items and from liberalization of agriculture and textiles and clothing) are likely to outweigh losses from erosion of preferences. Moreover, in a number of cases these countries are already being pressed for graduation out of preferences and could lose a large part of these preferences in the normal course of events. The impact of the reduction of preference margins on African and Caribbean countries is likely to be generally small because existing preference margins are relatively small owing to the commodity composition of their exports. As seen in Table 6, for example, the simple average preference margins granted to sub-Saharan African countries range from only 0.9 percent to 4.4 percent, with a median rate of less than 2.5 percent.

While preferences received by developing countries pertain largely to the lower-than-MFN tariffs faced by their exports, another dimension of preferential treatment stems from the access granted to some high-cost developing country exporters in areas that are subject to quantitative restrictions, such as agriculture and textiles and clothing. This aspect of preferences will not have much effect on agriculture because current levels of access can continue to be preserved under the Round.[32] Moreover, preferential access of high-cost suppliers under the MFA will to some extent be preserved for the duration of the transition period by virtue of back-loaded liberalization of textiles and clothing. However, selected countries (e.g., in North Africa and the Caribbean), which rely overwhelmingly on preferences on industrial products, could be adversely affected. More generally, MFN tariff cuts under the Round will also reduce discrimination against third countries under existing customs unions and free trade areas.

For net food importers, the impact would depend on the extent to which food prices rise after agricultural liberalization; this is not clear yet. Some estimates of price increases for various agricultural products range between 4 percent and 10 percent over the medium term;[33] but they assume greater liberalization than contained in the final agreement. Furthermore, the poten-

[31]See UNCTAD (1994).

[32]The requirement under the agriculture agreement of the Round to guarantee a certain amount of imports as a share of domestic consumption can be met by granting market access to preference-receiving countries in line with their current market shares.

[33]See Brandao and Martin (1993).

Table 6. Industrial Country Tariff Preferences for Non-Oil Imports from Sub-Saharan African Countries[1]
(In percent)

	OECD Average	
Exporting Country	Preferential tariff	Preference margin[2]
Nigeria	2.7	−0.9
Ethiopia	0.7	−1.3
Congo	0.1	−1.4
Angola	0.2	−1.5
Sudan	0.1	−1.5
Liberia	0.6	−1.7
Zambia	0.3	−1.7
Gabon	0.6	−2.0
Madagascar	0.5	−2.0
Zaïre	0.3	−2.1
Central African Republic	0.2	−2.2
Ghana	1.0	−2.2
Guinea	0.6	−2.3
Mauritania	1.7	−2.3
Tanzania	0.1	−2.3
Malawi	1.1	−2.4
Uganda	0.9	−2.4
Cameroon	0.4	−2.5
Zimbabwe	0.9	−2.5
Chad	0.4	−2.7
Botswana	0.3	−2.8
Togo	0.3	−2.8
Niger	0.1	−3.0
Côte d'Ivoire	0.7	−3.1
Mauritius	1.3	−3.1
Sierra Leone	0.5	−3.1
Kenya	0.5	−3.3
Senegal	0.5	−3.3
Mali	0.4	−3.4
Swaziland	0.8	−4.4

Source: Yeats (1993).

[1]Tariffs are simple (unweighted) averages of nominal duties levied on the country's exports.

[2]Preference margin is the difference between the simple average tariff on the African country's exports and the simple average tariff on other exporters of the same products.

tial effect on prices could be offset through likely productivity increases in agriculture-exporting countries. The adverse impact, if any, will probably be felt to the extent that countries are commercial importers of food. Recipients of food aid will be affected insofar as the reduction of agricultural surpluses also reduces availability of food stocks for aid; food aid per se is exempted from export subsidy commitments.[34] Finally, domestic agriculture sectors in many countries could receive a boost as world market distortions are reduced, provided that appropriate policies are pursued to reap the benefits from liberalization.

The Uruguay Round has clarified and strengthened the rules with respect to a number of trade policy instruments, notably safeguards, antidumping, and subsidies and countervailing measures. Strengthened rules are important in determining the conditions of international trade and investment. The predictability of policy and security of market access engendered by strong rules contribute to the dynamic gains from the Round. Strong multilateral rules also enhance the ability of governments to control domestic pressures for protection. Nonetheless, there is room for latitude—albeit less than in the past—and it would thus be important for national authorities to apply the rules in a manner favoring liberal solutions. In this connection, the improvements in the dispute settlement system are particularly beneficial.

On institutional structure, the creation of the WTO will place the rules-based trading system on a more permanent and legally secure footing. The WTO (and its biennial ministerial meetings) will provide a forum for continuous multilateral trade negotiations in the future, exercise surveillance over member countries' trade policies, and administer a strengthened dispute settlement system, which should increase the speed and automaticity of procedures and compliance with rulings and limit the scope for unilateral actions.

One of the important achievements of the Round has been to bring two of the most dynamic areas of world trade—intellectual property and services—within the scope of the trading system.[35] The higher standards and improved enforcement of intellectual property protection will increase sales and profits of intellectual property-based industries, particularly in industrial countries (although in some sectors this would be at the expense of consumers in technology-importing countries). In the long run, better intellectual property protection could increase the incentives to undertake research and development and product innovation, benefiting consumers worldwide.

The services agreement in the Uruguay Round institutes a multilateral framework for this important sector of trade based on the principles of nondiscrimination and transparency. Unless they explicitly invoke an exemption, parties to the agreement on services cannot discriminate between foreign services or service suppliers (MFN treatment). Countries have also undertaken specific commitments to provide foreign service suppliers market access and treatment no less favorable than that applying to domestic service

[34]A special Uruguay Round decision adopted by ministers at Marrakesh recognizes that there could be negative effects on least-developed and net food-importing countries arising from reduced availability of basic foodstuffs and possible short-term difficulties in financing commercial food imports. The decision provides for the establishment of appropriate mechanisms to avoid such negative effects.

[35]Between 1980 and 1991, trade in intellectual property and services expanded by 256 percent and 132 percent, respectively, compared with 95 percent for trade in goods.

suppliers (national treatment), subject to the conditions and qualifications listed in their schedules of commitments. The agreement also requires that parties publish all service-related laws and regulations, and establish inquiry points to provide information on services to other members. The MFN and transparency principles apply to all services sectors, while commitments on market access and national treatment apply only in respect of sectors that countries have entered in their schedules. While the commitments largely involve a binding of the existing levels of market access, which provide security and confidence for investment activity, a framework is also in place for negotiating further liberalization in services. Further benefits from liberalization of market access will have to await future negotiations, especially financial services.

The Uruguay Round gave an impulse toward greater integration of developing and least-developed countries into the multilateral trading system. They participated more actively in the negotiations than previously and undertook greater commitments to liberalize and lock in their trade reforms. They were better able than in the past to secure improved market access in sectors of interest to them, and to strengthen the rules-based trading system that is vital to ensure the success of their own reform efforts. While the Round retains the principle of "special and differential treatment"[36] for developing and least-developed countries, they have effectively reduced reliance on this principle by taking on more commitments than before. In some areas, developing and least-developed countries will have longer transition periods than industrial countries to fulfill their commitments (e.g., in agriculture and subsidies), and, in other areas, they will face less strict disciplines than industrial countries (e.g., in agriculture and tariffs).

In conclusion, when implemented, the Uruguay Round agreement would reduce the scope for trade conflict, unilateralism, and inward-looking regionalism. Its achievements in market liberalization, strengthening of rules and institutions, and extension of discipline to new areas will be far reaching. Equally important, the Uruguay Round agreement has created an environment conducive to tackling future challenges in trade policy. However, work remains to be done in ensuring its expeditious ratification and effective implementation and in designing further liberalization in areas where barriers remain high despite the Round (e.g., agriculture, textiles and clothing, and services).

[36]Developing countries with special and differential treatment under GATT have greater ability to impose trade restrictions than industrial countries; they benefit from preferential access for their exports in industrial country markets; and they may grant preferences to each other's exports under conditions less stringent than normally under GATT.

IV

Post–Uruguay Round Agenda

The Final Act of the Uruguay Round provides for completing negotiations in key service sectors within specified time frames, including financial services, telecommunications, transportation, and movement of natural persons, and for instituting rules on other aspects of services. Apart from this, the post–Uruguay Round "agenda" is not strictly defined but comprises a loose list of old and new issues that have a bearing on the conduct of trade and trade-related policies. At the Marrakesh meeting concluding the Round in April 1994, many issues were mentioned for future discussion.[37] Clearly, efforts will also be needed to pursue further market liberalization in specific areas where distortions remain high despite progress under the Round (e.g., agriculture, steel, and civil aircraft).

This section discusses two categories of "new" issues that were not explicitly addressed by the Round but that appear to be taking a prominent place in the post–Uruguay Round agenda. The first category covers the manner of achieving certain important non-economic goals—better environment and labor standards—and their interface with trade policies. The second relates to the trade effects of domestic policies, such as competition and investment policy, which are becoming important determinants of the conditions of competition between domestic and foreign suppliers. Both of these categories will feature prominently in the OECD's future work program.

Trade and the Environment

As concern about the global environment has grown, the interface between trade and environment policies has received increased attention. Trade conflicts arising from environmental considerations have increased,[38] while international trade agreements (e.g., NAFTA, WTO, and the Uruguay Round) are increasingly incorporating environmental concerns.[39] Trade ministries agreed at Marrakesh to establish a new Committee on Trade and the Environment under the WTO (this will encompass the work of the GATT Group on Environmental Measures and International Trade). The Committee will have a mandate to examine a wide range of issues and will report on its deliberations to the first biennial meeting of the WTO.

One dimension of the trade-environment nexus relates to the environmental effects of trade policies. The environmental impact of trade liberalization is difficult to predict ex ante because of the variety of its effects on the scale of activity, the composition of output, and techniques of production. A number of studies suggest a positive correlation between liberal trade and a better environment.[40] However, when environmental resources are inappropriately priced, trade liberalization can lead to environmental degradation.[41] But that should not generally be a reason for eschewing trade liberalization or maintaining restrictions, since they are seldom the most effective instruments for addressing environmental problems. This is because such problems emanate from distortions in production or consumption, or both, rather than from trade. Under these circumstances, maximizing economic and environmental benefits would suggest that implementation of trade liberalization be accompanied by domestic (production or consumption) policies aimed at correcting the environmental externality at its source.[42]

A second dimension concerns differential environmental standards across countries, their implications for competitiveness, and how to design appropriate international responses to them. Some have argued that low environmental standards (particularly in developing countries) confer an "unfair" advantage in interna-

[37]These include internationally recognized labor standards, immigration policies, competition policy including rules on export financing and restrictive business practices, investment, regionalism, interaction between trade and financial and monetary matters including debt and commodity markets, company law, mechanism for compensating preference erosion, links between trade, development, political stability and the alleviation of poverty, and unilateral or extraterritorial trade measures.

[38]A well-known dispute in this regard was the one in which a GATT panel ruled that trade restrictions applied by the United States against tuna imports from Mexico contravened GATT rules; the restrictions were defended on the ground that Mexican tuna fishing practices resulted in the killing of more dolphins than prescribed under U.S. law.

[39]The preamble to the WTO states ". . . while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development" (GATT (1994), p. 9).

[40]See Anderson (1992); Runge (1993); and Birdsall and Wheeler (1992).

[41]See Lopez (1993); Pearce and Warford (1993).

[42]See GATT (1992). If first-best domestic policies are not available, efficiency gains from trade liberalization would have to be weighted against its possible adverse environmental consequences.

tional trade and in investment ("eco-dumping"). A related argument is that the competitive advantage conferred by lower standards abroad puts pressure on all countries to lower their standards.[43] It has therefore been argued that either standards should be harmonized upward or trade restrictive actions should be allowed against countries with lower standards.

While not contesting the desirability of improving environmental standards, developing countries have questioned whether they have the financial means to do so in all cases. They have argued that differences in environmental standards between countries, particularly where they pertain to environmental problems confined to national borders, reflect assessments about the costs and benefits of environmental preservation that can vary according to a country's level of development. According to this view, trade restrictions should not be permitted to offset differences in standards because they will deprive countries (with lower standards) of the benefits of freer trade, create the risk of protectionist abuse, and prevent the search for other more appropriate solutions.[44] The commonly shared concern to raise environmental standards could be achieved through raising incomes (e.g., through more trade), and by providing financial assistance where there are costs involved in doing so.

In cases involving transborder environmental spillovers, there are a number of multilaterally negotiated agreements that provide financial and technical assistance to countries to adopt first-best domestic policies to deal with these problems. Some of these agreements incorporate trade restrictions as ultimate enforcement mechanisms; the assistance provided would make countries willing signatories to such agreements, rendering unlikely the need for restrictive measures. The GATT/WTO's future work on the environment is expected to address the issue of the appropriate safeguards under which trade-restrictive measures may be used as enforcement mechanisms in such multilaterally negotiated agreements.

In its own work, the Fund would need to remain sensitive to environmental concerns; its policy advice and program design would need to ensure that environmental problems are not aggravated but rather made easier to solve.

Trade and Labor Standards

Protection of labor standards on human rights and social welfare grounds is a long-standing, internationally accepted objective and an essential element of the conventions of the International Labour Organization (ILO).[45]

International trade unions and other public organizations have long called for outlawing certain labor practices and for conditioning freedom for international transactions, including trade, on minimum labor standards and employment conditions. Strengthening enforcement mechanisms for ILO conventions is the most appropriate international response to securing adequate labor standards. The GATT permits restrictions on products made with prison labor, but otherwise does not sanction the use of trade actions as a means for improving labor conditions.[46] While recognizing that labor standards are not a central element in the Fund's work, the Fund needs to be sensitive to labor concerns and help countries implement economic reforms in a manner that is conducive to improved social conditions, including labor standards.

There is also the perception that low labor standards enable countries to keep labor costs low, thereby conferring "unfair" competitive advantage on them in trade and in attracting investment ("social dumping"). However, low labor standards per se need not confer comparative advantage, especially if they reflect low productivity; wages and labor standards can be expected to rise over time as labor productivity and incomes grow with development. Differences in labor standards between countries reflect many factors, and attempts to offset such differences through trade restrictions are likely to reduce global trade and welfare and worsen labor conditions in labor-abundant countries.

As regards the argument that unrestricted trade with developing countries that have low wages and labor standards contributes to rising unemployment in industrial countries, preliminary work done in the OECD shows that while there can be sectoral effects, there is no firm evidence that these factors result in higher aggregate unemployment.[47] Long-term trends in unemployment in industrial countries are related to deep-seated structural rigidities, particularly labor market inflexibility and the extent to which skills required in a

[43] See Bhagwati (1994).

[44] The avoidance of protectionist trade measures and adherence to multilateral disciplines in relation to environmental objectives are recognized in United Nations Conference on Environment and Development's (UNCED's) Agenda 21 and principle 12 of the Rio Declaration. See United Nations (1993).

[45] A large number of ILO members have already adopted certain "core" standards, including freedom of association, protection of the right to organize and to collective bargaining, establishment of a minimum age of employment, protection against discrimination, equal remuneration, and prohibition of forced labor.

[46] Proposals for the inclusion of a social clause in international trade agreements may be traced back to the 1947 Havana Charter for the International Trade Organization (ITO), which included a draft provision on "fair" labor standards (Charnovitz (1992) and Hansson (1983)). However, the definition of "fair labor standards" was not spelled out, nor were trade sanctions contemplated. More recently, considerations of fair labor standards prompted the introduction of a supplemental agreement on labor standards to NAFTA. In the context of the Uruguay Round, no agreement was reached on the inclusion of labor standards in the future work program of the WTO on account of opposition from many developing countries. This topic is included in a list for possible future discussion in the WTO.

[47] See, for example, Oliveira Martins (1993).

declining industry can be adapted to the needs of expanding industries.[48]

Trade-Related Competition and Investment Policies

As conventional trade barriers (tariffs, QRs) are lowered, attention is shifting to domestic policy instruments (subsidies, regulations) as a source of trade friction between countries. Competition policy aimed at addressing "private barriers"—arising from certain practices of, or arrangements between, firms—is one such instrument. An example is complaints by Japan's trading partners that exclusionary business practices emanating from weak standards or inadequate enforcement of Japanese competition laws contribute to problems of market access for foreign suppliers.

The agenda for future work on the international dimensions of competition policies is not yet clearly defined. The first task is to identify the issues and concerns of countries, with a view to determining the approach, contents, and forum for future international cooperation on competition policies. The OECD is at the forefront of such analysis. One issue is to explore whether and how antidumping laws might be incorporated into a competition policy framework, rendering them less subject to misuse. A second issue is to identify competition policy standards that give rise to trade conflicts. An example would be the use of competition laws to provide advantage to domestic firms in home and world markets (e.g., by granting exemptions for domestic firms involved in import and export cartels, and research and development joint ventures) at the expense of foreign firms or consumers. A third issue is to explore ways of improving enforcement of competition laws internationally, including through use of multilateral dispute settlement procedures. Future work would also need to take into account the concerns of developing countries, many of which do not have competition laws per se but are beginning to institute them.

The rapid growth of foreign direct investment (FDI) in recent years has brought attention to the importance of investment policies in trade relations between countries. Openness and nondiscriminatory treatment of foreign direct investment will be critical in maximizing the global gains from international specialization. The Uruguay Round agreements on services and on trade-related investment measures (TRIMs) address some investment issues, but the latter provide for a more wide-ranging review of investment and competition policies within five years of the WTO's entry into force. The OECD has nonbinding rules on investment under its National Treatment Instrument and the Liberalization Codes for capital flows and invisibles. The World Bank has nonbinding guidelines on policies that might be followed by countries regulating foreign direct investment.

Future multilateral discussions on investment will need to address two types of policies: first, those that restrict FDI through rules on rights of establishment, discriminatory treatment of foreign investors, and onerous standards of performance; and second, policies that serve to attract investors away from other locations (e.g., through subsidies and other incentives), resulting in inefficient use of world resources. The forum in which future rules are negotiated would depend on the need for enforceable rules on investment, as well as the number of countries willing to undertake greater obligations on such rules.

[48] For a discussion of these structural problems in the labor markets, see, for example, Commission of the European Communities (1993).

V

Role of the Fund

This section reviews the trade policy content of the Fund's recent surveillance and lending activities, and issues of cooperation with the GATT/WTO.

Surveillance

In seeking to facilitate the balanced expansion of international trade and to promote economic growth, the Fund in its surveillance—and without prejudice to the GATT's primacy in the trade area—considers trade policy issues as they affect domestic adjustment of individual members, other members, and the global economy. Trade policy issues are featured prominently in the Fund's multilateral surveillance (World Economic Outlook exercise and the deliberations of the Interim Committee) and in Article IV consultations with individual members.[49] This section surveys the nature and coverage of trade policy issues in Article IV consultations during 1991–93.[50]

Trade policy issues were featured regularly in staff reports (and to a lesser extent also in accompanying background papers), and broadly focused on some or all of the following themes: (1) the stance of the member's trade regime (protection); (2) regional integration; and (3) the strengthening of the multilateral trading system.

Most reports reviewed recent trade policy measures taken by the consulting country to liberalize its trade regime or increase sectoral or across-the-board protection. The Fund's policy advice emphasized the importance of trade liberalization in the structural and macroeconomic adjustment process of both industrial and developing countries.

For major trading nations, in addition to the assessment of the overall trade policy stance, specific topics of relevance were examined (e.g., competition policy, trade-distorting subsidies, agriculture, and automobile restrictions). More in-depth coverage was featured in some cases (e.g., potential welfare gains to the United States from liberalization in the textile and clothing, and steel sectors, and analysis of the impact of the *keiretsu* system on market access in Japan). The Fund has encouraged liberalization of trade-distorting measures both generally and with regard to specific items (e.g., the CAP, import bans on rice, antidumping). Reports on major industrial countries have also been cognizant of the need for better market access for developing and transition economies. This was particularly evident in reports of members of the EU, where the importance of access for the transforming economies in Eastern Europe (and the countries of the former Soviet Union) was repeatedly emphasized.

Article IV consultation reports on developing countries stressed the need to further liberalize QRs, reduce tariffs, and simplify the tariff structure. The thrust of recent trade reforms was generally reported, but coverage of the authorities' future intentions in the trade area varied considerably across countries. An example of a good quantitative coverage was the report on China, which provided a comprehensive analysis of the scope of licensing and other import control measures and the characteristics of the tariff structure.

More attention is being paid in staff reports to the topic of regional integration. For example, the NAFTA and the CUSFTA were featured in the reports on the United States, Canada, and Mexico; the Internal Market Program and association agreements with Eastern Europe were discussed in the reports of the larger members of the EU; the Association of South East Asian Nations (ASEAN) was covered in the reports for Thailand and Malaysia; and more recent reports have referred to the Cross-Border Initiative among 13 eastern and southern African countries. Most of the coverage of regional trading arrangements remained rather descriptive, though there were exceptions (e.g., NAFTA and CUSFTA). Fund policy advice stressed the need to minimize possible trade diversion effects of regional trading arrangements by also reducing trade barriers against nonmembers. It also emphasized that regional liberalization should be supportive of, and complement, MFN liberalization.

With regard to the multilateral trading system, the Uruguay Round was prominently featured in the consultations with major trading nations. Some reports discussed the consulting country's objectives and areas of

[49] Article IV consultations refer to the annual economic policy discussions that take place between the Fund and individual members.

[50] The survey is based on a sample of 69 staff reports and 46 background papers covering 26 countries (the major industrial countries and randomly selected other nonprogram countries). The sample included Australia, Belgium, Bolivia, Canada, China, Finland, France, Germany, Greece, Italy, Japan, Korea, Malaysia, Mexico, New Zealand, Norway, Paraguay, Senegal, Sweden, Thailand, Trinidad and Tobago, Tunisia, Turkey, the United Kingdom, the United States, and Zambia.

interest in the Uruguay Round. Particularly in the case of the Group of Seven countries, the Fund urged them to exert leadership to bring about a rapid conclusion of the Round.

Overall, the survey revealed that the Fund has increasingly recognized the importance of trade policy issues in Article IV consultations. There is room to further improve consideration of these issues through analyses of the impact of protection on domestic adjustment and to link the discussion of trade policy more closely with other macroeconomic and structural policies. For members of a regional group, where competence on trade is with the regional authority (e.g., the EU), it is nevertheless important to feature the impact of the trade policy on the national economy, as well as the member's input into the formulation of the regional policy. In the coming years, the impact of the implementation of the Uruguay Round on the consulting member's economic and financial situation would need to be monitored. Improving the coverage of regional integration (including analysis of its internal and external impact) would also be important.

Trade Policy in Fund-Supported Programs

This section summarizes the main results of a staff survey of the trade policy content of recent Fund-supported programs and selected design issues. The survey covered 78 Fund-supported programs approved in 1990–93 with 59 countries under stand-by arrangements, the extended Fund facility (EFF), the structural adjustment facility (SAF), and the enhanced structural adjustment facility (ESAF).[51]

The survey reveals substantial progress in trade reforms during 1990–93 among program countries. The trend toward reduced reliance on QRs observed in the 1980s intensified in the 1990s. The number of restrictive QR regimes fell from 35 at the end of 1990 to 14 by the end of 1993, while relatively open ones increased from 14 to 40 over the same period. The greatest progress in eliminating QRs was made by economies in transition in Eastern Europe and the Baltic countries, where state involvement in trade was reduced sharply, and by program countries in the Western Hemisphere. Substantial progress was also made in Africa, particularly in countries where exchange system reforms allowed for the elimination of QRs used for the allocation of foreign exchange.

Progress on tariff reform was less rapid. The number of tariff-restrictive regimes declined from 38 at the end of 1990 to 26 at the end of 1993, while open tariff regimes remained unchanged at 5. Western Hemisphere countries made significant progress, as many of them adopted ambitious liberalization programs to restructure and open up their economies. Although many countries in Africa, Asia, and the Middle East lowered tariffs (and in some cases by large magnitudes), the reductions were only in a very few cases large enough to classify their tariff regimes as open or moderately restrictive.

The combined (QR plus tariff) trade regime showed at the end of 1990 53 countries with restrictive trade regimes, 5 with a moderately restrictive stance, and only 1 with a relatively open regime; by the end of 1993, the respective stances were 33, 22, and 4. The most rapid overall progress was recorded in Eastern Europe and the Western Hemisphere. According to certain macroeconomic indicators, and without inference of causality, the survey showed that slower trade reformers (as a group) initially faced more difficult macroeconomic conditions (in terms of current account and fiscal imbalances, reserve levels, and dependency on trade taxes) compared with the faster reformers. Over the period under review, the latter group improved significantly its fiscal and reserve positions and reduced reliance on trade taxes while containing the deterioration in external current account positions. On the other hand, the slower trade reformers experienced some improvement of their current account positions at the same time as their fiscal and reserve positions did not improve, and reliance on trade taxes declined by only a small amount. The macroeconomic characteristics of the slow and fast reformers suggested that fast reformers were more willing or able to undertake bolder, comprehensive reforms.

Reversals in trade liberalization were experienced in only 13 of the program countries (22 percent of the total). The extent and nature of reversals varied, but in most cases they were limited, as specific goods or imports from certain countries were targeted discriminatorily. Almost half the reversals involved economies in transition (often in the form of new import surcharges). This was due to the rise in protectionist pressures with appreciation of real exchange rates and the need to contain fiscal deficits, following difficulties in implementing timely or effective complementary domestic fiscal reforms.

The increased attention to trade liberalization in Fund-supported programs was evident in the conditionality applied to trade measures. In 34, or 44 percent, of the programs reviewed, disbursements were contingent on the implementation of trade measures, while in another 33 programs, governments made commitments to liberalize trade without the use of binding conditionality. Given their more structural orientation, it is not surprising that in about three fourths of the programs supported by ESAFs, SAFs, and EFFs, disbursements were contingent on trade measures; such conditionality was applied in only one fourth of stand-by arrangements. Tighter conditionality was more often applied to the liberalization of QRs than to tariff reform, as priority was given to the former. The type of

[51]The scope, methodology, and detailed analysis of the survey findings are featured in Volume II, *Background Papers*, of this study.

conditionality depended to some extent on the country's initial trade policy stance as well as on its willingness to liberalize trade unilaterally. Implementation of conditional trade measures in Fund-supported programs was broadly satisfactory; most cases where the targets were not met were in the nature of delays rather than complete failure of implementation.

Trade reforms are often integral parts of both Fund and World Bank lending operations, and collaboration between the two staffs is close, not only through the procedural requirements of SAFs and ESAFs (in terms of formulation of policy framework papers) but through other means as well. The survey of Fund-supported programs revealed that Fund staff have consulted or relied on Bank staff in the design of trade reforms in most of the programs. When complex tariff reforms were phased over time and were featured in Bank-supported adjustment operations, Bank staff took the lead in the negotiation and design of trade reform with the authorities, while consulting Fund staff on the macroeconomic effects of the reforms. Fund staff often took the lead in designing QR liberalization and the prerequisite modifications of exchange systems. With the decline in reliance on QRs in many countries, Fund staff are becoming more active in tariff reform design, especially when such reform is required early in the program.

The experience with Fund-supported programs highlights the issues that need to be considered in designing trade reform: (1) the importance of the interaction of trade and other program policies and hence the need for an integrated, comprehensive approach; and (2) the need to adhere to a medium-term trade reform strategy with clearly established and preannounced immediate and medium-term objectives. In many of the programs reviewed, fiscal considerations—generating and maintaining revenues—were a major determinant in limiting the magnitude of tariff reforms and the speed of their implementation. Similarly, exchange and trade restrictions often acted as substitutes, and appropriate exchange rate policies were needed to ensure that trade reforms were consistent with balance of payments objectives; the effectiveness of exchange rate policies in turn was enhanced when complemented by the liberalization of the trade and payments regime. Consequently, trade policy needs to be geared to medium-term efficiency goals, while deviations for short-term fiscal and balance of payments considerations should be limited and kept strictly temporary.

The survey revealed certain other lessons for the design of trade reforms. Since QRs are less transparent and more restrictive than tariffs, their removal at the outset of the program is important. When such an approach is not feasible and a phased approach is adopted, precisely defined and monitorable numerical targets for their reduction (as well as exceptions) are needed. To hasten the progress in liberalization, QRs can initially be replaced with their tariff equivalents.

Given the considerable progress that has so far been made in eliminating QRs, the focus, in the future, will increasingly be on tariff reform. The detailed features of the reform would depend, of course, on the particular circumstances of the country. While the aim of tariff reform would be to reduce effective protection, program design would need to be geared to easily monitorable targets, such as average and maximum nominal tariffs. The design of tariff reform should emphasize several elements, including to incorporate all import taxes and charges into the tariff structure, eliminate discretionary exemptions, simplify the tariff structure into a few bands, lower the maximum tariff with only a few exceptions, and reduce the average statutory tariff rate. The experience of successful tariff reformers, in particular those in Latin America, shows that it is possible within a period of 2–5 years to reduce tariff bands to 3 to 5, to bring high tariffs (in some cases, triple digit) initially to a maximum of 30–35 percent and then subsequently to 20 percent or less, and to reduce average statutory tariffs to about 15–20 percent initially and to about 10 percent in the subsequent stage.

Collaboration with the GATT/WTO

The GATT and the Fund pursue common objectives in promoting an international trade and payments system that is free of restrictions. The work of the two bodies has linkages and complementarities. The existing cooperative relationship between the GATT and the Fund is likely to intensify with the establishment of the WTO. Both institutions are approaching universal membership; globalization has heightened awareness of policy interdependence; and increased commitments under the Uruguay Round make it imperative to be alert to policy consistency issues. Issues for future Fund and WTO (and World Bank and WTO) collaborations are only now beginning to be addressed and thinking in this regard will probably evolve as the WTO is established and gains experience. The Fund (and the World Bank) and the WTO will be considering the institutional mechanisms—formal and informal—that might be necessary to further strengthen their cooperative relationships.

Jurisdictional Issues

The complementarity between the Fund and the GATT was recognized at the inception of the GATT. The cooperative relationship between the GATT and the Fund is provided by GATT Articles XIV and XV, whereby it was recognized that exchange measures under the jurisdiction of the Fund and trade measures under the jurisdiction of the GATT should not be used to impair the benefits that members derive from each institution. The Fund was accorded primacy in regulating exchange measures, including those that had trade effects. The principles of this cooperative relationship in the area of goods have been carried over into the WTO. With the inclusion of services in the WTO, the possibility of overlap will also arise in the services area in

relation to exchange measures that affect services transactions, particularly on the current account. The Uruguay Round services agreement accords primacy to the Fund in regulating such measures.

Surveillance

The exercise of the respective surveillance functions of the Fund and the GATT has been characterized by complementarity rather than duplication. GATT exercises surveillance over specific aspects of trade policies (e.g., implementation of the MFA by the Textiles Surveillance Body, implementation of the Tokyo Round Code on Antidumping by the Committee on Antidumping, etc.). Since the establishment in 1989 of the trade policy review mechanism (TPRM), GATT also exercises surveillance over individual countries' overall trade policies. The frequency and nature of this function, however, is different from that of Fund surveillance. In contrast to annual Fund surveillance, TPRM reports are prepared at intervals of two, four, and six years depending on the importance of the country in world trade (recently a flexibility of up to six months was introduced in these report cycles).[52] The TPRM is primarily geared to enhancing the transparency of the trade regime and the reviews are published. TPRM reports feature the macroeconomic environment (including exchange rate policy) of the member as background information, but do not engage in independent macroeconomic policy analysis.

The GATT assesses the trade policy stance of individual members, and adjudicates disputes over specific trade issues, but does not engage in discussion or negotiation of detailed trade reform packages. In contrast, Fund surveillance examines trade policy as part of the whole gamut of the member's economic and financial policies, with emphasis on its impact on domestic adjustment and on other Fund members. Both in its policy advice and in the design of programs, the Fund engages in often detailed blueprints for future trade reform in the context of comprehensive integrated packages of macroeconomic and structural measures that often generate additional benefits in terms of improving confidence and credibility of the reform effort and catalyzing external financing.

The Fund (and World Bank) encourages members to undertake unilateral trade liberalization to improve the efficiency of the domestic economy, irrespective of "negotiating leverage." Multilateral trade negotiations under the auspices of GATT deal with the reciprocal exchange of "concessions" among participants. MTNs tend to be slow but cover many countries and help generate political support domestically when it is perceived that others are also "giving up" protection. The two approaches—unilateral liberalization and multilateral trade negotiations—are both essential and can be simultaneously implemented without contradiction.[53] GATT "concessions" are "bound" and therefore irreversible, providing predictability and security of access. Trade liberalization by developing and transition economies under Fund- (and World Bank-) supported programs is not bound; it has proceeded much faster and deeper than under the GATT, but is open to the risk of reversal.

Coherence of Macroeconomic and Trade Policy

During the Uruguay Round negotiations, some participants raised the issue of coherence of exchange rate and trade policies. While it is not clear precisely how this issue is defined, it reflects the value that is attached to exchange rate stability. It is often frustrating for trade negotiators to find that the benefits they believed they had obtained through hard-fought compromises on tariff concessions in specific sectors are perceived to be nullified by unforeseen exchange rate changes. Another concern relates to the possible harmful effects of exchange rate volatility on trade flows. Empirical studies provide ambiguous results in this respect (see Box 3). More generally, the Fund's emphasis on the need for balanced and coordinated macroeconomic policies, by setting an environment for greater exchange rate stability, becomes all the more important if exchange rate volatility does have negative effects on trade. Examples of other aspects of concern that have been raised pertain to the persistence of current account imbalances that tend to generate protectionist pressures (as illustrated by the case of Japan); the efficacy (in the aggregate) of policy advice to individual countries to adopt export-oriented strategies against a background of world recession; or possible cumulative competitive devaluations that may result from encouraging devaluations in the individual country context.

On policy coherence, the WTO provides for cooperation with the Fund (and the World Bank) specifically (Article III) and more generally (Article V), but does not establish a mechanism for cooperation.[54] A Minis-

[52]The first 4 trading entities (identified in terms of their share of world trade) are subject to review every 2 years, the next 16 are reviewed every 4 years, and the remaining countries are reviewed every 6 years (with the exception of some least-developed countries, which may be subject to longer review cycles).

[53]In practice, there have been linkages. For instance, some countries have considered holding back on unilateral liberalization for the sake of negotiating leverage. In the Uruguay Round, developing countries asked for—but did not receive—negotiating "credits" for their unilateral liberalizations.

[54]Article III.5 (Functions of the WTO) says: "With a view to achieving greater coherence in global economic policymaking, the WTO shall cooperate, as appropriate, with the International Monetary Fund and with the International Bank for Reconstruction and Development and its affiliated agencies" (GATT (1994), p. 10). Article V (Relations with Other Organizations) calls upon the General Council, which will carry out the functions of the WTO, to "make appropriate arrangements for effective cooperation with other intergovernmental organizations that have responsibilities related to those of the WTO" (GATT (1994), p. 11).

Box 3. Exchange Rate Volatility and Trade

Exchange rate volatility has long been suspected of directly depressing international trade by introducing an additional measure of uncertainty. It has also been accused of fueling protectionist impulses, which, in turn, exert negative trade effects indirectly by stimulating protectionist commercial policies. The empirical evidence for both types of linkages is mixed.

At the request of the Director-General of the GATT, a Fund staff study reviewed the literature on the effects of exchange rate volatility on world trade; it concluded that the results were inconclusive.[1] The large majority of empirical studies could not establish a significant link between exchange rate variability and the volume of trade. The Fund staff study also examined survey evidence in this area and reported that, by and large, the ability of firms to hedge in the forward market greatly mitigated the potentially adverse trade and investment effects of exchange rate variability.

Since the IMF (1984) review, a number of studies have appeared that also suggest inconclusive results. Following up on a study by Akhtar and Hilton (1984) that found significant adverse trade effects, Gotur (1985) examined the robustness of their results along several lines. When the basic model of Akhtar and Hilton was extended to cover additional countries, different sample periods, alternative indices of exchange rate volatility, and different estimation techniques, Gotur found that while significant adverse effects are sometimes observed for specific cases, viewed in the large, the results tend to be insignificant or unstable. Kenen and Rodrik (1986) examined the effect of real effective exchange rate (REER) volatility on global trade flows. Again, the results of their regression analysis were mixed, although the weight of their evidence seemed to support the negative-effects hypothesis. Thursby and Thursby (1987) investigated the effects of both nominal and real exchange rate volatility in a gravity-type trade model. Their model specification attempted to control for exchange-risk hedging activity in the forward market. When this was done, Thursby and Thursby found evidence of a negative relationship between exchange rate variability and bilateral trade whether nominal or real exchange rate indices were used.

More recently, Savvides (1992) argued that sufficient care has not been taken in past studies to separate anticipated from unanticipated exchange rate variability. If uncertainty is the problem, only the unanticipated component of exchange rate variability should exert a negative influence on trade flows.[2] By estimating a separate equation to explain REER variability, Savvides was able to investigate the impact of unanticipated exchange rate variability on a country's export growth. Unanticipated exchange rate variability was found to produce a negative and statistically significant effect on real export growth while the anticipated component of rate variability showed no such effect. Savvides suggested that this distinction may partly explain the inconclusive results of previous studies.

The studies cited so far focused principally on the uncertainty-generating effects of exchange rate volatility on trade. But exchange rate volatility may also exert negative trade effects by inducing more protectionist commercial policies over time, or alternatively by causing a slowdown in the pace of trade liberalization. An unanticipated appreciation in a country's REER, for example, can prove costly to import-competing interests whose plans for production and investment were formulated under significantly different expectations. This development may stimulate new coordinated calls for stronger barriers to imports while also increasing political receptivity to petitions for protection. Because there is generally an asymmetry in the process of imposing and removing protectionist trade barriers, greater rate volatility may cause the level of protection to ratchet upward, or to ratchet downward at a slower rate.

In this regard, although focused on the effect of changing *levels* of the REER, Clifton (1985) concluded that his empirical work is "broadly consistent" with the view that exchange rate volatility can stimulate an increase in protectionist pressure. After finding a statistically significant relationship between the level of the real exchange rate and import penetration, he argued that when combined with earlier studies establishing a significant relationship between import penetration and levels of protection, this offers indirect support for the positive link via a "ratchet" effect between exchange rate variability and increased protectionism. In other words, if high levels of the REER tend to produce protectionist policies that are not removed when the REER declines, REER variability would tend to impede trade as protectionist commercial policies are ratcheted upward.

Brada and Mendez (1988) tested simultaneously the effects of unanticipated exchange rate volatility on trade via trade frictions due to uncertainty and via induced protectionist changes in commercial policies. They found general evidence of a negative relationship between rate volatility and trade, and this was particularly strong for bilateral trade flows between countries that each peg to different major currencies (e.g., dollar versus sterling pegs). Brada and Mendez argued that this appears to have occurred because both importers and the exporters tended to face highly restrictive trade policies—policies induced, in part, by rate volatility.

De Grauwe (1988) developed a simple theoretical model that showed that increases in exchange risk may cause exports to rise or fall depending on a firm's degree of risk aversion. He then suggested that if a systematic link between exchange rate variability and trade is to be found, one should look for a connection to trade policy developments. By focusing on longer-run real exchange rate variability, De Grauwe argues that his empirical design is well suited to capturing the effects of rate variability on protectionist pressures. He identified a statistically significant negative association between longer-term real exchange rate variability and trade flows, and argued that this is consistent with the proposition that periodic currency misalignments tend to enhance protectionist pressures and thereby negatively affect trade flows.

[1] IMF (1984).

[2] It is noteworthy that Gotur (1985) pointed out this shortcoming in her concluding section and indicated that preliminary testing using a measure of unanticipated volatility did not significantly change her results. Kenen and Rodrik (1986) also explicitly claimed to be investigating the effects of unexpected changes using several simple predictors of future rates.

terial Declaration in the Final Act calls for greater policy coherence.[55] As established in its relationship with the GATT, future Fund and WTO cooperation should be founded on the efficient pursuit of shared objectives that take into account linkages between trade and macroeconomic policies, the need for policy consistency, and avoidance of duplication.

Consistency with GATT/WTO Obligations

The Fund's (and the World Bank's) advice on trade policy needs to be consistent with GATT/WTO obligations of member countries. For example, Fund- and Bank-supported programs sometimes recommend increases in (minimum) tariffs in the context of comprehensive tariff reforms aimed at lowering average tariff levels and reducing tariff dispersion, and harmonizing the tariff structure. If such increases raise tariffs above their bound levels, they could breach the member's obligations in the GATT/WTO. Another example relates to "other charges" on imports. When a GATT member binds its tariffs, it concomitantly commits not to raise the level of other charges on the relevant import item (in order not to vitiate the effect of the tariff binding). This needs to be taken into account before increases in service fees, statistical taxes or other similar charges are recommended for revenue or other purposes. Similarly, consideration of import surcharges for fiscal or balance of payments reasons needs to take account of GATT/WTO obligations.

In practice, instances of GATT-inconsistent Fund policy advice have been rare in the past. But with the marked increase in commitments under the Uruguay Round, especially the extensive coverage of developing countries' tariff bindings, the need for vigilance on this matter is much greater. Increased informal consultation with GATT/WTO staff would help to better identify potential conflicts before recommendations are formulated and implemented. And, of course, national authorities need to be alert to potential consistency problems.

Similarly, the Fund (and the World Bank) need to be aware of GATT/WTO rules and regulations that may carry repercussions that could affect program implementation. For example, export promotion through export subsidies on manufactures and direct forgiveness of debt (including to specific enterprises in the context of privatization or restructuring programs) are countervailable. In a number of cases, debt forgiveness has been necessary to push through privatization programs and to put the reorganized enterprise on a firm footing; in such instances, trading partners need to exercise caution and discretion—in a manner favoring liberal solutions—on the use of countervailing duties, even though GATT/WTO rules sanction such duties.

While Fund-supported programs avoid including GATT-inconsistent measures in program design, they have in general also avoided *directly linking program* conditionality to GATT obligations. Thus, for example, Fund programs may contain actions to reduce tariffs (in line with GATT objectives) but they do not require these tariffs to be "bound" in the GATT. Trade liberalization under Fund-supported programs has often helped developing countries subsequently to take the further step and bind (in whole or in part) their tariff schedules in the GATT (usually at levels higher than applied rates); but the two actions are separate and there is no direct or conditional link between them.

Balance of Payments Restrictions

Another manifestation of formal cooperation between the GATT and the Fund relates to the Fund's participation in the consultations of the GATT Committee on Balance of Payments Restrictions; the Fund's input helps the GATT Committee to judge the appropriateness of maintaining trade restrictions for balance of payments purposes. In the WTO, the role of the Fund in balance of payments consultations will be expanded to cover both goods and services.

Just as in the Fund there is increased emphasis on the desirability of members accepting the obligations of Fund Article VIII, so also there is now in the GATT a greater appreciation of the importance of encouraging members to reduce reliance on GATT Article XVIII:B (or Article XII).[56] This raises the question of the links, if any, between the member's acceptance of Fund Article VIII and its disinvocation of GATT Articles XVIII:B and XII. There is no legal link in the sense that action in one area requires adjustment in the other. The

[55]The Declaration on the Contribution of the WTO to Achieving Greater Coherence in Global Economic Policymaking calls upon the WTO to "pursue and develop cooperation with the international organizations responsible for monetary and financial matters, while respecting the mandate, the confidentiality requirements and the necessary autonomy in decision-making procedures of each institution, and avoiding the imposition on governments of cross-conditionality or additional conditions." Accordingly, the Declaration invites the "Director-General of the WTO to review with the Managing Director of the International Monetary Fund and the President of the World Bank, the implications of the WTO's responsibilities for its cooperation with the Bretton Woods institutions, as well as the forms such cooperation might take, with a view to achieving greater coherence in global economic policymaking" (GATT (1994), p. 387).

[56]These Articles allow developing countries (Article XVIII:B) and industrial countries (Article XII) to temporarily maintain trade restrictions (which would otherwise have been inconsistent with GATT) for balance of payments purposes. Currently, the following countries consult with the GATT Balance of Payments Committee under Article XVIII:B or XII: Bangladesh, Egypt, India, Israel, Nigeria, Pakistan, Philippines, Poland, the Slovak Republic, South Africa, Sri Lanka, Tunisia, and Turkey.

acceptance of Fund Article VIII may suggest that the member has reached a stage of convertibility that may place it in a better position to disinvoke also GATT Articles XVIII:B and XII. The Fund's assessment of the balance of payments justification for trade restrictions would be an important determinant of the GATT/WTO Balance of Payments Committee's consideration of this matter. A number of developing countries have been reluctant to bind their tariffs at the (lower) actual prevailing rates because of concerns of potential balance of payments problems in the future. By assisting members to achieve convertibility and medium-term balance of payments viability, the Fund would also help them lay the conditions for sustainable trade liberalization that is made permanent through GATT/WTO bindings.

Appendix I

Trade and Growth

While increased trade, promoted by liberalization of trade barriers, in concert with supporting exchange rate and stabilization policies, acts as a powerful stimulus to economic growth, trade theory traditionally has focused on the static benefits of trade liberalization, which tend to be rather small. It is often argued that static benefits as usually measured should be viewed as a lower bound since several potentially important effects are omitted, including elimination of rent seeking, gains to foreign producers from increased exports, elimination of disincentives to quality upgrading under QRs, and increased product variety.[57] These effects can add significantly to static gains. Additionally, the trade literature has long emphasized that open trade regimes lead to higher rates of economic growth. Liberalization could lead to higher growth with the import of more efficient capital goods and reduction of monopoly power. Recent developments in the theory of economic growth have been applied in an open economy setting to capture more formally the links between trade and economic growth.

Dynamic Gains from Trade

The new growth models (endogenous growth theory) specify several channels through which international trade can lead to a permanent increase in economic growth via technical change, thereby providing a potentially important conceptual foundation for empirical studies.[58] Trade may facilitate the international diffusion of knowledge, thereby speeding up growth. Liberalization may eliminate redundancy of product designs, if there is overlap under restricted trade. Trade may also stimulate innovation and growth by expanding the effective market size for producers. A high-skilled, labor-scarce country may see the cost of research and development fall because of trade liberalization, thereby stimulating innovation and growth. For a developing country, trade may provide access to a larger set of specialized inputs and production techniques, which may lead to increased growth. Learning by doing can also widen the range of specialized inputs available to producers, or expand the range of differentiated consumer goods, with the set of goods becoming increasingly sophisticated as learning proceeds; trade liberalization can increase the learning rate, thereby leading to increased economic growth. In any event, welfare (real national income) may increase as a result of trade liberalization even if growth falls and vice versa.

There have been few attempts to specify empirical models based on the new models of trade and growth. Baldwin (1989, 1992) computes the dynamic gains from the Internal Market program to eliminate all barriers to trade and factor movements within the European Union, and Kehoe (1994) draws upon cross-country regressions over the 1970–85 period contained in Backus, Kehoe, and Kehoe (1992) to illustrate the potential dynamic gains from increased trade for Mexico. While admittedly rough, the calculations contained in Baldwin (1989) and Kehoe (1994) illustrate that dynamic gains from trade liberalization may dwarf static gains from trade.

Empirical Studies

The links between trade and growth are varied and complex, running in both directions. Consequently, while empirical studies have consistently supported a positive link between exports and economic growth, their conceptual underpinnings have sometimes been unclear. Additionally, it has proven difficult to assemble a reliable set of trade barrier measures that are comparable, across either countries or different time periods; this has posed a problem for establishing the precise quantitative nature of the links between trade liberalization and economic growth.

Empirical evidence on the relationship between trade and growth has taken many forms, including principally large multicountry case studies[59] and econometric studies based on highly aggregated cross-country data sets.[60] A key element of such studies is the definition and measurement of outward orientation that is used. Some studies have stressed the nature of the trade regime while others have taken a more comprehensive approach to measurement of "openness." The nature of the trade regime has been measured by many indicators, including the effective exchange rate for ex-

[57] See Feenstra (1992).

[58] See Grossman and Helpman (1991); Francois and Shiells (1993).

[59] See Balassa (1971); Bhagwati (1978); and Krueger (1978).

[60] See Edwards (1993); Rodrik (1993); and IMF (1993).

ports relative to imports, which indicates the distortion in export prices relative to prices of import substitutes, and the real exchange rate, defined as the price of tradable goods relative to the price of nontradables; the indicators have alternately been combined into one index or used separately. The multicountry case studies have documented many microeconomic inefficiencies resulting from a protectionist regime, all ultimately leading to high capital-output ratios and reduced economic growth.[61]

Cross-country econometric studies generally find that dismantling trade barriers stimulates exports and hence economic growth. Krueger (1978), for instance, finds a strong link between the real effective exchange rate faced by exporters and export growth, while movement toward a more liberal trade regime, measured by dummy variables to take account of relaxation of QRs, is statistically significant but substantially less important than the exchange rate. Krueger also finds substantial evidence of a strong link between exports and real GDP growth, although the direct effect of trade liberalization on economic growth (increasing the supply of foreign inputs may lead to an increase in capacity utilization or new investment) is not significant.

Dollar (1992) finds (in a cross-section study of 95 developing countries) that outward orientation is highly correlated with economic growth (measured by per capita GDP growth). His measure of outward orientation, which is based mainly on a country's price of traded goods, relative to international (U.S.) prices of traded goods, corrects for misalignment of the exchange rate in addition to trade restrictions and other distortions, so that the effects of trade liberalization on economic growth are not separately identified in the study. He concludes that if countries in Latin America and Africa had achieved a level of outward orientation comparable with that in Asia, growth in these countries would have been substantially higher.

Edwards (1992) utilizes a cross-country data set (averaged over 1970–82) to analyze the relation between trade orientation and economic growth. A theoretical endogenous growth model is used as a rough guide to specify a model in which real GDP growth depends on aggregate investment as a share of GDP, the gap between the world's and the country's stock of knowledge, and an index of trade intervention for the country. The empirical results indicate that countries with less-restrictive trade policies have grown at a significantly more rapid pace than countries with more restrictive trade policy regimes. This result is robust with regard to the choice of trade restrictiveness measure used, measurement error, other influences on economic growth (human capital accumulation, political instability, and the share of government expenditure in GDP), and choice of time period.

Conclusion

While there are caveats attached to both the voluminous empirical literature, as well as the burgeoning new theoretical endogenous growth literature, and there is much additional work to be done in combining the two, the empirical evidence and economic theory generally support the long-held view that there is a strong link between international trade and economic growth.

[61] See Bhagwati (1978).

Appendix II

Glossary of Terms

Antidumping duty. Levy imposed on imports deemed as being "dumped." Article VI of GATT and the Tokyo Round Antidumping Code permit the imposition of antidumping duties equivalent to the difference between the export price and the "normal value" of the product if it causes or threatens to cause material injury to an established industry or "materially retards" the establishment of a domestic industry.

Countervailing duty. Levy imposed on imports by the importing country to offset government subsidies in the exporting country. GATT Article VI and the Tokyo Round Subsidies Code allow, under certain circumstances, the imposition of countervailing duties in the case of material injury or threat of material injury to domestic producers from imports of like products that benefit from subsidies (export or domestic) or when such subsidies "materially retard" the establishment of a domestic industry.

Dumping. Price discrimination between exports and domestic sales of a given product. The dumping margin, which forms the basis of antidumping duties, may be determined according to GATT Article VI as the price difference between the price of the product exported from one country to another and (a) the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country or, in the absence of such domestic price, (b) the highest comparable price for the like product for export to any third country, or (c) the cost of production in the exporting country plus a reasonable addition for selling cost and profit.

Generalized System of Preferences (GSP). International agreement negotiated under the auspices of GATT, providing temporary and nonreciprocal duty preferences accorded by the developed to the developing countries. A ten-year waiver from the GATT most-favored-nation provision was granted in 1971 to permit implementation of the GSP. It was not necessary to review the waiver because a similar objective was achieved by the 1979 GATT decision on "Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries" resulting from the Tokyo Round (the Enabling Clause).

Gray area measures. Measures, such as orderly marketing arrangements and voluntary export restraint agreements, which were outside GATT surveillance and whose consistency with GATT was not determined (prior to the Uruguay Round Final Act).

Least-developed countries. The term "least-developed countries" refers to a category defined by the United Nations and used in the GATT to identify certain very low-income countries.

Margin of preference. Difference between the most-favored-nation and the preferential tariff.

Most favored nation. Fundamental principle embodied in GATT Article I and in GATS Article I, whereby any privilege or concession granted by one contracting party to a product or service of another country will be unconditionally granted to the like products or services of all other contracting parties.

Nontariff measures (NTMs). All government actions other than tariffs with a potential trade-distorting impact, including quantitative restrictions, subsidies, government procurement practices, and technical barriers to trade.

Rules of origin. Rules that define the criteria for establishing the country of origin of a product for purposes of assessing tariffs or other import restrictions. Origin rules are used to enforce the individual tariff schedules of countries participating in a free trade area. They usually stipulate a minimum value-added requirement for duty-free access of partner country products to the domestic country.

Safeguard measures. Temporary protective measure undertaken to (a) safeguard domestic producers of given goods from an import surge (GATT Article XIX permits such measures under certain conditions); (b) protect the country's reserve and balance of payments position (GATT Articles XII and XVIII:B); and (c) protect infant industries in developing countries (GATT Article XVIII:C).

Subsidies. Government assistance to the development, production, or export of specific goods. Subsidies can take the form of either direct financial support or indirect support through tax exemptions, subsidized loans or loan writeoffs, government procurement practices, and subsidies to the production of inputs.

Tariff binding. Obligation undertaken in GATT not to raise tariff rates on specific products above a certain level without compensating reductions in other tariffs.

Bindings are also referred to as tariff concessions in GATT terminology. Applied tariff rates may be lower than bound rates.

Tariff dispersion. Range of tariff rates within a country's tariff schedule.

Tariff escalation. Progressively higher tariff rates as the stage of processing of goods advances, resulting in high effective rates of protection of final products.

Tariff peaks. Tariff rates that are particularly high compared with the general tariff schedule of a given country.

Tariff quota. Application of a higher tariff rate on imported goods after a specified quantity of the product has entered the country. In the context of the European Union's GSP, for example, a tariff quota refers to the quantitative restriction on the amount of a certain good that can enter the EU duty free; after this threshold is reached, the MFN tariff applies.

Tariffication. Replacement of quantitative restrictions or other nontariff barriers with approximate tariff equivalents.

Trade-related aspects of intellectual property rights, including trade in counterfeit goods (TRIPs). The Uruguay Round TRIPs agreement will increase the standards of intellectual property protection around the world, improve the effectiveness of its enforcement nationally, and provide a forum for the multilateral settlement of disputes between countries.

The types of intellectual property covered are patents, trademarks, copyright and related rights, trade secrets, geographical indications, including appellations of origin, semiconductor layout design, and industrial designs.

Trade-related investment measures (TRIMs). Measures employed by countries, usually in relation to foreign enterprises, which require or induce them to meet certain yardsticks of performance. The most commonly used TRIMs are local (or domestic) content requirements (LCRs), when a firm must ensure that a specified amount or share of production (value or volume) uses local inputs; export performance requirements, when a firm must ensure that a specified amount or share of local production be exported; and trade (foreign exchange) balancing requirements, when a firm must ensure that imports be no greater than a specified proportion of exports.

Voluntary export restraint arrangements (VERs). Bilateral agreement between an exporter and an importer whereby the former agrees to limit exports of a given product. The agreement may be concluded at government or industry level.

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