Trade Policy Issues

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Chorng-Huey Wong
Naheed Kirmani

International Monetary Fund

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Papers presented at the seminar on Trade Policy Issues,
March 6–10, 1995

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Preface

The IMF seminar on trade policy issues, held in Washington on March 6–10, 1995, afforded senior officials from member countries, academics, and officials of the IMF, the World Bank, and the World Trade Organization (WTO) an opportunity to discuss recent developments and current issues in trade policy in industrial, developing, and transition economies, the achievement and impact of the recently concluded Uruguay Round, the role of the WTO, the post–Uruguay Round agenda, and the role of the Fund in the trade area.

As indicated in the welcoming remarks of Mr. Ouattara, Deputy Managing Director, one of the IMF's mandates, as defined in its Articles of Agreement, is "to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy." A major theme of the seminar was that further trade liberalization, supported by appropriate macroeconomic policies and reforms, would foster growth of the new global economy and benefit the industrial, developing, and transition countries alike.

While recognizing that concluding the Uruguay Round represented a significant achievement, participants agreed that many issues remained, both in the implementation of the Round and in further liberalization in some difficult areas, such as agriculture, textiles, trade-related investment measures, and services (especially financial services). In addition, new issues such as competition policy, technology policy, labor standards, and environmental considerations were emerging that needed to be dealt with. There was general agreement on most of the issues discussed, but there were also a few on which no consensus was reached.

We are particularly indebted to our colleagues in the IMF, the World Bank, and the WTO, who participated in the seminar and contributed to the publication of this volume. Special thanks are due to Patrick B. de Fontenay, who was Director of the IMF Institute at the time of the seminar, to Chorng-Huey Wong and Naheed Kirmani, who organized the seminar and served as its moderators, and to Emma Aguiluz and Sher Sandusky, who typed the manuscripts. Juanita Roushdy of the External Relations Department provided editorial assistance and coordinated the publication process. Needless to say, the seminar would

not have been successful without the keen interest and active participation of all the participants.

Jack Boorman, *Director*
Policy Development and Review Department

Mohsin S. Khan, *Director*
IMF Institute

List of Abbreviations

APEC	Asia-Pacific Economic Cooperation Council
BIS	Bank for International Settlements
CAP	Common Agricultural Policy (of the European Community)
CEFTA	Central European Free Trade Agreement
CIS	Commonwealth of Independent States
CMEA	Council for Mutual Economic Assistance
EC	European Community
EFF	Extended Fund Facility
EFTA	European Free Trade Association
ESAF	Enhanced Structural Adjustment Facility
EU	European Union
FDI	foreign direct investment
FTA	free trade area
GATS	General Agreement on Services and Trade
GATT	General Agreement on Tariffs and Trade
GSP	Generalized System of Preferences
ILO	International Labour Organization
IMF	International Monetary Fund
ITO	International Trade Organization
MAI	Multilateral Agreement on Investment
MERCOSUR	Southern Cone Common Market
MFA	Multifiber Arrangement
MFN	most favored nation
MTN	multilateral trade negotiations
NAFTA	North American Free Trade Agreement
NTBs	nontariff barriers
NTM	nontariff measure
OECD	Organization for Economic Cooperation and Development
PSI	preshipment inspection
QRs	quantitative restrictions
REER	real effective exchange rate
RTA	regional trading arrangement
SAF	Structural Adjustment Facility
TRIMs	trade-related investment measures
TRIPs	trade-related aspects of intellectual property rights
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

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Contents

The following symbols have been used in this book:

. . . 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., 1995–96 or January–June) to indicate the years or months covered, including the beginning and ending years or months; and

/ between years (e.g., 1996/7) to indicate a fiscal (financial) year.

"Billion" means a thousand million.

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

Overview

Chorng-Huey Wong and Naheed Kirmani

The 14 chapters in this volume are either papers presented or remarks made at a seminar on "Trade Policy Issues," organized by the Fund's Policy Development and Review Department and the IMF Institute and held in Washington on March 6–10, 1995. The seminar covered a wide range of topics such as the design and implementation of trade reform; trade liberalization issues in industrial and transition economies; regional trading arrangements; the results of the Uruguay Round; institutional matters related to the World Trade Organization (WTO); and the post–Uruguay Round agenda.

Design and Implementation of Trade Reform

There was general agreement among participants that an outward-oriented strategy and liberal trade would foster both economic growth in individual countries and global prosperity. This was particularly important in a world economy that was becoming increasingly integrated. The main issue related to designing trade reform in a manner that minimized short-term dislocations of output and employment. Some participants were of the view that, within the context of general trade liberalization, key industries with future potential needed to be protected on infant industry grounds; others cautioned that the historical evidence was that such an approach might be costly. Participants agreed that prudent macroeconomic policies, including particularly those geared to avoiding real exchange rate appreciation, were necessary complements to trade reform. The evidence from a number of developing countries and transition economies was that real exchange rate appreciation, brought about by large capital inflows or other reasons, could adversely affect the authorities' efforts to pursue further trade liberalization or might even cause partial reversals in such liberalization. Participants also recognized that fiscal reform aimed toward reducing reliance on trade taxes as a revenue source was necessary for effective implementation of tariff reforms.

Trade Liberalization in Industrial Countries

In discussing trade liberalization in industrial countries, participants recognized that in the post–World War II period these countries had significantly reduced tariffs and other trade barriers, although there were a number of sectors, such as agriculture and textiles and clothing, where protection levels remained high, causing difficulties for developing and transition economies that had a comparative advantage in those areas. Participants were concerned about the extensive use of antidumping measures by industrial countries. Reform in this area was thus a matter of crucial importance. Also discussed was the issue of whether industrial countries should continue to pursue the historical policies of reducing at-the-border trade barriers ("shallow integration") or seek to harmonize national differences in domestic policies that could have implications for market access ("deeper integration"). Most believed that harmonizing domestic policies among different countries would remain very difficult due to a variety of reasons including cultural differences. Another question was whether industrial countries should pursue further global liberalization by a "multitrack" (i.e., unilateral, bilateral, regional, or multilateral) approach or only through multilateral channels. Some participants were critical of the use by some industrial countries of unilateral and bilateral approaches to market opening in partner countries, because this effectively put the stronger economic power in a better bargaining position. While most participants favored the multilateral approach to further liberalization under the auspices of the WTO, it was pointed out by some that seeking agreement on multilateral liberalization among the large group of members of the WTO could entail time-consuming compromises.

Particular Issues in Transition Economies

There was general agreement that economies in transition needed to reduce further state intervention, particularly restrictions on exports. Participants agreed that removal of export barriers should be an integral part of overall price liberalization, and that well-functioning foreign exchange markets needed to be established. A number of participants expressed concern about antidumping measures by industrial countries against economies in transition. Furthermore, resort to antidumping measures was also increasing in the economies in transition themselves as in other developing countries (antidumping petitions were often initiated by multinational firms). This again pointed to the need for stronger multilateral disciplines to contain the abuse of an-

tidumping as an instrument of protection in all types of economies. Ideally, antidumping policies should be placed in a competition policy framework; short of this, antidumping policy should be reoriented from its current sectoral perspective toward a national perspective, requiring stricter provisions in national antidumping legislation, careful consideration of the costs to the economy of antidumping measures, and assigning a formal role to antitrust authorities in commenting on the competition effects of proposed antidumping actions.

Regionalization of World Trade

The motivation and impact of the proliferation of regional trading arrangements, including the European Union (EU), North American Free Trade Agreement (NAFTA), and Asia-Pacific Economic Cooperation Council (APEC), were reviewed. Most participants were of the view that the trend toward increased regional trading arrangements in recent years had net trade-creating effects and thus far had been complementary to multilateral trade liberalization. Nevertheless, a number of participants expressed concern that growing regionalism could ultimately adversely affect countries that were left out of the major regional arrangements. To avoid this, it was important that multilateral liberalization accompany or precede the formation of regional trading arrangements. Some participants thought that further efforts were needed to implement transparent and liberal rules of origin and that future multilateral liberalization should address the issue of regional barriers to trade and investment, including in the form of technical standards.

Impact of the Uruguay Round and the Role of WTO

Participants generally welcomed the conclusion of the Uruguay Round, which would have positive effects on global incomes. It was pointed out that the benefits of the Round would be largest for those countries who had liberalized the most. Some participants commented that, while the envisaged full integration of agriculture and textiles and clothing into multilateral disciplines was an important achievement, liberalization in these areas was rather modest or heavily backloaded. Recent studies indicated that potential losses for least developed African countries were likely to be small in terms of preference erosion and food import costs. Even so, some participants felt that adequate attention should be given to short-term disruptions that could be experienced by these countries. At the same time, they emphasized the importance of appropriate domestic policy responses to maximize

the net benefits of the Uruguay Round. A number of participants called upon the international organizations—the Fund, the Bank, and the WTO—to assist developing countries, particularly the least developed countries, to identify the transitional costs of implementing the Uruguay Round in individual countries and advise on appropriate actions in terms of both adjustment and financing. Participants also noted that the strengthening of rules, particularly with regard to dispute settlement following the establishment of the WTO, would have significant, though nonquantifiable, benefits.

Post–Uruguay Round Issues

Participants welcomed further steps toward broadening the benefits of a rule-based global trading system. Subjects identified in the post–Uruguay Round period as meriting further liberalization included agriculture, textiles and clothing, trade-related investment measures, and services (especially financial services). Some participants were of the view that new issues such as competition policy, technology policy, labor standards, and environment needed to be addressed as part of the post–Uruguay Round agenda. While there was agreement that attention to these issues would inevitably increase in the future, many participants cautioned against linkages between trade and labor standards and trade and the environment because of concerns that this could be used as a cloak for protectionism. A number of them preferred that issues not directly related to trade be considered in forums other than the WTO. Participants agreed that, to build consensus on the pursuit of further liberalization, policymakers and the public would need to better appreciate the benefits to the domestic economy of trade liberalization, rather than perceiving it merely as a "concession" to be exchanged with other countries' "concessions."

1 Opening Address

Alassane D. Ouattara

It is indeed my pleasure to welcome you to this seminar on Trade Policy Issues organized by the IMF Institute, headed by Patrick de Fontenay, and the Policy Development and Review Department of the Fund, headed by Jack Boorman. I am very pleased that you have been able to take time from your busy schedules to come to Washington for this seminar.

The seminar is timely because, as you know, the World Trade Organization (WTO) has just been established and there are many issues to be discussed regarding the implementation of the Uruguay Round, its economic effects, and the post–Uruguay Round agenda. More generally, this is a unique opportunity for you to exchange views among yourselves, and with the staffs of the Fund, the Bank, and the WTO, on current issues in trade in industrial, developing, and transition economies.

What is the role of the IMF in the trade area? We could say that the IMF, the World Bank, the WTO, and the United Nations (UN) system are the four pillars of the institutional structure of multilateral cooperation for global development, with each having essential and interdependent roles to play. The IMF's direct responsibilities mainly concern macroeconomic policies, international payments, and exchange relations, rather than trade relations, which are more the responsibility of the WTO. But why has the IMF been given the responsibilities it has? Part of the answer is the objective of promoting international trade. This is clear from Article I of our Articles of Agreement, which states that one of the purposes of the Fund is "to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy." The Fund has pursued the purpose of facilitating the expansion of international trade in four principal ways. First, by promoting the adoption by its member countries of macroeconomic policies conducive to sustainable growth. Second, by providing temporary financial assistance to countries with balance of payments difficulties, thereby (and I quote again from Article I) ". . . providing them with the opportunity to correct

maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity." Among such measures to be avoided are certainly trade and exchange restrictions. Third, the Fund has promoted the convertibility of currencies, which has been essential to the development of a multilateral system of payments and therefore also to multilateral trade relations. And fourth, the Fund, in collaboration with the General Agreement on Tariffs and Trade (GATT), and now the WTO, has promoted trade liberalization in the context of Fund-supported adjustment programs and Fund surveillance.

The WTO is now responsible for developing and safeguarding the multilateral trading system, while the Fund remains responsible for developing and safeguarding the multilateral payments system. The two roles are complementary, and the two institutions will necessarily continue to work hand in hand.

The benefits of liberal trade and exchange regimes in terms of resource allocation, growth, and welfare, are well-known—as are the costs of the alternative—and I am sure that this audience does not need me to elaborate on them. Let me just refer briefly to experience.

First, in the early postwar decades, following the establishment of the IMF, the World Bank, and the GATT, there were major reductions in trade and exchange restrictions. Average tariffs on manufactured goods in industrial countries were reduced from about 40 percent in the late 1940s to about 6 percent four decades later. At the same time, there was a widespread move among the industrial countries toward current account convertibility. These developments contributed to a virtually unprecedented growth of both trade and output, providing a striking example of trade as an engine of growth.

Second, in the past decade or so many developing countries have taken unilateral action to reduce their trade and exchange restrictions, often as part of comprehensive adjustment and reform programs supported by the IMF and the World Bank. The results of these reforms are illustrated by some global data. Between 1961 and 1975, the volume of exports of non-oil developing countries grew at half the pace of exports by the industrial countries; this relationship has since been reversed, so that, for instance, between 1986 and 1993 the volume of exports of non-oil developing countries grew at an average annual rate of 10 percent, compared with 5 percent for the industrial countries. Moreover, the growth rates in developing countries have clearly been influenced by their trade strategies. Thus, since the mid-1980s real GDP in strongly outward-oriented developing countries has grown much faster than in other developing countries. In fact, the dynamism of the outward-oriented, successfully adjusting countries has not only

significantly strengthened the foundations of their own economies but has also provided crucial support for global growth during the recent period when the industrial world experienced weak activity. This was most striking in 1993, when these countries accounted for virtually the whole of global growth.

Third, in the countries in transition from central planning to market-based economic systems, where trade and payments have been liberalized, and where this has been accompanied by effective macroeconomic stabilization and by other reforms required for markets to work, positive results have become visible. In fact, positive output growth, led to a significant extent by exports, was recorded last year in a number of countries in Central and Eastern Europe, including Estonia, Hungary, and Poland among the countries represented here today. Impressive progress has also been made by a number of countries in transition in Asia, notably China, on the basis of outward-oriented strategies.

So the lessons of experience are clear. Nevertheless, over the last decade prior to the conclusion of the Uruguay Round, we have seen, especially in industrial countries, a proliferation of new nontariff barriers, including quotas and voluntary export restraints, as well as an increased tendency toward countervailing and antidumping measures. Regional initiatives have proliferated, and there has been a growing tendency to manage trade relations through unilateral and bilateral approaches. These trends have no doubt been encouraged by periods of weak growth, by persistently high unemployment in industrial countries, and by new competitive challenges arising from globalization and the dynamic trade performance of some developing countries. Unfortunately, we have been learning again that while defensive trade policies feed on economic weakness, economic weakness is exacerbated by the ensuing protection.

The eventual conclusion of the Uruguay Round was a testimony to the commitment of participating countries to check these protectionist trends and to strengthen the liberal trading order. During the next few days, you will discuss the agreements reached by, and the likely impact of, the Uruguay Round, as well as trade policy issues for the 1990s. Here, I would just mention a couple of points.

First, trade liberalization in any country needs to be supported by appropriate macroeconomic and other structural policies. Sound fiscal, monetary, and exchange rate policies can help ensure that a country's balance of payments and reserves are sufficiently strong to withstand the short-term pressures that may arise as a result of liberalization. This point becomes increasingly important as capital markets are globalized, because the balance of payments position and the exchange

rate can change dramatically within a short period of time, as a result of changes in foreign investors' confidence. The recent financial crisis in Mexico is a case in point.

Among the structural policies that are complementary to freer trade, I would emphasize labor market policies. In many industrial countries where structural unemployment has grown to unacceptable levels over the past two decades, there is now greater recognition of the need to take action to improve labor market flexibility and to ensure that new jobs can replace old ones that inevitably will surrender to the forces of competition.

The second point I would like to make is that unilateral trade liberalization and regional trade agreements can realize their full benefits only in the context of a liberal, rule-based, multilateral trading system. As I mentioned earlier, many developing countries and economies in transition in recent years have benefited from unilateral trade liberalization. But these countries also need access to markets in other countries to ensure the success of their adjustment efforts, and this can be gained through multilateral agreements that remove protectionist measures. Similarly, regional trade agreements can provide their members with benefits through trade creation and the creation of new opportunities for economies of scale. There is also the serious risk, however, that they divert trade away from third countries by discriminating against them. A strong multilateral system is necessary to ensure that regional agreements remain outward-oriented and are consistent with and complementary to the objective of global free trade.

The conclusion of the Uruguay Round will lead to significant progress in many respects, but I would like to emphasize that many obstacles to free trade remain and new issues, such as labor standards and environmental considerations, are emerging that could affect the trading order. The Fund will be collaborating closely with the WTO to seek to ensure that appropriate policies are pursued at the national and global level to keep the world economy open and strong.

Introduction 2

Jack Boorman

As Mr. Ouattara's remarks have suggested, we in the Fund have been devoting increasing attention to structural reforms as a necessary complement to macroeconomic stabilization in the design of Fund-supported adjustment programs, and more generally in the advice that the Fund provides to member countries in the context of its surveillance responsibilities. Over recent years, in fact, the most successful Fund-supported adjustment programs have been those that have had a medium-term focus with corresponding emphasis on structural reforms, including in that context trade reforms, which are crucial. To further that effort, the Fund, the World Bank, and the new WTO must increasingly complement each other in assisting countries in their trade liberalization efforts. The Fund's own perspective in such efforts is to integrate trade reform with comprehensive macroeconomic adjustment programs, taking account of the many links between trade and macroeconomic policies. We all know that inappropriate macroeconomic (including exchange rate) policies can constrain an economy's ability to compete abroad and could also generate protectionist pressures at home. Trade policies, in turn, can affect macroeconomic policies through their impact on fiscal balances, on the balance of payments, and on the exchange rate. The fact is that exchange and trade restrictions often operate as substitutes, and progress in one area can be hampered by developments in the other.

We hope this seminar will provide an occasion for us to share our rich and diverse experiences concerning the design and implementation of trade reforms. We very much look forward to a productive exchange of views from the different perspectives that all of you bring to the issues and problems involved. By combining analytically sound economic policy with a sharpened appreciation of political and administrative realities, we can together come up with good, workable programs for trade reform.

One of the questions we in the Fund frequently face in the context of our surveillance discussions with members—and even more so in the discussions on Fund-supported adjustment programs—relates to problems of access to foreign markets. This cuts both ways—industrial countries are concerned that the level of trade barriers in devel-

oping countries remains high, but developing countries themselves often complain that their efforts to open markets are discouraged by the impediments they face to access to industrial country markets for their exports. The Fund does take a keen interest and has an important stake in promoting open markets, not only for the sake of world trade but also for the success of the adjustment efforts of our developing members and our transition member countries. Anecdotes abound in this area. In the course of negotiations of Fund-supported adjustment programs, all too often we hear about the impediments that developing and transition economies face in trying to expand their access to industrial country markets. When we raise this issue in the context of our surveillance discussions with our industrial country members, we sometimes hear protestations about the openness of their markets. There is a need to improve the transparency of trade regimes, and also to bring attention to the inconsistencies in some country policies in this area—for example, provision of financing and promotion of adjustment would be more fruitful if the reforming countries were allowed to freely export their products. That is one of the perceptions that a dialogue in a seminar of this nature, I think, can help to foster.

Over the next few days we will also be exploring the effects of the Uruguay Round on the world economy, including in the areas of market liberalization, strengthening of rules and institutions, and extending rules to new areas. Many of you, we know, are in excellent positions to monitor the effects of the Round on your own countries and to advise on the necessary policy measures to maximize the Round's benefits. We are keen to hear your assessment of the areas that require particular adjustment in light of the Uruguay Round agreements. We intend to devote the necessary attention to monitoring the economic and financial impact of the Round on individual countries, particularly on their balance of payments adjustment and financing needs. This is particularly important in light of the concerns of a number of our member countries and the potential adverse impact on food import costs and on the erosion of preferences. In various forums, including the Development Committee, there have been calls by individual countries to consider creation of new facilities to address the potential costs of the Uruguay Round. At this stage we believe that the Fund is well placed to assist countries in meeting their possible balance of payments financing needs due to the Round. But we are anxious to hear your analysis of the potential problems in this area, in your own countries, or more generally. And we are willing to keep an open mind about the necessary actions that the Fund must take to assist its member countries, if suggested by future developments.

As a result of the Uruguay Round and the establishment of the WTO, strengthened collaboration between the Fund and the WTO has acquired greater significance. You will be hearing from representatives of the WTO during this week. The Fund and the new WTO, which share common objectives, need to ensure that they give consistent policy advice to their members and to avoid cross-conditionality and also to ensure that trade and macroeconomic policies are coherent, mutually reinforcing, and contribute to a strong and open global economy. In the months ahead, we in the Fund, together with representatives from the WTO, will be exploring the cooperative mechanisms that are needed for the two institutions to achieve these objectives. Of course, the goal of coherence and consistency also needs to be achieved at the national level—this topic deserves your particular attention, both at this seminar and in your work in your own countries. This is reflective, for example, of the point that I made regarding transparency in trade systems. You cannot have the trade minister saying one thing and the aid minister saying another, and still expect to have consistent and coherent policies across countries.

While the Uruguay Round has made significant progress in a number of areas, obstacles to freer trade and investment remain. The lowering of these barriers will need to feature in the post–Uruguay Round work program. In addition, new aspects have emerged concerning the interface between domestic policies and trade policy objectives—for example, in the areas of competition policies and the promotion of improved labor and environmental standards and practices. The multilateral system will need to respond effectively to these challenges, while avoiding exploitation of the new issues by protectionist interests.

Finally, I hope this seminar will increase our common awareness and appreciation of the various trade issues—current and prospective—that need to be addressed, as well as provide guidance on how best the Fund and its member countries can tackle these issues in the context of a cooperative framework. I look forward to the active participation of all of you in this seminar.

An Overview of Recent Trade Policy Developments 3

Naheed Kirmani

This paper gives you an overview of the main topics that we are going to discuss during the week, against the backdrop of recent developments in the world trading system. A number of these issues will be discussed in more detail in subsequent papers.

In the period 1990–94, five main themes can be identified in developments in international trade policies. First, multilateral trade negotiations under the Uruguay Round were going on. Second, the trend toward regional integration intensified. Third, unilateral—or what trade negotiators call "autonomous"—liberalization was being pursued as part of the economic reform efforts of developing countries and economies in transition (but was relatively limited among industrial countries). Fourth, trade frictions escalated (particularly prior to the conclusion of the Uruguay Round) both among industrial countries and between industrial and developing countries; indeed, such frictions emerged also on a south-south basis among developing countries. Fifth, as mentioned by the earlier speakers, new issues demanded more attention from the international community; these related to the links between trade policies and domestic policy issues—such as competition policy, labor standards, and environmental issues—a harbinger of the shape of future international trade policy discussions.

I will say more on these themes later on. But before that, it would be interesting to briefly review the longer-term structural changes that have been influencing the global trading system, and which have in direct or subtle ways shaped the themes of the 1990s.

A remarkable phenomenon of the past several decades is the globalization of production and investment. Globalization means that the world is getting more integrated, it is getting smaller, and certainly trading conditions are getting to be much more competitive. As companies go global and intra-industry trade increases, the distinction between "foreign" and "domestic," or "border" and "nonborder" is not as simple as it used to be. A company may originate in country "A," may locate in country "B," may source its materials from countries "C" and "D," and may export to countries "E" and "F." Globalization implies that it is difficult for countries to pursue isolationist strategies

consistent with sustainable growth. The trend toward integrated exchange, trade, and capital markets has gone too far to be easily reversed without damaging the world economy.

Rapid technological change has facilitated globalization. True, technological change has always been going on to a certain extent—but its scope and speed in recent decades has been awesome. It has contributed not only to greater efficiency but also to a more competitive and riskier environment. If a firm does not keep up, the risk of bankruptcy is much greater than in earlier decades. Rapid technological change also affects the ability of governments to successfully intervene in the market. Governments have generally been poor at picking "winners" in the past, but rapidly changing technology has made the selection even riskier.

Another notable development is the greater diversification in the world trading structure. This also has been happening gradually, but the results have become much more striking in this decade and are likely to become even more so in the next. Many of the advanced developing countries have turned into economic power bases that as a group have the capacity to fundamentally affect the course of the world economy and world trading patterns. Together, these countries are in a position to mount a strong challenge to the established economic power base of industrial countries. An interesting element of the new trading powers is that some of them have become very strong in particular activities while continuing to experience low per capita income on an aggregate basis.

I would also mention a particularly important structural change that is taking place that will have profound effects on the world economy. I refer, of course, to the major transformation that is going on in the economies in transition as they shift from the command economy model to one based on market forces. In Eastern Europe the transformation started earlier and has made considerable headway. In the Baltic countries, Russia, and other countries of the former Soviet Union, it is in process and progress has been uneven. These economies are coping simultaneously with major institutional and structural changes and major stabilization efforts—indeed, a whole new way of doing things is underway. The process involves tremendous difficulties but also holds great promise. No doubt there are still lots of things to sort out, but once stabilization is in hand and the initial stages of the transformation are completed, it will become more apparent that the Baltic countries, Russia, and other countries of the former Soviet Union and Eastern Europe have tremendous potential; potential that will represent new challenges to the established players in the world trading system. Integrating these countries into the multilateral trading sys-

tem in a manner that is both speedy and smooth is an exciting challenge to all concerned. The end of the cold war has also brought other changes in its wake. For example, the United States has decided to give commercial objectives relatively greater priority over strategic and political considerations than in the past—this has important implications for the conduct of its trade policy.

Those are some of the longer-term structural changes that are affecting the world trading system. Coming back now to the five themes characterizing the first part of the 1990s, let me elaborate a little.

Regarding multilateral liberalization, during 1986–93 the most ambitious multilateral trade negotiations in the history of the GATT took place under the Uruguay Round. This Round was different from other rounds in the scope and breadth of its coverage. It not only encompassed liberalization in traditional areas, such as tariff reductions, but also addressed seriously some of the old issues that had defied resolution in the past—specifically agriculture and textiles and clothing. Normal GATT rules in these sensitive sectors were either nonexistent or not applied (indeed, GATT actually sanctioned restrictions through mechanisms such as the Multifiber Arrangement). The Uruguay Round went even further to cover "new" areas, such as intellectual property rights and services. In the coming sessions you will have an opportunity to assess the accomplishments under the Uruguay Round and its likely economic impact.

In early 1994 when the Fund staff was preparing its assessment of international trade policies for the Executive Board,[1] most quantitative studies on the Uruguay Round reported aggregate global welfare gains in a relatively narrow range of about $200–275 billion (at 1992 prices) once the full effects of the Uruguay Round were realized (in about ten years). During the latter part of 1994 and in early 1995, as details of the actual commitments of countries became available, new studies on the Uruguay Round (by the World Bank, the Organization for Economic Cooperation and Development (OECD), the GATT Secretariat, and by academicians) produced a much wider range of benefits of global welfare gains ($25–510 billion). The wider range reflects differences in modeling assumptions. Some of the realized benefits from actual liberalization will clearly be less than expected earlier (e.g., in agriculture). Incorporation of some dynamic effects results in much larger estimates of welfare gains. Whatever is the "correct" quantifica-

[1]Subsequently published in the IMF's World Economic and Financial Surveys series as *International Trade Policies*, Vol. I, *The Uruguay Round and Beyond: Principal Issues*, Vol. II, *The Uruguay Round and Beyond: Background Papers* (Washington, 1994).

tion, the most important thing to remember is that in the absence of agreement on the Round, the counterfactual would have been decidedly undesirable. Given the escalation of trade frictions that were occurring, there would have been an erosion of confidence, a very significant deterioration in the world trading environment, and a possible slide into inward-looking protectionism and regional blocs.

I will not go into details of the Uruguay Round at this time, but I would like to mention two issues that many Fund member countries (particularly our developing country members) are concerned about—namely, the impact of the Round on the erosion of preference margins and on the cost of food imports. The Fund staff's qualitative analysis suggests these costs are not likely to be major, at least in the aggregate. A closer look at preferences suggests that they are used most by advanced developing countries, who probably need them the least; in any case, these countries stand to lose their preferences through the "graduation" process. Regarding net food importers, the more recent studies on this aspect point to very small increases in food import prices as a result of the Round, and even these changes are spread over a number of years. While our analysis does not suggest significant global problems on these two counts, there may well be significant effects on particular sectors or on particular countries. While we do not want to be alarmists about the problems, we would neither want to appear dismissive of the concerns of developing countries. Hence in our work—and hopefully you will do the same in your own countries—we need to monitor the impact of the Uruguay Round on individual countries. We plan to do this in the context of our regular surveillance activities (through Article IV consultations).

My second theme was the trend toward regional trading arrangements (RTAs). Last year we studied this topic and found to our amazement that there are close to a hundred RTAs, excluding arrangements where preferences are nonreciprocal (i.e., one-way arrangements, such as the Generalized System of Preferences (GSP)). Some RTAs have been on the books for a long time but are not active. Many others have been reactivated, and many new ones have been established. When we think of "regional integration," our minds immediately recall the bigger, more well-known RTAs such as the European Union and the North American Free Trade Agreement (NAFTA). But there are many others, some formed between two countries, others by three, four, or more members.

Does this proliferation of RTAs mean that the world is going regional? If so, should we be worried? These are frequently asked questions, and the answer may have been less positive in the early 1990s than it is today. In the early 1990s, there was considerable concern that

a Uruguay Round agreement might not materialize and the world would divide into three blocs—one in Western Europe centered around the European Union, the second in the Western Hemisphere centered around the United States, and the third in Asia centered around Japan (although Japan is not currently a member of any RTA except for the Asia-Pacific Economic Cooperation Council (APEC)—which is not strictly a free trade area). The fear was that these three blocs would "war" with each other on the trading front. And countries not belonging to any of the three blocs (e.g., the Middle East) would be left to fend for themselves or, worse, be caught in the crossfire.

With the conclusion of the Uruguay Round, the increase in regional arrangements appears less threatening. The IMF has analyzed the growth in RTAs and has not found major shifts toward inward protectionism (the case of the European Union's Common Agricultural Policy is an exception). Indeed, RTAs have generally developed concomitantly with the growth of trade with nonmembers. This partly reflects the fact that regional liberalization has proceeded alongside unilateral liberalization (on a most-favored-nation (MFN) basis), or with GATT-sponsored multilateral liberalization, or both. For instance, RTAs have proliferated in Latin America but they were accompanied in the 1980s and the early 1990s by policies geared toward eliminating quantitative restrictions and sharp reductions in previously high tariffs, both on an MFN basis. This reduces the scope for trade diversion and inward integration behind high protectionist barriers. The economies in East Asia are integrating naturally, without much reliance on formal RTAs to bring this about.

While the evidence of the recent past suggests that RTAs have not inhibited increased world trade and global integration, one cannot afford to become complacent about regional integration. We need to continuously monitor how regionalism develops, so that the trade-creating aspects of RTAs are maximized. We have identified a list of characteristics that should be associated with "good" RTAs. These characteristics call for adherence, at a minimum, to the requirements of GATT Article XXIV—that is, RTAs should cover substantially all trade and should not increase restrictions on third countries. We would suggest that they go beyond this minimum to include other features: for example, that MFN liberalization precede or accompany new RTAs and that they have liberal rules of origin and liberal accession provisions for potential new members. Good regional arrangements are those that are a stepping stone toward more global liberalization—the ultimate goal remaining an open multilateral trading system.

The third theme I had mentioned was unilateral trade liberalization. Unilateral liberalization has been a hallmark of the reform efforts in

developing countries and in the economies in transition. This has especially been the case in Eastern Europe and in Latin America, but also to a considerable extent in Asia, Africa, and the Middle East. Some of the aspects of this trend of unilateral liberalization will be discussed in the session on the design of trade reform. There has been a remarkable sea change in developing countries' attitudes toward trade reform that appears rooted less in ideology than in pragmatism. The strategy of inward-looking protectionism, and growth based on import substitution, proved to have limits. Hence, more and more developing countries are trying the outward-oriented approach. Unfortunately, only a few industrial countries (e.g., Australia and New Zealand) have undertaken broad-based unilateral trade liberalization in recent years. Most other instances of unilateral liberalization in industrial countries have been in specific sectors or in limited areas, as most industrial countries have preferred the routes of multilateral or regional liberalization.

My fourth theme was the escalation of trade frictions. Many of the cases of trade tensions between the European Union and the United States in the late 1980s and the early 1990s were testing the ground for the eventual agricultural agreement in the Uruguay Round. The trade frictions between Japan and the United States (as well as with the European Union) were generally of a different nature, related more to market access problems stemming from competition policy issues or intangibles such as "attitudes" or "the way of doing business." Notwithstanding the escalation of disputes in the 1990s, industrial countries' resort to trade restrictions remained stable, as measured by the percentage (about 14 percent) of industrial countries' imports subject to nontariff measures. The fact that this ratio has not risen is encouraging but, of course, we would very much want it to decline.

Within the category of nontariff barriers, resort to measures such as quotas and voluntary export restraints has been declining. However, it is most discouraging that recourse to antidumping duties has been increasing. The antidumping instrument today can hardly be regarded as a defense against predatory practices, but rather as an instrument used in lieu of safeguards. Politicians have often considered that it is easier to sell liberalization domestically if there is some safety valve remaining by which to occasionally appease domestic lobbies—and antidumping has become the preferred instrument for doing so. But the risk is that the use of the antidumping weapon can get out of hand fairly quickly. Indeed, we believe such use has already grown too fast. There is a risk that developing countries will start emulating the unfortunate behavior of industrial countries in this respect. In fact, this is already occurring as many developing countries are trying to set up

their own antidumping instruments so that, as they liberalize, they have this particular mechanism ready at hand to play around with. Regrettably, the Uruguay Round lost a golden opportunity to reform antidumping rules, although it did bring about some marginal improvements. Current practices regarding antidumping are too complex and insufficiently transparent to provide reassurance that it is not simply a mechanism for old-fashioned protection.

Finally, I want to briefly touch upon the post–Uruguay Round agenda—there is a separate session on the topic in this seminar. As traditional trade barriers come down, attention is focused on new kinds of issues affecting market access. This is hardly surprising. If tariffs are reduced and quantitative restrictions are eliminated, but market access continues to be impeded, it is only fair to ask whether there are domestic (rather than border) measures that are responsible. Perhaps competition policy is not being enforced properly, or the appropriate instruments have not been developed—if so, it is possible that competition policy is effectively favoring domestic industries over foreign production. These questions are being increasingly asked as the market-access effects of domestic policies begin to be scrutinized. This is also part of the study of the so-called Japan problem. Japan has few visible border restrictions, but foreign firms experience difficulties in entering its market. Hence, the effectiveness of Japanese competition policy is increasingly being questioned by its trading partners. You will have a session on industrial countries, and some of these aspects are likely to be raised. Domestic policies toward foreign investment also influence market access. Hence, trade-related investment policies and the need for new multilateral rules on investment (particularly foreign direct investment) are also issues for the new trade agenda.

Another new issue is the interface between trade and environmental policies. The world is becoming increasingly sensitive to the need to preserve the environment—and indeed this should be a subject of utmost importance. The environment question has become linked with trade in part because some feel that trade (and growth) can cause environmental damage, in part because the trade instrument is a potentially handy sanction mechanism to enforce desirable changes in environmental policies, and in some part because it is a convenient device to cloak protectionism in the guise of environmental concerns. How the trade-environment nexus is worked out in the multilateral arena could have important repercussions on the conduct of future trade policies. Similarly, issues related to improvements in labor (social) standards, and the possible role of trade policy in this area, are being debated in the international community.

The traditional view ascribed the role of trade policy to affect resource allocation and to provide a certain level of protection to domestic producers. In practice, trade policy has been used for other purposes, too—for fiscal reasons, as a source of revenue; for balance of payments reasons, particularly by developing countries; for income distribution reasons; and periodically for strategic reasons. Today, many more motivations are emerging—competition policy, investment, labor standards, environment, human rights, and so forth. While each of these issues merits attention in its own right, it is debatable whether linking these with the use of the trade instrument is an appropriate or even sensible way to proceed. Beyond this question is whether, in a more competitive world, such multiple purposes for the trade policy instrument will not increase the risk of its abuse by protectionists.

Issues in the Design and Implementation of Trade Reforms—Experience in Developing and Transition Economies 4

Naheed Kirmani

I would like today to discuss selected issues in the design and implementation of trade reforms based on our experience with adjustment programs supported by the use of Fund resources. It would be useful at the outset to examine the recent record on adoption of trade reform measures in developing countries and in economies in transition. We surveyed 78 Fund-supported programs with 59 countries approved in 1990–93 under Stand-By Arrangements, the Extended Fund Facility (EFF), the Structural Adjustment Facility (SAF), and the Enhanced Structural Adjustment Facility (ESAF).[1] Measuring trade regimes, especially quantitative restrictions (QRs), across such a large group of countries is rather difficult. The assessment of QRs was based on the import and export coverage and the intensity of the respective QRs. The tariff regime was specified in terms of average tariff levels *inclusive* of various other duties and charges that add to the cost of imports. The tariff and QR regime was combined to provide an indication of the overall trade policy stance. Countries were ranked in terms of whether their trade regimes were relatively open, moderately restricted, or very restricted.

The survey revealed that substantial progress in trade reforms took place during 1990–93 among program countries. The trend toward reduced reliance on QRs observed in the 1980s intensified in the 1990s. 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 made in Africa, particularly where exchange system reforms eliminated QRs used for the allocation of foreign exchange. Progress on tariff reform was less rapid. Western Hemisphere countries made significant progress, as many of them adopted ambitious liberalization

[1]See Chapter II in IMF, *International Trade Policies*, Vol. II, *The Uruguay Round and Beyond, Background Papers*, World Economic and Financial Surveys (Washington, 1994).

programs to restructure and open up their economies. Although many countries in Africa, Asia, and the Middle East lowered tariffs—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 restricted." The combined (QR plus tariff) trade regime showed that at the end of 1990, 53 countries had restricted trade regimes, 5 were moderately restrictive, and only 1 had a relatively open regime. By the end of 1993, 33 countries were classified as restrictive, 22 had a moderately restrictive stance, and 4 had relatively open regimes.

The most rapid overall progress in trade reform 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. The latter countries improved their fiscal and reserve positions significantly, reduced reliance on trade taxes while containing the deterioration in current account positions, and simultaneously undertook trade reform. The group of slower trade reformers experienced some improvement in their current account position, but 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, more comprehensive reforms.

Let me now turn to design issues. We have generally found that the overall trade reform effort is best addressed in the context of a medium-term strategy with clearly established and announced immediate and medium-term objectives. This helps avoid uncertainty regarding the direction of trade policy and provides economic agents clear signals for decisions on investment and production. Adhering to preannounced targets establishes the credibility of the reform effort, which is important for its success. Furthermore, trade reform is likely to be more successful if accompanied or preceded by complementary macroeconomic measures (e.g., fiscal, exchange rate) and structural measures (e.g., exchange system liberalization, price decontrol, privatization, measures to facilitate labor mobility).

Within the trade regime, program design has given priority to eliminating QRs early in the reform process, as these are less transparent and more restrictive than tariffs. A number of countries have considered a one-step removal infeasible and have opted for a phased reduction. In such cases, care should be taken not to bunch all of the most

sensitive items toward the end of the phasing period, as this is often not credible. Targets for the phased reduction of QRs need to be precisely defined and monitorible. Fund-supported adjustment programs have often targeted a declining import-coverage ratio, or the number of product groups to be subject to QRs at each stage (the choice of an appropriate base period would be particularly important). When tariffs replace QRs, they should not exceed the tariff equivalents of the QRs and should be gradually reduced over time.

With regard to tariffs, for most developing countries and economies in transition that cannot affect the foreign currency prices of their imports, theoretical considerations call for zero tariffs across the board. In practice, however, we know that governments do not pursue the objective of pure welfare maximization, and tariffs are used for revenue, income distribution, balance of payments management, and protecting domestic industries. With the exception of the balance of payments, these objectives suggest that the theoretically optimal tariff structure should be differentiated. However, practical considerations suggest otherwise. With regard to the protection objective, the difficulties and pitfalls of targeting suggest that it is preferable to adopt the alternative approach of broader-based protection with relatively narrow differentiation among sectors. With regard to other objectives, considerations of political economy, administrative convenience, and lack of information also provide strong arguments against complex and differentiated tariff structures. In particular, if interest groups perceive that the authorities are unwilling to provide too much differentiation in protection, they may refrain from further lobbying to secure greater protection, thereby minimizing rent-seeking costs. Less complex tariff structures can be administered more easily, avoiding cumbersome paperwork and reducing the incentive to misclassify products.

These considerations have shaped the design of tariff reform in Fund-supported adjustment programs. Such reform aims for simplicity, maximum transparency, and eventually the ideal of a relatively low and uniform tariff structure. This involves moving from specific to ad valorem tariffs, amalgamating "other duties and charges" into the tariff structure, eliminating discretionary and other exemptions, reducing the number of tariff rates to a few, lowering the maximum tariff with only a few exceptions, and reducing the average tariff. In order to mitigate the antiexport bias due to high tariffs, a duty-drawback system should be implemented, whereby import duties paid on producer inputs that are physically "consumed" in export production are rebated to domestic manufacturers upon export of the goods physically embodying those imports. Unfortunately, duty-drawback

schemes in many developing countries are often administratively cumbersome and inefficient.

The extent and speed of trade reform would naturally need to take into account the initial position (degree of distortions) and be tailored to individual country circumstances. Some countries have opted for gradually phased reductions of very high tariff levels and dispersion (e.g., a number of countries in Asia), while others have managed faster reform (e.g., in Eastern Europe and Latin America). The experience of successful tariff reformers shows that it is possible within a period of 2–5 years to reduce tariff bands to 3–5, to bring high tariffs (in some cases, from triple digits) 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.

Finally, I would like to talk about two particular design issues—fiscal and exchange rate—that we have repeatedly encountered in the design of Fund-supported adjustment programs.

Fiscal considerations (namely, generating and maintaining revenues) are a major determinant in limiting the magnitude of trade reforms and the speed of their implementation. Although trade taxes are not optimal instruments to raise revenues, in practice, developing countries and economies in transition rely heavily on them. A gradual approach to tariff reform has been adopted in a number of countries where trade taxes account for a high proportion of tax revenue (e.g., Bangladesh, Sri Lanka, and Zimbabwe). Since Fund-supported adjustment programs generally target the central government budget (and trade taxes tend to accrue to the central government), revenue considerations can drive tariff policy even when trade taxes account for less than 10 percent of total tax revenues (e.g., Argentina). But the concern about the revenue impact of a tariff reform may not be well founded in all cases. A well-designed tariff reform may actually improve the import tax collection rate at the same time as statutory tariff levels come down, at least in the initial stages. This is because in many cases tax collection rates are below statutory tariffs reflecting the widespread use of exemptions; and smuggling, tax evasion, misclassification, and corruption are sometimes encouraged by very high tariffs.

Even so, there have often been conflicts between short-term fiscal objectives and medium-term trade reform goals. The lesson from our experience with Fund-supported programs is that program design needs to explicitly recognize the link between fiscal and trade policy. It is essential that tariff reform be coordinated with tax reform so that revenue effects are anticipated. Tariff reforms can be effectively imple-

mented and sustained, particularly in cases where the central government's budget is restructured early in the reform process to decrease the relative importance of trade taxes in total revenue. Thus, a clear timetable for the development of alternative domestic (nontrade) revenue sources is often needed to ensure the success of tariff reforms.

Appropriate exchange policies are essential to ensure that trade reforms are consistent with balance of payments objectives. Exchange and trade restrictions often act as substitutes. A prerequisite, or at least a complementary measure, of effective trade liberalization is the adoption of liberal exchange systems. The effectiveness of exchange rate policies is itself enhanced when complemented by the liberalization of the trade and payments regimes. Where trade restrictions are pervasive, the equilibrium exchange rate is likely to be well above its restriction-free level. Under such circumstances, trade liberalization may lead to a deterioration in the current account, as the boost to imports, including private consumer demand, is likely to be felt more rapidly than the impact on exports. In the absence of adequate reserves, a significant reduction in trade barriers would normally need to be accompanied by a devaluation to safeguard the balance of payments. Of course, if the trade reform improved confidence so as to generate capital inflows in sufficient amounts, a devaluation may not be necessary, at least for immediate balance of payments reasons. Domestic industries, however, will need time to adjust to the new realities of a major trade reform and a devaluation may still be necessary to avert future balance of payments problems. Where the initial trade restrictions are not pervasive, or trade liberalization is confined to specific input sectors, a devaluation may not be necessary provided that the improvements in competitiveness deriving from cheaper inputs are translated into higher exports quickly enough.

In countries experiencing a real exchange rate appreciation due to surges in capital inflows, or where the nominal exchange rate serves as an anchor but inflation remains higher than programmed, pressures for protection are likely to rise. Ideally, the real appreciation should be tackled with appropriate monetary and fiscal policies and not by resort to trade restrictions.

In general, using trade instruments for nontrade objectives is a second-best solution. Trade policy needs to be geared to medium-term efficiency goals. However, there may be emergencies where better alternatives are not available and deviations for short-term fiscal and balance of payments may be needed. If trade restrictions are inevitable, they should be limited and kept strictly temporary. The phased elimination of such temporary restrictions is an important element in the design of trade reform.

Demetris Papageorgiou and Michael Michaely

This paper draws on the findings of an extensive research project that we co-authored with A. Choksi, on trade liberalization experiences.[1] That research suggests criteria for successful—that is, sustained—trade liberalization policies and attempts to assess their short-term economic consequences. It assesses the potential for success of the recent wave of trade liberalization in Latin America. For Eastern Europe, the emphasis is on describing the current trade regime and outlining the necessary elements for trade reforms.

Most of this paper discusses the process of trade liberalization in Latin America, which within the last ten years has implemented profound policies to liberalize its trade regime. In this period, several countries in the region have embarked upon policies of trade liberalization unprecedented in scope and intensity in recent history. Trade liberalization was only a part of a wholesale reorientation of public policy toward a market-oriented economic environment, in the midst of macroeconomic calamity and stagnant economic growth. It was carried out by democratically elected governments with clear popular support.

In the first part, we summarize the findings of our research: What are the elements that lead to sustained trade liberalization, and what is its immediate economic impact? In the second and third parts, we discuss the evidence of the recent liberalization policies in Latin America and countries of the former Soviet Union and assess the extent to which they comply with the findings of the 1991 research. The discussion of Latin American trade liberalization is richer in empirical evidence and different in substance, than that of countries of the former Soviet Union, because the circumstances are radically different. The evidence in Latin America is confined to the unilateral trade liberalization and does not cover the several preferential trade agreements in which some Latin American countries have entered, including NAFTA, and Southern Cone Common Market (MERCOSUR).

[1]See Michael Michaely, Demetris Papageorgiou, and Armeane Choksi, *Liberalizing Foreign Trade: Lessons of Experience in the Developing World*, Vol. 7 (Oxford, England; and Cambridge, Massachusetts: Basil Blackwell, 1991). Hereinafter referred to as "the 1991 study."

Note: Throughout this paper the phrase "the former Soviet Union" is used to mean the Baltic states, Russia, and other countries of the former Soviet Union.

Successful Liberalizations and Economic Costs

Despite countries' fears that trade liberalization will have high economic costs, it has been found that adjustment costs incurred by successful trade liberalization are surprisingly small.[2]

Elements of Successful Liberalizations

The research by Papageorgiou, Choksi, and Michaely was broad in scope. It analyzed the course of liberalization in 19 countries, all of them market economies to varying degrees, during 36 distinct episodes of trade liberalization. It covered, by and large, every attempt at significant trade liberalization undertaken by developing countries from World War II until 1984, depending on the country. The results indicate that despite the complexities of the trade reform process and the differing circumstances that confronted each attempt at liberalization, the successful (sustained) programs shared common elements:

- *Momentum*. Programs that started boldly and followed through with further measures proved more durable than ones that took a more hesitant approach.
- *Reduced quantitative restrictions (QRs)*. Programs that decisively reduced or eliminated such direct interventions as import quotas generally succeeded. Those that did not generally failed. This was one of the study's clearest findings.
- *Competitive real exchange rates*. Most of the successful programs began with a depreciation of the (nominal and real) exchange rate. Thereafter, no particular trend was clearly associated with success—but most programs that lasted avoided sharp fluctuations of the real rate.
- *Prudent macroeconomic policies*. In general, the successful reformers kept their budget deficits smaller in relation to GDP than the others. In fact, reversals of trade liberalization were more commonly associated with poor macroeconomic policies than with any other factor, including the power of vested interests and short-run unemployment.
- *Proper sequencing of reforms*. Programs tended to go wrong when capital-market liberalization preceded trade liberalization.
- *Political stability*. Reforms, once introduced, were difficult to sustain against a background of unstable government.

[2]This section draws liberally from Demetris Papageorgiou, Armeane M. Choksi, and Michael Michaely, "Liberalizing Foreign Trade in Developing Countries: The Lessons of Experience" (Washington: World Bank, 1990).

One of the research's most important findings is that strong programs at the initial stage lasted longer than weak ones. Nineteen trade liberalization episodes were classified as strong and 17 as weak.[3] Five of the strong programs (26 percent) and seven of the weak ones (41 percent) were reversed. If anything, these figures understate the superiority of the strong reforms. The research defines episodes of liberalization to exclude those that collapsed within two years. If these unsuccessful cases had been included, they would have fallen overwhelmingly in the weak category. The golden rule of sustainable reform, therefore, appears to be that bold is best.

The research also found that trade liberalization programs that stay in place for six years are most likely to be sustained for many years. This could be because a six-year span normally involves a transition from one government to the next. Such transition usually presents the strongest challenge to the reforms. In addition, a new set of vested interests usually emerges from a more efficient economic environment that provides the needed political resistance to reverse the liberalization process.

Almost always, highly illiberal trade regimes use QRs extensively. Relaxing these restrictions has been the main content of sustained liberalization programs. Might other factors explain the results? For example, did the programs that included a major relaxation of QRs also cut tariffs substantially? The answer is no. Programs with radical QR reforms varied widely in their tariff reforms: sometimes tariffs were cut, other times they were raised, and in still others they were left unchanged.

The link between the depreciation of *the real exchange rate* at the implementation of trade liberalization and sustained reform seems to be strong in every case. Most of the trade liberalization episodes that were fully sustained experienced a real depreciation at the outset of the reforms. The remainder experienced no change in the real exchange rate. In no case did a fully sustained reform start with a currency appreciation. Most of the partially successful programs also began with a real depreciation, while those that failed were evenly divided between those with a rise or fall in the real exchange rate. The association is only less clear for the trend change in the real exchange rate during liberalization, and at its final stage.

The relevant role of *macroeconomic policy* in liberalization is to keep inflation low and thus maintain a real depreciation. One striking fact

[3]For details of classification, see Michaely, Papageorgiou, and Choksi, *Liberalizing Foreign Trade*.

from the research is that only a single episode of trade reform was fully sustained after being introduced alongside an expansionary fiscal policy. But the nature of fiscal and monetary policy at the beginning of trade reform does not discriminate between the partially sustained programs on the one hand and outright failures on the other.

The stance of macroeconomic policy at the end of the reform episodes seems to play a bigger role in the success or failure of reform. Sustained reform was usually accompanied by either a restrictive or neutral macroeconomic policy. If fiscal policy was expansionary and monetary policy accommodating at the end, the programs as a rule collapsed altogether or, at best, were only partially sustained. The research indicates that expansionary fiscal and monetary policies are the single most important cause of a reversal of trade reforms.

Countries have embarked on trade liberalization in a wide variety of economic circumstances. How did these differing *initial economic conditions* relate to the ultimate outcome of the reforms? At the risk of oversimplifying, initial conditions might be grouped under three broad headings: economically distressed, stable, and intermediate cases. The research findings indicate that liberalization programs that began under great economic strain tended to be strong, fast, and therefore relatively durable. The programs undertaken in more or less stable economic circumstances, and especially those that followed earlier successful episodes, also fared quite well. The in-between cases—reforms that began amid signs of economic deterioration but not a full-blown crisis—were the least likely to succeed.

Trade liberalization has usually been undertaken alongside other sorts of economic reform—*deregulation of international capital flows*, in particular. This raises the question of whether the ordering of such a package of reforms has any effect on its chances of success. The evidence from the research on this question is not as well based as the findings on trade reform proper for two main reasons. Capital market liberalization was beyond the main area of the research and few of the episodes of trade liberalization covered by it have been accompanied by capital market reforms (which were not very common until recently). The research investigated four such occurrences. This evidence is narrowly based and far from conclusive. As far as it goes, however, it supports the presumption that extensive capital market liberalization should be left until trade liberalization is well under way, but certainly should not precede trade liberalization.

Are there other factors that affect the reform not related to the design of the reform itself or to accompanying economic policies? The research investigated several such factors: economic size and income level of the countries, geographic size, and resource endowments. In

this respect one factor does stand out: *political stability*. The main criterion was political continuity, which need not mean one continuous government over a long period, or democratic or authoritarian governments.[4]

Short-Term Economic Costs

The short-term economic effects of trade reform are of great concern to governments. Trade reform will succeed only if it shifts resources from inefficient uses to new tasks. The bigger the projected long-term gains, the greater the shift will need to be. And big long-term, expected gains may require strong, bold trade reforms, with a pronounced effect on reallocation of resources. But this short-term reallocation carries economic costs and political risks.

Four major concerns are normally voiced in contemplating trade reforms: balance of payments deterioration, fall in national output, rise of unemployment, and deterioration of income distribution. The research looked in detail at these concerns and found the fears of high costs misplaced. To a surprising extent, the costs of adjustments are indicated to be very small, even in the short term.

In most liberalization episodes, countries increased their *foreign exchange reserves* in the months immediately following the start of their program. In most cases, liberalization rescued the country from falling reserves. Indeed, a rapidly worsening external position was quite often the reason why the reforms had been implemented in the first place.

In about half of the episodes, imports did increase in the months after liberalization began. Most of these involved episodes with major relaxation of QRs. Except in a few cases, the other half showed no trend, either upward or downward; in four episodes, imports actually fell.

Because imports, by and large, either showed no trend or increased, the overall improvement in balance of payments positions must have been the result of rising exports. And so it was. Taking an average of the 31 episodes for which good trade data were available, the annual growth rate of exports for the three years preceding the liberalization was 4.2 percent, while the annual growth rate for the year of liberalization and subsequent three years increased to about 11 percent in constant U.S. dollars. What may be more surprising is that the improvement in export performance was both quick enough and big

[4]The designation of a country as politically stable or unstable refers only to the period following the introduction of trade liberalization.

enough to bring about an immediate improvement in the balance of payments. The speed of reaction may partly be the outcome of speculative movements of (recorded) trade flows in response to largely anticipated devaluations.

How did *national output* fare in the short term? If anything, trade reform—especially strong reform—is associated with higher growth from the beginning. For all episodes, the average growth rate of GDP in the year preceding the reforms was 4.4 percent and the annual rate for the period including the liberalization and the three subsequent years was 5.6 percent. For the strong liberalization episodes, the corresponding rates were 3.5 percent and 5.4 percent, respectively, and for the weak episodes 5.6 percent and 5.7 percent.

On the short-term effects of liberalization *on employment*, the data suggest that they have been small. This evidence is based not on all episodes, as detailed data were not always available. Nevertheless, in most countries covered by the research, employment was not lowered even in broad individual sectors of the economy, such as manufacturing. This suggests that the reallocation of labor was achieved largely within sectors, causing less disruption than might have been feared.

It could be that the main concern of government in planning for trade liberalization is the short-term effects of the reforms on *income distribution* rather than GDP. The fear is that whatever the costs of adjustment, they will fall disproportionately on the poor. This risk would be great if the short-term costs in lost output and employment were large. But the evidence indicates that the short-term effect of liberalization on national output was strongly positive, and on employment at worst neutral.

The evidence on the precise effect of liberalization on income distribution is mixed and fragmentary. It leaves the issue open. There is no solid evidence that low-income groups gain particular benefits from liberalization (beyond sharing in the aggregate benefits). Equally, there is no support for the popular view that reform is bound to make the poor worse off.

Recent Liberalizations in Latin America

The recent wave of trade liberalization in Latin America began in 1985 with Bolivia and Mexico, followed by Uruguay in 1987, Argentina and Venezuela in 1989; and by Brazil, Ecuador, and Peru in 1990 (see Table 1). Several other countries in Latin America have also undertaken trade liberalization (Costa Rica in 1986, Guatemala in 1986, Honduras in 1990, Jamaica in 1985, Panama in 1991, Paraguay in 1989, and Trinidad and Tobago in 1985) but their reform process has been slow

Table 1. Recent Episodes of Trade Liberalization in Latin America

Argentina	(July 1989–April 1991)
Bolivia	(August 1985–February 1990)
Brazil	(July 1990–July 1994)
Colombia	(September 1989–December 1991)
Ecuador	(May 1990–August 1992)
Mexico	(July 1985–December 1989)
Peru	(August 1990–August 1991)
Uruguay	(July 1987–April 1992)
Venezuela	(February 1989–July 1991)

Source: Asad Alam, "Country Trade Profiles: Latin America and the Caribbean" (mimeograph; Washington: World Bank, 1992).

Note: Dates in parentheses indicate the period of the liberalization, defined to cover the enactment of all major trade reforms.

and uncertain. Furthermore, lack of comprehensive data for these countries makes it difficult to include their liberalization experiences in this overview of recent liberalization policies in Latin America.

Of the nine countries covered in this study, five (Argentina, Brazil, Colombia, Peru, and Uruguay) had attempted to liberalize their foreign trade in the 1960s and 1970s. The liberalization policy in Argentina, Brazil, and Peru collapsed altogether, in Colombia, it was partially reversed, and in Uruguay, it was sustained. For the other four (Bolivia, Ecuador, Mexico, and Venezuela), it was their first serious and persistent attempt to liberalize trade and reverse protectionist policies.

Although historical judgment may not yet be rendered, the several years that have passed since the implementation of these liberalizations do make it possible to observe a pattern of development. Could this pattern have been predicted by the inferences of the 1991 study?

A common thread that runs across most of these liberalizations is the economic circumstances under which they were implemented. All but Colombia and Venezuela faced severe macroeconomic problems. And in all but Colombia liberalization was one of several structural changes, in addition to macroeconomic stabilization.[5] Indeed, trade liberalization was an integral part of the governments' policies in Latin America for reducing their role in the economy, privatizing extensively public assets, and stabilizing their economies.

[5]For example, deregulation of internal market, privatization, and liberalization of the financial system.

Table 2. Policy Elements of Trade Liberalization

	Major Relaxation of Quantitative Restrictions?	Major Reduction of Tariffs?	Depreciation[1]	Sustained?
Argentina	Yes	Yes	No	Yes
Bolivia	Yes	Yes	Yes	Yes
Brazil	Yes	Yes	No	Yes
Colombia	Yes	Yes	Yes	Yes
Ecuador	Yes	Yes	No	Yes
Mexico	Yes	Yes	Yes	Yes
Peru	Yes	Yes	Yes	Yes
Uruguay	No[2]	Yes	Yes	Yes
Venezuela	Yes	Yes	Yes	Partially

Source: Asad Alam, "Country Trade Profiles: Latin America and the Caribbean" (mimeograph; Washington: World Bank, 1992).

[1]Indicates the direction of real effective exchange rate upon the implementation of trade liberalization.

[2]Uruguay had eliminated all quantitative restrictions in earlier liberalization.

The focus, in reviewing the evidence from these trade reforms, is whether they appear to be sustainable in light of the findings of the 1991 research. We shall first examine evidence pertaining to the design of successful liberalizations, then evidence on short-term economic effects.

Design of Trade Liberalization

One of the strongest findings of the research by Papageorgiou, Choksi, and Michaely was that bold, strong trade liberalization at the initial stage of the reform was strongly associated with its success. How, then, do these nine reformers compare with those identified in that study?

Table 2 describes the policy elements that were involved. In all cases but one, major reduction in QRs were implemented along with substantial reduction in the level and dispersion of *tariff rates*. Table 3 provides a comparison of tariff structures before and at the end of liberalization. The contrast in these structures is remarkable. For example, Bolivia's tariff range went from zero to 100 percent before the liberalization to only two tariff rates of 5 and 10 percent. Ecuador's tariff range went from zero to 338 percent before the liberalization to a range from zero to 20 percent following the liberalization. Even one of the milder users of these reforms, Venezuela, went from a tariff ranging from zero to 135 percent before the liberalization to one ranging from

Table 3. Tariff Structure Before and After Liberalization

	Before Liberalization	After Liberalization
Argentina	Tariff range from zero to 55 percent. Import surcharges 15 percent. Export taxes on some goods.	Three tariff rates: zero, 11, and 22 percent. Most export taxes abolished.
Bolivia	Complex system of tariff rates with exemption and high dispersion. Tariff range from zero to 100 percent.	Two tariff rates: 5 percent and 10 percent.
Brazil	Tariff range from zero to 105 percent.	Tariff range from zero to 35 percent with only nine tariff positions.
Colombia	Tariff range from zero to 200 percent.	Tariff range from zero to 40 percent. But 99.5 percent of tariff positions are within the range of zero to 20 percent.
Ecuador	Tariff range from zero to 338 percent. Prior deposits requirement surcharge.	Tariff range from zero to 20 percent.
Mexico	Tariff range from zero to 100 percent. Use of reference prices	Tariff range from zero to 20 percent.
Peru	Tariff range from zero to 84 percent. Some export taxes.	Two tariff rates: 15 percent and 25 percent. Eighty-two percent of tariff items fall under the 15 percent rate.
Uruguay	Five-tier tariff structure ranging from 10 to 55 percent. Additional taxes on exports. Reference prices.	Three-tier tariff structure of 10 percent, 15 percent, and 20 percent.
Venezuela	Tariff range from zero to 135 percent.	Tariff range from zero to 50 percent.

Source: Asad Alam, "Country Trade Profiles: Latin America and the Caribbean" (mimeograph; Washington: World Bank, 1992).

zero to 50 percent by 1991. Equally remarkable, these reforms were implemented in a very short time—mostly less than four years, and in some instances within two years (Argentina, Bolivia, and Peru).

How did these reforms treat *quantitative restrictions*? The 1991 study established a close association between sustained liberalization and drastic reduction in QRs at the initial stage of the reforms. Indeed, in that study strong liberalization and reduction in QRs were almost syn-

Table 4. The Evaluation of Quantitative Restrictions

	Before Liberalization	After Liberalization
Argentina	Extensive quantitive restrictions (QRs). Import licensing covering 42 percent of local production.	Quantitative restriction covering about 2 percent of manufacturing (primarily the car industry).
Bolivia	Extensive coverage with QRs.	No QRs.
Brazil	Extensive import licensing. Foreign exchange allocation controls. Reservation of Brazilian markets for local production for several products.	Most of the QRs have been eliminated. Some remain for official purchases.
Colombia	Import prohibition. Import licensing (together they covered 99 percent of tariff positions).	Import licensing for 1 percent of tariff positions.
Ecuador	Extensive import controls. Prohibition list for 9.5 percent of local production, import licensing, permit requirement.	Substantial reduction in QRs.
Mexico	Extensive use of import licensing covering 90 percent of tradable production. Export controls covering 25 percent of tradable production.	Import licenses reduced to about 20 percent of tradable production. Export controls reduced to 18 percent of tradable production.
Peru	Preferential regimes. QRs for 10 percent of tariff position. The importation of 10 percent of tariff items was prohibited.	No QRs.
Uruguay	No QRs.	No QRs.
Venezuela	The importation of goods falling under 45 percent of import positions was prohibited (11 percent), required import licensing (29 percent), or required health certification (5 percent).	The importation of goods falling under 18 percent of tariff positions was prohibited (5 percent), required prior licensing (5 percent), or required health certification (8 percent).

Source: Asad Alam, "Country Trade Profiles: Latin America and the Caribbean" (mimeograph; Washington: World Bank, 1992).

onymous. Table 4 summarizes the initial conditions with QRs and what was left of them at the end of the liberalization. All countries, with the exception of Uruguay, which had removed all QRs in its ear-

lier liberalization in the 1970s, had in place a complex system of QRs, such as import licensing, foreign exchange allocations, negative import lists, and outright import prohibitions. By the end of the reforms, four countries (Bolivia, Brazil, Ecuador, and Peru) had virtually no QRs or any other nontariff barrier left in their books. In Argentina, about 2 percent of local manufacturing is protected by QRs, mainly the car industry. In Ecuador, only 1 percent of tariff positions is subject to import licensing. Even in Mexico, which retained QRs covering 20 percent of local tradable production, the QRs apply primarily to the oil industry, which is an export activity. Among the eight countries that had extensive QRs before they began liberalizing, Venezuela appears to have retained the highest level of QRs; restrictions still apply to 18 percent of the import positions.

The evidence on the intensity of the reforms and of the substantial reduction in QRs would indicate, on the strength of the earlier research, that chances are good that these trade reforms will succeed. So far they have indeed been sustained, with the sole exception of the partial reversal in Venezuela.

The behavior of the *real effective exchange rate* (REER) at the time trade liberalization is introduced and at the end of the liberalization is presented in Table 5. The earlier study indicated a strong association between a depreciation of the REER at the introduction of liberalization and success of the liberalization. The same is true about a depreciation toward the end of a liberalization episode. The evidence from the nine episodes is mixed. At the initial stage, six countries experienced a depreciation of the REER: Bolivia, Colombia, Mexico, Peru, Uruguay, and Venezuela; in three—Bolivia, Mexico, and Venezuela—the depreciation was strong (more than 15 percent). Three countries, Argentina, Brazil, and Ecuador, saw an appreciation of their REER; it was strong in Argentina, small and temporary in Brazil, and small in Ecuador.

The trend of the REER during the liberalization was mixed. Argentina's, for example, continued to appreciate and, by the end of the liberalization, had appreciated considerably more than it had on average in the three years before liberalization. Bolivia's REER continued to depreciate with some fluctuations, and at the end of the episode it depreciated in relation to the period prior to the trade liberalization. Brazil's REER depreciated over the liberalization with sharp fluctuations, but at the end it remained at about the same level as it had been in the three years preceding the reforms. In general, three countries saw their REER appreciate during the liberalization period (Argentina, Ecuador, and Peru); three continued to depreciate; two indicated no trend one way or another; and Mexico's REER for the first half of the

Table 5. Behavior of Real Effective Exchange Rate During Trade Liberalization

	When Trade Liberalization Was Introduced[1]	During Trade Liberalization[2]	Long-Run Comparison[3]
Argentina	Appreciation +	Appreciation/ Fluctuation	More appreciated
Bolivia	Depreciation +	Depreciation	More depreciated
Brazil	Appreciation	Depreciation/ Fluctuation	No change
Colombia	Depreciation	Depreciation	More depreciated
Ecuador	Appreciation	Appreciation	More depreciated
Mexico	Depreciation +	Fluctuation; no-trend	More depreciated
Peru	Depreciation	Appreciation	More appreciated
Uruguay	Depreciation	Fluctuation; no trend	No change
Venezuela	Depreciation +	Small appreciation	More depreciated

Source: IMF.

[1]Indicates the immediate impact on REER of the trade liberalization. The + sign indicates a sharp appreciation or depreciation change.

[2]Describes the behavior of the REER during the entire liberalization period.

[3]Compares the prevailing long-run level of REER before and after the introduction of trade liberalization.

liberalization period continued to depreciate substantially but reversed its course in the second half and began to appreciate quickly.

At the end of the liberalization, Argentina and Peru had an REER that was more appreciated than the average REER for the three years prior to liberalization. Bolivia, Colombia, Ecuador, Mexico, and Venezuela had a more depreciated REER, while Brazil, and Uruguay saw no change.

This evidence suggests that the behavior of the REER in these countries did not provide effective support to the liberalization. A strong and sustained depreciation would have provided a strong impetus to the tradable sector and exports in particular and restrained the rapid growth of imports.

The earlier research indicated that expansionary *fiscal and monetary policies* are the single most important cause of a reversal of trade reforms. Judging from the course of the rate of inflation during the reforms, several countries have done a remarkable job in controlling fis-

cal and monetary policies. Argentina, Bolivia, Mexico, Peru, and Venezuela substantially reduced their inflation rate during the reforms. Ecuador and Brazil were unable to reduce it. The difference between the two, however, was that Ecuador's inflation remained at the annual level of between 45 percent and 50 percent, while Brazil's remained at the level of hyperinflation. Colombia experienced a minor increase while Uruguay, unable to insulate itself from Argentina's and Brazil's inflation, experienced a dramatic doubling of their rate of inflation (to 100 percent). Looking at inflation rates beyond the liberalization period, it appears that Argentina, Bolivia, possibly Brazil, Colombia, Mexico (until recently), Peru, and Uruguay have managed to rein in inflation, an indication that fiscal and monetary policies have been working. Venezuela has been slipping behind on this front.

Exchange rate policies radically changed with the introduction of trade reforms and the liberalization of capital markets. All economies unified their exchange rate. Argentina fixed the nominal rate while all others had a "flexible" nominal exchange rate.[6] In all countries individuals and businesses are permitted to buy and sell foreign exchange.

The need for stabilization was paramount for all of these countries. So was the need for structural reforms. With the exception of Colombia, and to a lesser extent Bolivia and Ecuador, structural reforms meant considerable change in the role of the public sector, in addition to trade liberalization, financial liberalization, extensive deregulation, and privatization of public assets. Argentina, Brazil, Mexico, Peru, and Venezuela did just that. The stabilization policy involved tightening monetary policy and very high real rates of interest. The combined effect of high interest rates on the one hand and the privatization of public assets, including public utilities, on the other brought in substantial and sustained capital inflows. As capital markets were liberalized along with the liberalization of merchandise trade, capital inflows caused the REER to depreciate less, or appreciate more, than it would have done in their absence.

The *initial conditions* of the economy when the countries embarked on the liberalization can be described as total collapse. Table 6 summarizes the trade regime and the macroeconomic situation at the outset of the reforms. All the trade reforms began under great economic distress, demanding (and enabling) strong and fast programs. In addition to a highly protective trade regime, most of them (with the exception of Colombia and Venezuela) had an annual rate of inflation ex-

[6]Flexible in the sense that it fluctuated; central bank involvement was evident in each country with flexible rates.

Table 6. Policy Environment on the Eve of Trade Liberalization

	Trade Related			Macroeconomic	
	QR Coverage	Tariff Rates[1]	Export Policies	Foreign Exchange	Inflation[2]
Argentina	Extensive	High/ dispersed	Subsidies/ taxes	Multiple rates/ controls	Hyper
Boliva	Extensive	High/ dispersed	Subsidies/ restrictions	Controls	Hyper
Brazil	Extensive	High/ dispersed	Subsidies	Controls	Hyper
Colombia	Extensive	High/ dispersed	Restrictions/ free trade zones	Controls	Moderate
Ecuador	Extensive	High/ dispersed	None	Multiple rates/ controls	High
Mexico	Extensive	High/ dispersed	Subsidies/ restrictions	Multiple rates	High
Peru	Extensive		Subsidies/ restrictions	Multiple rates/ controls	Hyper
Uruguay	None		None	Floating rate/ no controls	High
Venezuela	Extensive	High/ dispersed	Subsidies	Multiple rates/ controls	Moderate

[1]High-tariff countries are those where the top rate is in excess of 50 percent including surcharges. Tariff dispersion in all these countries was more than 50 percentage points (the difference between the lowest and highest tariff rates).

[2]"Hyper" indicates annual rates of inflation in excess of 1,000 percent; "high" indicates annual rates of inflation above 40 percent but less than 100 percent; "moderate" indicates annual rates of inflation between 20 percent and 40 percent.

ceeding 40 percent. Four countries had inflation rates in excess of 1,000 percent (Argentina, Bolivia, Brazil, and Peru); three others had lower, but still very high, inflation rates (Ecuador, Mexico, and Uruguay). The governments had no other choice but to embark on a program of reform that was both strong and decisive and therefore credible.

Concerning the sequencing of *trade and capital market liberalization*, all of the countries introduced trade reforms before or at the same time as capital liberalization. Bolivia, Peru, Uruguay, and Venezuela appeared to have introduced the liberalization of these two markets at the same time, while Argentina, Brazil, Colombia, and Ecuador staggered the reforms. This pattern partly agrees with the presumption that capital market liberalization should wait until trade reforms are undertaken.

An important element of these liberalization episodes is the political environment which they were implemented. With the sole exception of Venezuela, where several riots and two failed military coups d'état followed the reforms, the reforms were fully supported by the public. They were undertaken by elected governments, and several of them have withstood the task of transition from one government to the next (Brazil, Bolivia, Colombia, Mexico, and Uruguay). The test of political transition is an important predictor of the long-term success of the reforms; Venezuela is the only case that has failed to pass the test.

Short-Term Economic Costs

Two important aspects of the short-term economic effects of liberalization, balance of payments, and national output are addressed here. Tables 7 and 8 indicate the performance of exports and imports before, during, and after liberalization. The evidence from the individual countries indicates that in six countries (Argentina, Bolivia, Ecuador, Peru, Uruguay, and Venezuela) the growth rate of exports following liberalization was higher on average than before the reforms were introduced. In Colombia, the growth of exports was higher after liberalization only if the year of liberalization is included. On the import side, seven countries showed stronger import growth on average after liberalization than before (Argentina, Bolivia, Colombia, Ecuador, Mexico, Peru, and Venezuela). Brazil had higher growth rates for imports following liberalization if the year of liberalization is included, and Uruguay had lower import growth after liberalization. On average for all episodes, exports grew by 4.3 percent annually in the three years prior to liberalization, while the growth rate jumped to 7.0 percent following liberalization. Equally important, the growth rate of exports went from 2.4 percent in the year before liberalization to 7.4 percent in the year of liberalization.

The change in the performance of imports after liberalization was even more dramatic. It went from –1.5 percent before liberalization to growth rates ranging from 13 percent to about 14.5 percent annually after liberalization.

Looking at trade flows in a different way (Table 8), we see the result is different when trade performance is weighted by each country's exports and imports. Actual annual average exports after liberalization increased by 3.8 percent, including the year of liberalization, while prior to liberalization they grew annually at a rate of 7.4 percent. The corresponding figures for imports are 3.0 percent and –4.9 percent, respectively.

Obviously, imports grew more rapidly than exports, although this has not yet generated trade deficits. The rapid increase of imports is

Table 7. Trade Performance

(Percentage change in trade flows in 1987 U.S. dollars)

			Three Years Prior to Liberalization			Year of Trade Liberalization	Three Years After Liberalization				
		T_1[1]	–3	–2	–1		+1	+2	+3	T_2[1]	T_3
Argentina (S)[2]	Exports	–3.3	–15.0	–12.1	17.1	26.4	–4.0	0.6	2.0	6.2	–0.5
	Imports	4.4	22.6	11.8	–21.2	–10.1	–18.2	69.9	75.8	39.3	55.8
Bolivia (S)	Exports	–3.3	–1.1	–6.1	–2.8	–10.0	17.5	3.8	12.6	6.0	11.3
	Imports	–18.0	–44.0	10.7	–20.7	65.7	–11.8	8.5	–30.8	7.9	–11.4
Brazil (S)	Exports	11.5	14.5	17.3	2.8	–7.7	4.9	12.9	. . .[3]	3.4	8.9
	Imports	4.6	–8.0	–7.1	28.8	13.6	7.4	–1.2	. . .	6.6	3.1
Colombia (M)	Exports	17.5	31.5	24.5	–4.3	39.9	13.4	15.6	13.2	20.5	14.1
	Imports	–0.3	–13.3	–1.5	13.9	–2.6	16.4	–7.1	50.3	14.2	19.9
Ecuador (S)	Exports	1.0	–17.3	29.0	–8.8	–1.8	20.0	0.2	. . .	6.1	10.1
	Imports	–4.2	–4.6	–15.5	7.4	–10.3	31.1	4.6	. . .	8.5	17.8
Mexico (S)	Exports	15.8	12.7	25.7	9.1	–5.8	4.0	–12.9	–10.5	–6.3	–6.5
	Imports	–9.2	–37.9	–26.4	36.8	13.8	15.5	–23.3	1.4	1.8	–2.1
Peru (S)	Exports	3.5	5.6	4.6	0.4	25.2	17.6	5.2	. . .	16.0	11.4
	Imports	–7.0	21.2	–5.0	–37.1	22.6	9.6	26.1	. . .	19.4	17.8
Uruguay (S)	Exports	3.2	–10.7	–2.7	22.9	–5.9	10.0	7.3	7.9	4.8	8.4
	Imports	13.0	10.8	–5.7	33.9	11.6	–1.9	1.8	4.0	3.9	1.3
Venezuela (S)	Exports	–7.0	–6.5	0.3	–14.7	6.0	15.4	8.3	–4.9	6.2	6.3
	Imports	3.1	–7.5	4.1	12.8	–22.8	5.8	54.9	24.3	15.5	28.3
Total	Exports	4.3	1.5	9.0	2.4	7.4	11.0	4.6	3.4	7.0	7.1
	Imports	–1.5	–6.7	–3.8	6.1	7.9	6.0	19.4	27.8	13.0	14.5

Source: World Bank, *World Tables* (Washington,1994).

[1] T_1 is the average annual change in trade flows for the three years prior to the year of trade liberalization; T_2 is the average annual change in trade flows for the year of liberalization and the subsequent three years; T_3 is the average annual change for the three years immediately after the year in which trade liberalization was introduced.

[2] (S) indicates strong liberalization, and (M) moderate liberalization.

[3] Data for these countries for these years are not available on a comparable basis.

Table 8. Performance of Trade Flows Before and After Liberalization[1]

(Percentage change weighted by 1987 U.S. dollars)

		Three Years Prior to Liberalization			Year of Trade	Two Years After Liberalization		
	T_1[2]	3	2	1	Liberalization	1	2	T_2
Exports	7.4	5.9	13.5	2.7	1.2	6.5	3.7	3.8
Imports	–4.9	–21.3	–10.1	16.7	4.8	–1.4	5.7	3.0

Source: World Bank, *World Tables* (Washington, 1994).

[1]The trade flows of Brazil, Ecuador, and Peru for the third postliberalization year are excluded because comparative data are not available.

[2]T_1 is the annual average growth rate for the three years prior to liberalization. T_2 is the annual average growth rate for the three years following liberalization and the year of liberalization.

explained mostly by the extent of the liberalization, the dismal performance of imports (and production) prior to liberalization, and the presence of capital inflows.

The evidence also indicates that the liberalization period coincides with an acceleration of the growth rate *of the GDP,* if the year of liberalization is not included. For the nine countries combined, the average GDP declines during the year trade reforms were introduced (–0.9 percent). Six countries (Argentina, Bolivia, Brazil, Mexico, Peru, and Venezuela) had negative GDP rates of growth in the year trade reforms were introduced. Undoubtedly, the decline in GDP is associated with the strong stabilization packages that these six countries introduced at the same time as trade reforms. The growth rate of GDP of all nine countries accelerates in each subsequent year following the year of liberalization.

Obviously, then, liberalization is not associated with lower economic growth. If anything, these trade reforms, being strong and fast, are associated with higher growth, supporting the findings of the 1991 study. Unfortunately, the lack of data precludes a more systematic study of the liberalization on employment and income distribution. Even if relevant data on employment and income distribution were available, it would have been difficult to sort out their relation to liberalization from the effects of the stabilization policies and other structural reforms.

Compatibility with the Earlier Experience

Based on the experience of liberalization episodes of the postwar era, what may we conclude about the sustainability of the recent re-

forms in Latin America? Could the Latin American countries have designed the liberalization of their trade regimes substantially better? Would a different approach to trade liberalization have been preferable, in the sense that it would increase its chance to be sustained and reduce the economic costs of transition?

Recognizing that the implementation of trade reforms varied widely from one country to another, the evidence reviewed here, nevertheless, points to some general observations common to all nine liberalizations. It strongly suggests that the design of the trade reforms themselves was good, consistent with what earlier inferences have indicated as the attributes of sustainable liberalization. The only uncertainty for their future success lies outside the confines of trade liberalization, in the interplay of stabilization and the ensuing appreciation of the REER.

All these reforms were strong, with immediate implementation, imparting credibility and determination. From the outset, they decisively reduced quantitative restrictions, which the 1991 study had found to be the most important predictor of success. All eight countries with QRs sharply reduced or eliminated them.

On the real effective exchange rate the evidence is less clear, but nevertheless, six of the nine liberalizations began with depreciation of the REER (Bolivia, Colombia, Mexico, Peru, Uruguay, and Venezuela); three of these countries experienced strong depreciations (Bolivia, Mexico, and Venezuela). At the end of liberalization, five countries had their REER depreciated in comparison with the start of liberalization (Bolivia, Colombia, Ecuador, Mexico, and Venezuela), two saw it appreciate (Argentina and Peru), and the other two (Brazil and Uruguay) saw no change.

The REER is not a policy instrument. Among other factors, it reflects overall trends in macroeconomic policy. Several countries have been able in the long term to either reduce inflation substantially (Argentina, Bolivia, Mexico, and Peru) or keep it under control, at modest levels (Ecuador, Colombia, and Uruguay). The success of these countries in stabilizing their economies may well prove to be the critical element for the success not only of the trade reforms but of the entire package of economic restructuring as well.

Failure or success in getting inflation under control permanently will affect the viability of the financial institutions and political stability. The combined influence of stabilization and structural reforms has placed significant stress on the banking system. Argentina, Brazil, Mexico, Peru, and Venezuela have experienced different degrees of difficulties with their banking system. Only time can tell whether they will be able to manage this challenge effectively.

Failure to control macroeconomic policy, and therefore inflation, may affect the will and determination of the governments to maintain their current policies. So far, there has been no major opposition to trade reforms, except in Venezuela. In all other eight countries, trade reform has been supported by the public and most of the political parties. In this respect, it is encouraging that all nine countries have agreed to participate in the multilateral trade agreement of the Uruguay Round and have indicated strong interest in participating in a free trade agreement in the Western Hemisphere.

The 1991 research found that trade reforms that remain in place for six years or more are almost certain to be sustained indefinitely. On that basis, Bolivia, Mexico, and Uruguay seem to be on a safe path. Not only have their liberalizations lasted more than six years, but they have withstood the test of governmental change as well. For Argentina, Brazil, Colombia, Ecuador, and Peru, the prospects are encouraging. Argentina and Peru will soon join Brazil and Colombia, in having new governments and the chance to test the resilience of the trade reforms. Venezuela is the only country in which the liberalization remains uncertain. Not surprisingly, Venezuela is a case of liberalization that has *not* started with a situation of economic collapse. Hence, public support for the policy was shaky from the inception of liberalization. The policy did not go as far for the rest of the countries,[7] and the new government appears to be much less committed to the trade reforms than its predecessor.

In conclusion, the recent reformers in Latin America have met fully four of the conditions found necessary for a sustained trade liberalization by the 1991 research: strong initial steps toward liberalization, substantial reduction in QRs, initial economic conditions that required strong reforms, and political stability in the sense that there was continuous broad political support for these reforms. Some of the liberalizations have also passed the test of time and have survived political transition.

The 1991 study underlined the importance of depreciation of the REER at the start of the liberalization and at the end of it. We saw that six countries began their liberalization with depreciation, and two ended it with appreciation of the REER. The 1991 research found in particular that no country's liberalization survived while the REER was appreciating at the end of the reform. The REER tended to appreciate *beyond* the period of liberalization in all countries except Bolivia. The major factors for this sustained appreciation appear to be the im-

[7]But it was nonetheless strong and swift.

mediate opening of capital markets, the structural reforms, and the stabilization efforts of these countries. In the 1991 research, only 4 liberalization episodes, out of 36 examined, experienced the liberalization of capital markets at the same time or soon after trade reforms were introduced. There were few observations to base a thorough assessment of the effects of substantial inflows on the tradable sector, and the impact of substantial reductions of such flows on foreign reserves and macroeconomic policy. Nevertheless, the available evidence indicated a negative effect of capital inflows on the tradable sector and, when these inflows were substantially reduced or reversed, a negative impact on foreign reserves and on the fate of liberalization.

The recent events in Mexico would probably shed some light, in the near future, about the probability of repetition of this pattern. If similar developments in capital flows were to occur in these countries, it would be difficult to tell whether the governments will manage to withstand their consequences, as Chile succeeded in doing in the early 1980s, or succumb to the pressures, as Argentina did at the same time, and witness a collapse of the reforms. It is difficult to foretell the outcome partly because the nature of inflows is substantially different now than in the 1970s, involving to a large extent private capital and direct foreign investments, and partly because the current political climate is undoubtedly in favor of trade liberalization, unlike in the earlier times.

Speculating further, it could be the case that these trade reforms were so strong that by the time large capital inflows were recorded the economic restructuring was well under way, so that it did not have an adverse effect on the tradable sector. Partial evidence consistent with this argument is that the growth rate of exports and of GDP increased by the same order of magnitude in the postliberalization period.

Furthermore, the collective experience of these countries with the prevailing policies prior to these reforms, which inflicted severe economic costs, may have persuaded policymakers and the people at large that deregulation and trade liberalization is the way to go, notwithstanding the probable transition costs and events that in the past would have led to a severe setback.

Trade Regime in the Former Soviet Union

This section will be quite different from its predecessors. It would be inappropriate to expect the pattern of trade liberalization in Russia, the Baltic countries, and other countries of the former Soviet Union, which was part of an overall change of the economic regime, to share much with the liberalizations in Latin America. What we will do here is pre-

sent the basic elements of the emerging trade regime and pose the question of what would be the essential ingredients of further liberalization. The former Soviet Union (this applies, to a large extent, also to the former eastern block outside the Soviet Union—the members of the former Council for Mutual Economic Assistance (CMEA)) has gone through a dramatic shift in its conduct of international transactions, just as it has in other facets of economic life. Whether to refer to this change as "trade liberalization" is an open question. If liberalization is to be judged by the prevalence of instruments of government intervention in trade as they are practiced in a market economy, then the former Soviet Union has undergone a process contrary to liberalization. If, on the other hand, liberalization is understood—as we think it should be—as a process that brings relative prices closer to what they would be without government interference, and in which prices replace nonprice instruments of interference, then a substantial liberalization has indeed taken place—its degree varying from one republic to another.

Prior to the disintegration of the Soviet Union and the start of the process of change toward market economies—from the end of 1990 through early 1991—"international" trade of the present independent states was, in fact, predominantly *domestic* trade: About 80 percent, on average, of total trade among the states and between them and the outside world consisted of interrepublic trade. Of the other 20 percent, a high proportion consisted of trade with other CMEA countries, which shared some important attributes with interrepublic trade. This trade had none of the attributes of foreign trade. It required no means of payments other than the local currency; it was financed through the same banking system; and it involved no government barriers to trade—being, in this sense, completely "free." But, like any other (i.e., intrarepublic) trade in the Soviet Union, interrepublic trade was not guided by any market mechanism, nor did it follow the guidelines of comparative advantage. Location of economic activity, as well as trade relations of each enterprise—whether within the state or outside it—was fully determined by commands of the planning machinery. Any relationship between these production and trade patterns and what a market would have established was, then, purely coincidental.[8]

The shift (still partial, mostly) to a market mechanism has led to at least *some* approximation of what the pattern of trade would be in a free market. But state intervention is still heavy and strongly discrim-

[8]Aside, of course, from a few important instances related to the physical availability of natural resources: oil, for instance, was, and is, inevitably produced (but not necessarily refined) where it is found in the ground.

inates against tradables, probably even more than in the high-protection market economies prior to their liberalization. Unlike in the market economies (Argentina prior to 1990 may have been a partial exception), the instruments of intervention in trade of the Baltics, Russia and other countries of the former Soviet Union are related to *exports* rather than to imports. Most of the latter are formally free of either tariffs or nontariff barriers; whereas exports are subject to heavy restrictions in almost all of the states, both through export taxes (which may take the form of forced sale of the foreign exchange proceeds at a low exchange rate) and through the prevalent requirement for licensing.[9]

The discouragement of exports derives from a variety of sources—most of them unique to the Baltics, Russia, and other countries of the former Soviet Union, either because of the starting attributes of the regime or because common forces have been influencing these countries. To start with, a major problem facing producers, both before and after the disintegration of the Union, has been the *scarcity of inputs*: it is of prime importance for an enterprise to ensure the availability of its essential inputs. This leads to the restriction of exports (of machinery and, mostly, intermediate inputs—although to some extent also of certain consumer goods) and to an increase in their availability at home. True, overall availability would have increased with the purchase of imports provided for by exports, but this is beyond the concern of the agencies involved.

A contributing factor has been the frequent maintenance of *domestic* low prices for exportable goods. In such a system, combined often with a high real depreciation—as will be discussed shortly—it becomes highly profitable to buy locally and resell in the export market. The licensing is then intended either to prevent the exports—for the reasons mentioned before—or to assign the (often huge) rent involved in exports to the parties that the government deems worthy. With these price differentials, it should be noted that the prevention of exports may indeed often be welfare enhancing (the benefit of exportables in domestic use exceeding the price received from export sales); but short, of course, of changing the price system altogether, export *taxes* rather than licensing should on all counts be the preferred instrument.

Raising tax revenues is, indeed, another common motivation for export restrictions. This is done both through a straightforward tax or, often, through the enforcement of the sale of (part of or all) export proceeds to the government at an exchange rate substantially below a

[9]This form of discrimination against tradables has, indeed, been an apt representation of Abba Lerner's famous "symmetry theorem."

"market," or "free" level of the rate (say, the rate at which free imports are financed). The motivation for the latter instrument—the forced sale—is often somewhat different: the government does not believe that export proceeds would otherwise be offered in the foreign exchange market, and be accessible to the government (which demands it as an importer and payer of foreign debt). In other words, assuming that the government cannot in effect buy sufficient foreign exchange at the free rate, the saving perceived by the government is much higher than the observed difference between the free rate and the "penalty" rate paid to exporters.

Until quite recently, when all the countries of the former Soviet Union (except the Baltics) were part of a ruble area, a particular motivation existed to discourage *interrepublic* exports. By exporting to another state, the country in question would be paid in rubles, but it could produce rubles itself (though not *cash* rubles, Russia excluded) with no real costs, so that the export would amount to a complete waste. It is only when Russia started constraining this possibility that the motivation disappeared for the peripheral republics; but it still exists today for Russia itself.

As noted, a substantial real depreciation has been a common feature; the Baltics have been the major exception, as was Russia for most of 1993–94. This depreciation results partly from the trade regime itself, with its heavy restrictions on exports (thus leading to a vicious circle—a higher real devaluation strengthening still further the motivation for export restriction). But other factors have been crucial. These are, first, a heavy asset demand for foreign exchange, liquid foreign assets being almost the only available instrument to hedge against inflation. In most countries of the former Soviet Union, a dramatic deterioration of the terms of trade has been another source. This resulted predominantly from the change of the oil price in interrepublic trade: the price increased from a small fraction of the world price level to something close to that level—a change that benefited primarily Russia, at the expense of the other states.

The level of the foreign exchange rate has been a major suppressant of imports (this is the way export restriction turns into import restriction). Since import barriers were absent at the start of the process, and no demand for added protection (to that effected through the exchange rate) was forthcoming, imports have mostly remained free of specific barriers. Not surprisingly, the exception to this rule has been the Baltic countries, primarily Estonia and Latvia, in which real *appreciation* has taken place. In these two countries, a gradually increasing demand for protection against imports has been provoked. It has led, indeed, to both tariff and nontariff barriers, primarily against imports

of agricultural produce. By now, these barriers have become a source of major distortions in these economies. In this sense, they have moved away from trade liberalization.

What would constitute "trade liberalization" in the countries of the former Soviet Union? Once more, such liberalization is of little meaning if not given within a more general context. That is, trade liberalization makes sense only as part of an overall change in the price system and the application of the price mechanism. Otherwise, it is neither feasible nor even necessarily desirable.

Assuming that prices in general are predominately determined by a market mechanism, and are close to their equilibrium levels, trade liberalization would consist predominantly of the following measures:

(1) Removing barriers on exports—barriers imposed now through licensing, taxes, compulsory sale of foreign exchange proceeds and (indirectly) compulsory sales of exportable goods to prescribed enterprises.

(2) Establishing foreign exchange markets. Nominal trade liberalization would create a system far removed from that of a "free trade" system in the absence of well—functioning foreign exchange markets (whether within a fixed-rate or a floating-rate regime), in which most of the export proceeds are sold and most of the financing needed for imports is acquired.

(3) The third main trade liberalization measure is negative: refraining from imposing barriers on imports. The absence of such barriers at present is not of much significance, given the high (universal) protection provided by the high real exchange rate in most of the countries of the former Soviet Union. If, on the other hand, imports remain free when the exchange rate assumes some "normal" level and the protection granted through it disappears, this would indeed be a true measure of maintaining a free trade system.

Finally, the circumstances that seem necessary for introducing liberalization and implementing its major components, would also be those that are likely to grant sustainability to trade liberalization. First and foremost, changes in the trade regime must be part of a *comprehensive* economic liberalization: without an overall freeing of prices, so that they approach equilibrium market levels, trade liberalization will neither progress nor endure (nor, again, should it necessarily be desirable). An overall stabilization would be essential just as in normal market economies, so would be a well-functioning market for foreign exchange, which would imply, in turn, a reasonably functioning financial system. But freeing foreign capital markets, on the other hand, does not seem a priori to be essential for sustaining trade liberalization (experience does not have much to tell us yet about this issue).

5 Trade Policy Reforms: The Indian Experience

*Tejendra Khanna**

India embarked on a comprehensive economic reform program in mid-1991. The external trade sector became the focus for substantive liberalization from the very beginning of the reform process. As a result, substantial progress has been achieved in this sector during the last three and a half years. This paper, which appraises this period, is divided into three sections. The first provides the background against which the reforms were initiated. The second deals with the major policy initiatives and an appraisal of their impact. The third is devoted to the issues and policy dilemmas faced in designing and implementing the trade policy reform package.

Brief Evaluation of the Prereform Strategies

For over forty years in the postindependence period India pursued a strategy of economic development oriented toward import substitution and self-reliance. Strongly influenced by the socialist ideology, the Industrial Policy Resolution adopted in the early 1950s stipulated that the commanding heights of the economy should be under public ownership and control. Major sectors of manufacturing, such as steel, heavy-engineering facilities, earthmoving equipment, process plants, aircraft, ships, telecommunications and power facilities, basic chemicals and smelting of nonferrous ores, were reserved for the public sector. Even in areas open to the private sector, the establishment of new production capacities was tightly controlled through an elaborate system of industrial licensing covering medium and large undertakings and a system of registration covering small units. Before such capacities were allowed to be created, an overall demand-supply assessment was undertaken within the framework of a centralized planning apparatus. In sectors where a clear supply gap had emerged, there was often a race among competing private entrepreneurs to secure the required industrial-licensing approval. Obtaining a license itself was perceived as a major achievement. At times, with a view to preventing

* Secretary to the Government of India, Ministry of Commerce, New Delhi.

others from entering the same field of production, an existing manufacturer would sponsor another party to get some capacity allocated, not with the intention of implementing the project but for blocking another person from doing so. As a result, several quasi-monopolies were created, wherein concerns about quality, productivity, cost control, and efficiency were relegated to lower levels of priority. In some cases, the desire to allocate the available incremental production capacity among a larger number of applicants would result in the licensing of suboptimal-sized units that could not, ipso facto, enjoy the economies of scale.

Securing a letter of intent for establishing a new manufacturing unit was, however, only the beginning of a series of other approvals that had to be laboriously pursued by the entrepreneur. Proposals for importing technology or foreign investment had to go before an Interministerial Foreign Investment Board. Questions regarding reasonableness of technical license fees, royalties, and other forms of capital repatriation had to be answered. Applications for the import of capital goods and other raw materials and components had to go before a separate Licensing Committee in the Office of the Chief Controller of Imports and Exports (CCIE). While considering such applications, the CCIE would seek the technical opinion of the Directorate General of Technical Development (DGTD) as to whether the items proposed could not be sourced from within the country itself. Besides, in the case of capital goods and instruments, a trade notice had to be published in the Indian Trade Journal by the party seeking the import permission, and a period of 45 days had to be given to indigenous suppliers who might wish to offer their equipment to meet the entrepreneur's needs. The entrepreneur had also to engage in technical discussion with the DGTD officials to convince the latter that the item sought to be imported had special technical features that could not be matched by domestically produced substitutes, if any.

Yet another factor to be considered at the time of granting an industrial license was whether the entrepreneur either belonged to a "monopoly house" or was already enjoying a monopoly position in the domestic market, such terms being defined in the "Monopolies and Restrictive Trade Practices Act." If a market leader wanted to expand its production base, permission could be refused on the grounds that creation of a near monopoly would amount to an excessive concentration of economic power, which had to be prevented. Such refusals forced some Indian companies to venture overseas and, unintentionally, started the process of "globalization," involving the setting up of overseas production bases by them.

Once the Indian entrepreneur had surmounted hurdles of industrial licensing, import licensing, and rigorous foreign exchange controls, it

had the opportunity to function under conditions of relatively low competitive pressure from within and little fear of competition from imports, keeping in view the existence of both quantitative restrictions on import (QRs) as well as high levels of import tariff, which in some cases could be as high as 300 percent. Naturally, as mentioned earlier, considerations of design, quality, cost efficiency, and productivity were at a discount within the production and distribution system.

Since the macroeconomic policy regime created an economy that was expensive and often inefficient, export promotion was sought to be achieved through microlevel strategies. This obviously meant identifying products that, according to the government's perception, should be promoted and designing a mix of incentives geared to that objective. The incentive mix, broadly consisted of fiscal incentives, incentives through import policy, and concessional export finance.

Postreforms Scenario

When reforms were launched in July 1991, the first two sectors that received attention were those of industrial licensing and import policy. In the case of industrial licensing, formal licensing requirements were given up for all industries except some that were retained on the licensing list for special considerations of sensitivity and environmental safety. In the case of import controls, the policy decision was taken that the import of all production inputs, as distinct from finished consumer goods, should be liberalized. Capital goods, intermediates, components, and industrial raw materials were almost entirely thrown open for import at the option of the manufacturer himself or by the trade, for stock and sale. The underlying logic was that if the Indian industry was to come of age and build up competitive production capability, it should be allowed access to the best capital equipment, instrumentation, and raw materials and components without having to knock on the doors of the import-licensing authorities. The broad area of consumer goods was, however, restricted on balance of payments considerations under Article XVIII of the General Agreement on Tariffs and Trade (GATT). The elaborate listing of items in different lists such as "Banned," "Negative," "Limited Permissible," and "Canalized" was pruned drastically.

During the period of elaborate import controls, exporters used to be permitted to obtain some inputs related to their export products under a system of "Replenishment Licenses." Over 100 pages in the Import-Export Policy Book used to be devoted to the listing of various export products along with associated "shopping lists" of items that could be imported under the replenishment license granted to exporters. Lifting

import controls on production inputs in the second half of 1991 made the system of replenishment licenses redundant.

As regards dismantling of the high import-tariff regime, in the first budget of the present government in July 1991, the peak import tariff rate was brought down from over 300 percent to 150 percent. In the regular budget for fiscal year 1992/93 presented in February 1992, the peak rate was reduced to 110 percent and in the subsequent budget of 1993/94 presented in February 1993, it was reduced to 85 percent. In the budget for fiscal year 1994/95 presented in February 1994, the peak rate was further brought down to 65 percent. The average tariff collection rate for all imports that stood at 47 percent in 1990/91 came down to 44 percent in 1992/93, 37 percent in 1993/94, and 30 percent in 1994/95. An Expert Committee on Tariff Rationalization appointed by the government has recently suggested that the peak tariff rate be lowered further to about 25 percent within the next two years or so. As a result of the steep drop in the level of tariff protection, India has more than met its tariff reduction commitments in the context of the Uruguay Round of Multilateral Trade Negotiations much in advance of the six-year transition period provided for achieving the targeted tariff reduction. In some items, which may still be attracting higher import tariffs, the necessary reduction would be made well within the permissible period.

Even before the reform process was initiated, it was clear to many observers that the export-incentive system as had been practiced was no longer feasible because of the fiscal burden it had been causing. Export subsidy for the Cash Compensatory Support in conjunction with the food and fertilizer subsidy had accounted for a substantial portion of the total budget deficits of the Government of India.

Since the total incidence of all export incentives was estimated to be around 20 percent, it could be argued that devaluing the external value of the rupee by the same order of magnitude would maintain the export price competitiveness at the same level. In addition, since the reform process also involved a paradigm shift from an administrative microlevel policy regime to a generalized market driven policy frame, the importance of the exchange rate as a determinant of trade flows would have to increase in the postreform period.

Practical feasibility of using the exchange rate as a determinant of trade flows depended upon to what extent the rupee, which was a nonconvertible currency and whose external value was strictly monitored, could be allowed to find its own level and whether and in what time frame convertibility could be introduced. It was clear in the beginning that trade policy reforms would have to look at the totality of the policy package, namely, quantitative and administrative controls

on imports and exports, the tariff structure, and controls on foreign exchange, in addition to the initial devaluation of the rupee to take care of the existing overvaluation and allowing it to float within the market parameters. The government adopted an incremental approach with respect to all these issues. First, the rupee was devalued in two stages: on July 1, and on July 3, 1991, by about 18–20 percent against major currencies. Immediately after the devaluation, trade policy changes were introduced. One major change was the abolition of the Cash Compensatory Support and introduction of partial convertibility of the rupee.

Prior to reforms, all foreign exchange earnings were to be compulsorily surrendered to the Reserve Bank of India. What was allowed in the initial phase of liberalization was that exporters would have to surrender 40 percent to the Reserve Bank at the official rate while the residual 60 percent could be sold at the market-determined rate. Although many feared that the rupee would crash in the market-determined segment, it showed remarkable strength after an initial dip. This emboldened the government to proceed toward "full convertibility" on the trade account. The logic was twofold: first, the dual rate was in fact a tax on exports, as exporters would have to sell 40 percent of their foreign exchange earnings at the official rate, which was 10–15 percent lower than the market rate. Second, full convertibility on the trade account would be the next step forward in deregulating the external sector of the Indian economy. Accordingly, the rupee's dual exchange rate system was abolished and a unified exchange rate system was introduced in the budget for 1993/94. Since then, the rupee has remained stable against major currencies.

In order to give a fillip to export production, the system of issue of advance duty-free licenses to facilitate such production using imported inputs of raw materials and intermediates has been strengthened. In addition, the Export Promotion Capital Goods Scheme was introduced to reduce the capital cost by allowing the import of capital goods at a concessional duty of 15 percent, subject to the assumption of some export obligations.

Prior to the launching of reforms, the negative list of exports consisted of five categories, namely, prohibited list, licensable list, ceiling list, canalized list, and the conditional list. The number of items under these heads has now been reduced to less than fifty under three heads: prohibited list, licensable list, and the canalized list. Export controls have been lifted from nearly 90 percent of the items that had been restricted. Simplifying trade documentation and introducing electronic trading concepts have also been receiving sustained attention.

Evaluation Framework and Record

The achievements of the reforms process vis-à-vis the trade regime can be evaluated prima facie by considering (1) to what extent quantitative controls on India's imports have been reduced; (2) what level of import tariff reduction has been achieved; and (3) to what extent policy stability and transparency in the system have been introduced.

The record with respect to the first has been fairly impressive. Using the proportion of imports subject to licensing, it is found that the proportion has declined from 52.6 percent in 1989–90 to only 33.8 percent in 1992–93 and to 30.2 percent in 1993–94. There has also been a corresponding decline in the number of import licenses issued. While during 1989–90, 116,094 import licenses were issued, the number dropped to only 41,000 during 1993–94. Further, to the extent of almost 95 percent, these licenses have been issued for duty-free or concessional duty imports having export linkages.

As mentioned earlier, the only substantial remaining area of import controls covers the sector of consumer goods. Even in this regard, significant import liberalization has recently been permitted through the Special Import License route, which is granted to Export Houses and Trading Houses, and so on, by way of an indirect incentive. Practically all textile items in addition to several consumer durables can be imported against such licenses.

The liberalized export-import policies will have maximum impact only when two conditions are satisfied: first, that there has to be long-term stability in the policy and, second, that there should be transparency, including procedural simplicity. To achieve the first condition, a five-year Export-Import Policy was announced for the period 1992–97. As regards procedural simplification, the ongoing efforts that have yielded positive results have to be assiduously maintained for some years to come.

The impact of the trade policy reforms on exports appears to be substantial. The first year of the postreform period could achieve an export growth rate of only 3.8 percent in nominal dollar terms, which was conditioned by several adverse factors, including the steep fall in India's exports under the Rupee Payment Arrangements to the former Soviet Union. In the second year, 1993–94, the rate of export growth substantially increased to over 20 percent in nominal U.S. dollar terms. The rate exceeded what even the major Southeast Asian countries could achieve. While it is true that a part of this growth was due to the low base, as well as the availability of exportable surplus of several items due to sluggish domestic demand, there is no doubt that this definitely represented a break from the trend rate of growth. The rate of

growth in exports in the current fiscal year during April 1994–January 1995 has been a little over 17 percent in dollar terms.

Specific Issues in Designing and Implementing Trade Policies

The Indian experience reveals that while designing and implementing trade policy reforms it was crucial to design collateral policies pertaining to tariffs and exchange rates, to restructure the institutional mechanism related to the administration of export-import policies, and to put in place an antidumping machinery to prevent disruption of domestic production due to dumped imports under the lower tariff regime. It became necessary to devise measures to accelerate export growth in the absence of sector-specific strategy and assistance, decide on the pace of removal of QRs and the optimal timeframe for opening up the previously protected industrial sector, bring about attitudinal change in the bureaucracy at the cutting edge, and effectively communicate the logic, rationale, and irreversibility of the trade reforms to domestic trade and industry.

It is not that all these issues cropped up simultaneously or even transparently. Often the issues and concerns surfaced as reactions to specific policy initiatives. For instance, the reduction in import duties on capital goods and removal of quantitative restrictions generated a reaction from the concerned domestic sector. Consequently, to create a "level playing field," a concessional duty on imports of inputs and reduction in the level of ex-factory excise duty was made.

While implementing the reforms to liberalize trade, a large number of import-licensing lists were abolished in April 1992. With the large-scale decanalization of imports and exports necessitated by freeing of trade, there was a need to restructure the existing institutional framework for trade; for instance, the Office of Chief Controller of Imports and Exports had to be restructured as the Office of the Director General of Foreign Trade with a focus on trade-promotion activities. The traditional role of state trading organizations, such as the State Trading Corporation (STC) and the Minerals and Metals Trading Corporation (MMTC), was curtailed due to decanalization and had to be reoriented with a greater thrust on export promotion. Competitiveness became the crucial factor in deciding on the success and profitability of these state trading agencies, and export activity became more relevant than imports. The focus also shifted from canalized to noncanalized items of trade besides requiring organizational restructuring. To make a trim and efficient structure, a Voluntary Retirement Scheme (VRS) was introduced to reduce the staff by approximately 25 percent. A study was

undertaken to work out the organizational restructuring of the state trading organizations with a view to simplifying and making transparent their role and working methods.

With the increased potential for agro-exports in the post-Uruguay period, special measures had to be designed in trade policy to give an advantage to agricultural exports. A new scheme for encouraging export-oriented units (EOUs) for agricultural products had to be introduced with a limited export obligation of 50 percent. Similarly, in an effort to give special support to services exports, a new scheme for encouraging service exports and permitting them the import of capital goods at concessional duty was introduced in the Export-Import Policy update in 1994.

With the liberalization of the import regime and acceleration of export efforts, the volume and rate of growth in the external sector has brought into focus physical infrastructure constraints relating to power, transport, and communications. Constraints on government budgetary resources and the compulsion to reduce public expenditure to reduce the fiscal deficit have necessitated the entry of private capital for infrastructure development. Policy changes have been put in place to privatize the setting up of export-processing zones, container freight stations, inland container depots, and air cargo complexes through a system of approvals by an Interministerial Committee. In addition, power and telecommunications sectors have also been thrown open to private capital as an enabling mechanism for fostering infrastructure development.

The policy change permitting the waiver of compulsory export inspection by the official statutory Export Inspection Agency (EIA) and the option to have an independent inspection arrangement as settled between the buyer and seller has reduced the role and revenue of the agency. With its role rendered partially redundant, special measures were required to redefine the role of the EIA. A supplementary role will hereafter be given to EIA, such as inspection, to ensure adherence to special quality requirements as per the health and safety standards of the importing country, such as in the case of marine products and for the investigation of specific quality complaints received from buyers. The role of EIA is being redefined accordingly and a special Voluntary Retirement Scheme has been introduced to handle the staff redundancy resulting from a reduced role for the EIA.

Given the federal structure of the country and the allocation of the subjects between the center and the states, special issues have been encountered in encouraging participation by the state governments in the national export effort. With subjects like agriculture and land reform falling directly within the purview of state governments, special

schemes have been devised toward the strategic removal of bottlenecks in the states. As land reform is a state rather than a union subject, efforts to increase the area under production of tea, spices, and cashew for export have implications involving land legislation at the state level.

The prevailing indirect tax structure with Octrol, sales tax, and other state levies tend to reduce the competitiveness of exports owing to the incidence of multiple taxation. Withdrawal of state levies would reduce the revenues of the state governments and restrict their capital resources for development. Hence, to ensure requisite support for the export sector, special compensation schemes will have to be devised to ensure that export performance is not negatively affected owing to the incidence of nonrebatable local taxes.

Elimination of subsidies as an instrument of trade reforms required abolition of budget support interest subsidy on export credit. The financing cost of high-interest export credit in India vis-à-vis the lower interest costs of competitor countries have obviously affected the cost competitiveness of Indian exports. New schemes for providing export finance at internationally comparable interest rates have had to be designed. Nonsubsidy schemes were introduced to permit rediscounting of export bills and to provide dollar-denominated postshipment and preshipment credit, thus reducing the incidence of interest rate differential on export costs.

The unfinished agenda of trade policy reforms in India will have to address such questions as completing the shift from QRs to a tariff-based regime and providing greater market access in services and financial sectors. The negative list of imports and exports would have to be limited to items that need to be restricted for reasons of environment and safety. In the post-Uruguay period, access to markets, especially in the area of financial services, will also need to be expanded. As the economy becomes more stable and as the external environment improves it would be possible to achieve full convertibility on the capital account as well. Likewise, regional and multilateral trade issues having a bearing on India's global trade performance will need to be addressed. The impact of regional groupings like the European Union, North American Free Trade Agreement, Asia-Pacific Economic Cooperation Council, Association of South East Asian Nations, and so forth, on multilateral arrangements in the context of the rule-based World Trade Organization with special reference to market access for India's export products will need to be evaluated to position India effectively in the global trading environment. New issues arising from environmental concerns relating to trade and the question of the linkage between trade and labor standards will have to be appropriately addressed.

6 Role of Trade Policy in Poland's Transition to a Market Economy

Paul Mylonas

The topic of my presentation is the role of trade policy in Poland's transition to a market economy. I will begin with a brief description of the economic situation existing in Poland just prior to the comprehensive stabilization and reform program of 1990 (the much debated "shock" or "big-bang" approach) and then delve briefly into the broad economic strategy that the Polish government introduced to address these initial conditions. Most of my presentation will describe the trade reform that formed an integral part of the initial "shock" program as well as the subsequent trade liberalization introduced through trade agreements with Poland's largest and geographically nearest trading partners. The last segment of my presentation will assess some aspects of the successes and failures of the reform program. I will conclude with some lessons that may be drawn from Poland's experience and hopefully have some time for questions.

But let me give a hint at them from the beginning. The case of Poland supports the basic tenet of free trade—that is, that free trade will improve a country's growth prospects—and indicates that transition economies are not unique and do not require different advice regarding trade reform. The main debate some five years ago was on the sequencing of structural reform, including trade reform, relative to the stabilization of the macroeconomy. Poland, as well as other cases since then, have indicated that this debate may be mostly a distraction and that countries should quickly introduce the most liberal and transparent trade regime that can be supported by macroeconomic conditions, with a clear timetable for future liberalization of the trade accounts. If the liberalization proves too ambitious, it can always be quite quickly adjusted at a later stage.

With this road map, let me begin. Prior to the 1990 reform, Poland had a nonmarket economy characterized by a dominant state sector, where state enterprises faced neither internal nor external competition, and where relative prices were highly distorted due to price subsidies and controls, all of which led to shortages. Production was concentrated in heavy industry and geared toward import substitution. The trade structure reflected the economy's heavy reliance on the Soviet market both for exports—mostly low-value-added and capital-

intensive manufactured goods—and for imports of raw materials, especially oil and gas at below-market prices.

In addition to what one could call "typical" problems of a centrally planned economy, Poland's initial prereform situation was characterized by a very high level of external debt, both to official bilateral and commercial creditors; a constraint that would require any liberalization program to create a sufficiently strong external position capable of servicing at least a small share of this debt (i.e., the amounts due after debt restructuring). The Polish situation was atypical in two other sociopolitical respects—the role of farmers and workers. First, agriculture was nominally controlled by the private sector prior to the reform, as most of the arable land was privately owned (78 percent). Initially, farmers achieved large windfall gains after the liberalization of food prices in late 1989. As these were subsequently reversed, farmers were left disgruntled and felt that they had not benefited from the reform process. Second, Poland had an especially influential workforce, which was due to the origin of Poland's socialist opposition in the trade union Solidarity, which later became a political force in Parliament. This strong position of labor has consistently produced strong pressure on wages and reduced the scope for privatization.

On top of these structural problems, when the new Polish government took office in September 1989, hyperinflation had emerged, beginning with the freeing of food prices in August 1989 and subsequently fueled by the large adjustments to administrative prices, wage developments that were out of control, and a government budget (which had deteriorated by some 8 percent of GDP during 1989).

In view of the severity of the economic problems, the need to establish credibility, and the window of opportunity provided by the political capital that the new government had—recall that it was the first democratically elected government of Poland in the postwar period—Poland opted for a radical strategy whereby structural reform was not postponed until after the achievement of macroeconomic stabilization but was introduced concurrently; of course, this did not mean introducing all structural reforms at once, but implementing those that could be done immediately.

Besides the more conventional heterodox stabilization program, which included using the nominal exchange rate and a tax-based incomes policy as nominal anchors, the Polish strategy envisaged the freeing of virtually all remaining prices, the liberalization of the trade and payments system, the breaking up of state monopolies (especially in retailing, food processing, and trading), exposing enterprises to financial discipline by eliminating subsidies and allowing bankruptcies to take place, reforming the tax system, undertaking far-reaching re-

form of the financial system, moving toward competitive labor markets, and privatizing many state enterprises. The program also introduced social safety nets (mainly through the form of unemployment compensation and welfare programs).

Within the overall strategy, the reform of the trade and payments system played a major, and basically twofold, role: first, by importing foreign prices to provide efficiency guideposts to the transforming economy—and thus eliminating relative price distortions, and thereafter to provide competition to domestic producers by combatting domestic monopolies. Over the longer run, the shift to an outwardly oriented strategy was geared to promoting growth, including through export promotion, in the hope that it would generate resources to service at least a component of the external debt, as Poland was not likely to have access to spontaneous private market financing until it concluded a debt-restructuring agreement with its commercial creditors.

The trade reform process began in 1990 when Poland abolished the state monopoly and administrative management of foreign trade, and the trade system was largely liberalized and made transparent, with customs duties becoming the main trade policy instrument. Most nontariff restrictions were eliminated (January 1990), and customs duties were suspended on 4,500 import items (June 1990)—with the average applied tariff being only 5.5 percent (see Table 1).

At the same time, the exchange system was liberalized and the exchange rate set to a competitive level. The multiple exchange rates were unified in January 1990, and many restrictions on the availability of foreign exchange were eliminated during 1990–91. Most important, the parallel market was legalized in March 1989, with residents being allowed to transact freely in this so-called kantor market where the exchange rate is determined flexibly by market conditions, resulting de facto in full currency convertibility for this segment of the market.

In 1991, the trade liberalization strategy had to be revised to support the budget and the balance of payments. The former had been weakened by the unexpectedly large drop in recorded output and the consequent decline in the traditional mainstay of the revenue base, taxes on state enterprises. At the same time, transfer payments increased rapidly as the social safety net had been put into place. Not unlike other countries where broad-based domestic taxes had not yet been put in to place, Poland resorted to raising fiscal revenues by taxing external trade. The external accounts had weakened because of the collapse of trade within the former Council for Mutual Economic Assistance (CMEA). First, from January 1, 1991, trade was undertaken at world market prices and settled in hard currencies. The price shock resulted in a deterioration in Poland's interregional terms of trade of about 30 percent in 1991, with

Table 1. Evolution of Customs Tariff Structure[1]

Harmonized Commodity Description and Coding System (HCDDCS)	January 1989	August 1990 to August 1991	August 1991	December 1993[2]
All commodities	**18.3**	**5.5**	**18.4**	**19.0**
Agricultural products	17.2	4.0	26.2	26.2
Industrial products	18.7	. . .	16.3	17.0
Mineral products	7.8	3.4	8.9	9.9
Chemical products	13.5	3.9	14.1	13.7
Plastics	19.9	5.5	15.0	14.9
Fur and leather products	17.2	5.1	25.7	23.5
Wood and paper products	18.7	7.4	13.4	13.4
Textiles, footwear, clothing	22.2	9.7	20.6	21.4
Industrial mineral and metal products	15.4	4.2	14.7	17.6
Machinery, transport equipment, precision instruments	21.9	3.9	16.1	16.6
Jewelry, arms, art objects, miscellaneous manufactured products	19.9	11.6	19.1	17.0

Sources: Organization for Economic Cooperation and Development; and Polish authorities.
[1]Based on average frequency, including suspended tariffs and tariffs on duty-free tariff quotas.
[2]December 1993 estimates are based on the classification of Combined Nomenclature of the European Union.

the price of critical petroleum imports from the Baltic countries, Russia, and other countries of the former Soviet Union estimated to have increased 118 percent. Second, the decline in trade was subsequently magnified as Poland's CMEA partners implemented parallel reform efforts. Though Poland was fortunate to have been the CMEA country with the smallest concentration of trade to the former CMEA—accounting for about a third of its total trade in 1989—trade with the CMEA countries (convertible and transferable ruble exports plus imports) fell precipitously and accounted for below 10 percent of total trade in 1994, with Russia accounting for over half of this remainder.

To compensate for these two unforseen factors—the fiscal difficulties and the weakening of the external sector, the tariff suspension was withdrawn in August 1991—and the average unweighted most-favored-nation (MFN) tariff rose to 18.4 percent (13 percent on a 1991 trade-weighted basis)—and was followed by the implementation of an across-the-board 6 percent import surcharge in December 1992, from which only alcoholic beverages, tobacco products, fuels, and automobiles were exempted.

The liberalization of Poland's trade system was not unilateral. Poland was fortunate in that the European Union (EU), to assist the transformation process, improved access to its markets. Previously, Polish export products faced the many restrictions that the EU applied to countries that it classified to be state-trading companies. In September 1989, a bilateral trade and cooperation agreement eliminated many nontariff barriers and granted MFN status. A few months later, in January 1990, most countries granted the more favorable Generalized System of Preferences (GSP) treatment for some goods. In December 1991, the EC opened further its markets to Poland, when Association Agreements with Poland, Hungary, and Czechoslovakia were signed. These agreements aim to establish free trade areas within a ten-year period and progressive economic integration with the EU through a wide range of economic and financial reforms (e.g., regarding the movement of capital and labor, the rules of competition, and the harmonization of economic and financial laws to community legislation).

The agreement contains provisions for immediate and progressive trade liberalization that are asymmetric in nature; the agreed trade liberalization would be introduced over five years by the EU and over seven years by Poland. From March, 1992, most tariff and all quantitative restrictions imposed by the EU on industrial goods (except cars) were eliminated, resulting in immediate free trade for about 50 percent of Polish exports and for about 70 percent of Polish industrial products by the end of 1994. Trade in so-called special products (cars, chemicals, furniture products, and cement) and textiles, coal, and steel, and agricultural products are covered by special protocols that provide liberalization over a longer period.[1] In addition, the Association Agreement contains safeguard provisions, which permit the implementation of protectionist measures in several cases; for example, infant industries, industries undergoing restructuring, and industries facing important social problems and requiring compensation for anticompetitive practices or subsidies. Furthermore, antidumping actions are permitted in accordance with the GATT articles.

In June 1983, in response to criticism of the remaining restrictive aspects of its Association Agreements with the Czech Republic, Hun-

[1]For textiles and clothing, duties will be phased out over six years and quotas dismantled before 1998. For steel and coal, duties will be eliminated over five years and QRs immediately for steel and after one year for coal. For agriculture, the liberalization process is more opaque. Some products are excluded from the agreement altogether (e.g., cereals). For others, levy reductions of 30–100 percent will be phased over five years, and QRs will be progressively increased by 10–20 percent a year from the initial (often low) base over five years.

gary, Poland, and Slovakia—especially the reproach that under the agreement the EU is opening access most slowly to markets in which the Central European Free Trade Association (CEFTA) countries have the highest export potential—the European Council at its Copenhagen meeting decided unilaterally to accelerate the implementation of the Association Agreements both for industrial and agricultural goods. As a result, all tariffs on industrial goods were eliminated as of January 1, 1995 (with the exception of textiles and steel products). At the time of the Copenhagen meeting, the EU explicitly accepted that the ultimate objective of the Association Agreements was these countries' accession to the EU.

The main Polish exports facing EU barriers following the implementation of the agreement, according to the Polish authorities, are agricultural products, with the main constraints being minimum prices and variable levies. However, the alleged frequent resort to, and the future potential reliance on, the safeguard clauses and antidumping action are also considered as barriers to trade expansion as well as a deterrent to foreign direct investment (chemicals, steel products, and cement). The recent trade statistics have not indicated that exports in sensitive areas—especially for industrial products—have grown significantly less rapidly than the nonsensitive exports. The main exceptions appear to be the coal, chemical, and agricultural sectors—where the slower growth may also be explained by excess supply in the EU. Finally, the Association Agreement could also impede foreign direct investment through its "rules-of-origin" clause. It requires that at least 60 percent of the value of a product be created in Poland for it to be eligible for the favorable treatment permitted under the agreement.

Similar agreements were concluded between Poland and the European Free Trade Association (EFTA) and with Czechoslovakia and Hungary. The agreement with EFTA parallels in many ways the EC Association Agreement; there is an asymmetric implementation of liberalization and the agreement contains safeguard clauses similar to those in the EU agreement. It could, however, be considered more liberal overall than the EC agreement as tariffs and QRs are eliminated for a larger group of industrial goods (except textiles and metallurgical products, mainly steel) and fish products have completely free trade. The CEFTA is also similar but involves symmetric trade liberalization, with the liberalization of trade in "sensitive" products (textiles, steel, and agriculture) undertaken over eight years and in "normal" goods over three to four years.

Poland is about to conclude the ratification of the GATT agreement of the Uruguay Round, and it will become effective on July 1, 1995

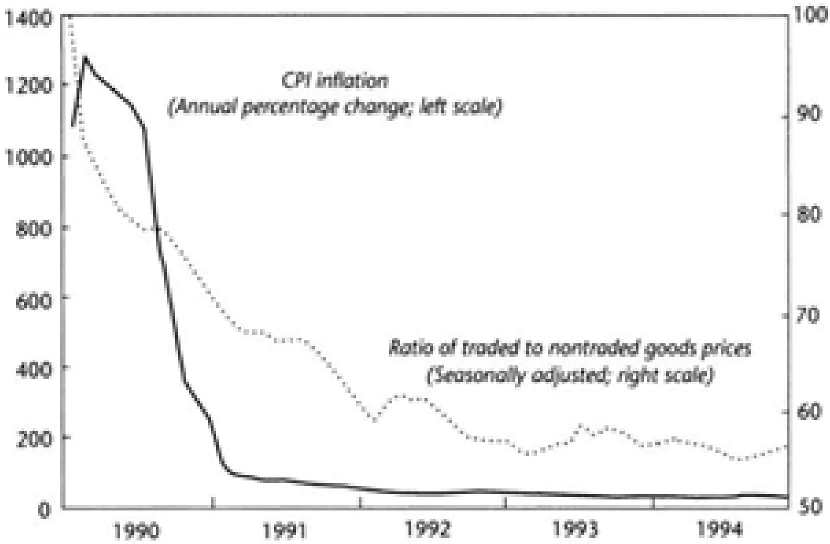
with Poland's accession to the World Trade Organization (WTO). Poland is also continuing to negotiate a reaccession protocol with the GATT. It has presented to the GATT a tariff schedule that it would be prepared to bind; the major remaining stumbling block to the conclusion of the negotiations is apparently the bilateral negotiations with two major industrial countries. The implementation of the Uruguay Round will have both positive and negative effects on Polish trade in the short run; on the positive side of the ledger, are the potential liberalization of trade in agriculture and textiles and the more stringent guidelines for the use of antidumping actions; on the negative side, is the reduction in the Multifiber Arrangement (MFA) tariffs on non-EU members, which will erode Poland's margin of preference obtained from the Association Agreement.

In contrast to the move by the EU to open access further to their markets at the time of the Copenhagen meeting, Poland introduced a somewhat more protective trade regime, especially toward agriculture. Poland raised the effective level of protection in July 1993 by (1) revising the tariff structure, resulting in lower duties on imported raw materials and semifinished products and higher ones on finished products and those products produced in Poland, and (2) increasing recourse to preferential (low or duty-free) tariff quotas for inputs. In June 1994, the government introduced variable import levies on several agricultural products, which, however, will be replaced with tariffs on July 1, 1995 as part of the Uruguay agreement. Such protectionism reflects Poland's political environment, in which the agricultural lobby has significant pull, the Poles' mimicking the methods developed to protect agriculture in the industrial countries of the world, and the Poles' belief that they need bargaining chips in future negotiations; in sum, they are behaving like most other industrial countries in protecting their agriculture.

Assessment of Reform Strategy on Trade

Has the "big-bang" reform program been a success in Poland? Without a doubt, the answer is yes. Inflation has fallen from an annual rate of over 600 percent in 1989, to below 30 percent in 1994 (Figure 1), growth has recovered quickly after dropping some 20 percent in the first two years of the program, and the recovery is in its third year with real GDP growth conservatively estimated at 6 percent in 1994. The critical role of the tradable sector is indicated by the growth of industrial production, which can be considered a crude proxy for the production of tradables (Figure 2), and the similarly astonishing growth in exports. Convertible currency trade (the sum of exports and imports)

Figure 1. Inflation and Traded and Nontraded Goods Prices



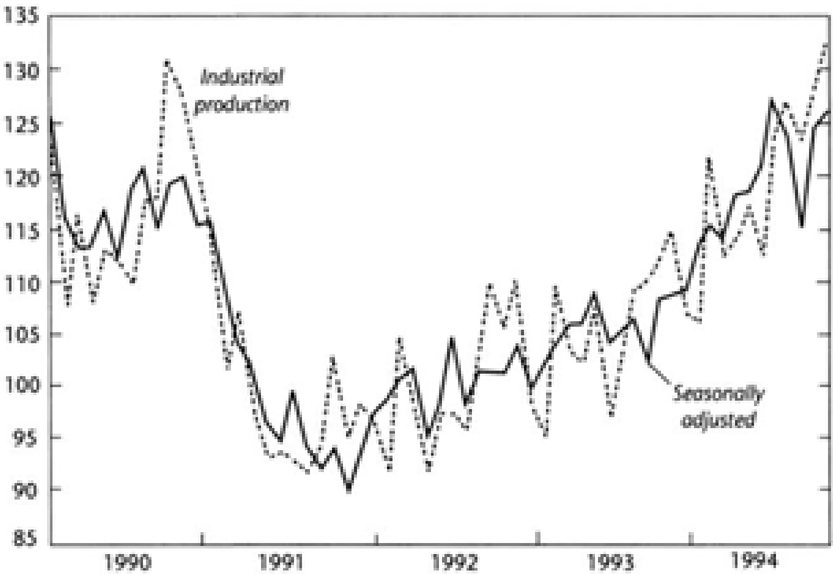
Sources: Polish authorities; and IMF staff estimates.

between 1989 and 1994 has almost tripled; this is equivalent to an increase of over 27.5 percentage points of GDP, from 16.9 percent to 44.5 percent of GDP (purchasing power parity basis with 1991 as base). The corresponding data for total trade (including transferable ruble trade and trade under bilateral agreements) shows an increase of 20.5 percentage points of GDP, indicating not only a reorientation, but an expansion, of trade.[2]

The dramatic increase in trade with non-CMEA countries has resulted in the EU becoming Poland's largest trading partner, accounting for about 60 percent of total trade in 1994, with the share to Germany being about one third (excluding unrecorded trade for which the bulk is cross-border trade with Germany). Just as impressive—reflecting the competitiveness of Polish exports—exports have managed to penetrate non-CMEA trading partners' markets by 8 percent

[2]Caution must be exercised in interpreting the value of trade in transferable rubles, as export and import unit prices were not market determined. In this paper, transactions in transferable rubles are converted into U.S. dollars using the transferable ruble-zloty cross-commercial rates.

Figure 2. Industrial Production
(Average 1992 = 100)



Sources: Polish authorities; and IMF staff estimates.

during 1993 and 15 percent in 1994, the year export growth was least affected by the reorientation-of-trade effect.

It is interesting to note that trade with industrial countries, excluding those with which Poland has signed regional trade agreements (United States, Japan, and Canada), does not appear to have been affected by the creation of this regional trading bloc, as both exports and imports to these countries have increased at a faster pace than to the regional partners during 1991–93.

A critical issue in assessing the impact of the reform effort is the extent to which the recent export developments reflect trade diversion—which by definition should be of limited duration—or trade creation. There is significant evidence that Poland has experienced a substantial amount of trade creation.

First, though the current structure of exports, for the main, still reflects the inheritance from the old CMEA trade regime, it also contains evidence that the structure of trade is shifting toward new products. Accepting the limitations of the data, it appears that the composition of trade is shifting away from low-quality products shipped to the cap-

tive market of the east toward products that are competitive in Western markets. This is brought out in a comparison of the composition of exports prior to the reform with the current one, which reveals that the current structure of exports parallels the one that existed between Poland and the industrial countries prior to the reform. Interestingly, trade with the former socialist countries (for the most part consisting of the CMEA countries, the most important being Russia) has shifted toward agricultural products from industrial products.

Second, the top exports through the end of 1994 contained further encouraging signs, as many nontraditional products were also high on the list, such as cars (mostly the Cinquecento automobiles produced by a joint venture with Fiat), garments, and furniture, besides traditional exports such as coal, iron and steel, refined copper products, wood products, and ships. This is also supported by Germany's customs data, which indicate a surge of new types of products from Poland, 3,500 in 1993 versus 1,500 in 1992, with the most common new items consisting of such high-quality products as instruments, measuring equipment, and chemical and wood products. In addition, an analysis by factor intensity also indicates that capital intensive, technologically advanced, and high-skilled-labor exports have increased their share of total recorded exports by over 3 percentage points between 1991–94.

Third, the private sector has increased its share of both exports and imports, from 4.9 percent and 14.4 percent in 1990 to 51.1 and 65.8 percent, respectively, in 1994.[3] Fourth, customs figures grossly underestimate total trade as they fail to capture much of the booming border trade; that is, day-trippers moving in both directions. This is supported by the fact that *net* purchases of foreign exchange by Polish commercial banks from kantors amounted to DM 3 billion in 1993 and that these kantors are concentrated near the German border. If one adds net purchases and sales from the kantor market to exports—as a proxy for unrecorded trade—exports would increase by 3.7 percentage points of GDP in 1994.

The structure of trade, however, reveals the potential limitations to sustained growth. An admittedly rudimentary classification of exports by their factor intensity reveals that during 1991–94, the share of unskilled-labor-intensive products (e.g., textiles) increased by almost 10 percentage points. If the relative expansion of such exports has been motivated by the recent decline of real wages, future growth prospects

[3]The lower share of the private sector in exports relative to imports most likely reflects the large unrecorded net export growth, the large share of industrial goods in exports—which are produced by state-owned enterprises—and the existence of state-owned trading companies, which still intermediate for small private firms unfamiliar with export markets.

could be hampered by the unlikely continuation of wage compression. In fact, wages in the economy increased by about 3 percent in real terms in 1994. In addition, natural-resource-intensive exports continue to represent the largest share of exports, an estimated 50 percent in 1991 and 1992. Such exports are traditionally low-value goods that are sensitive to the business cycle in partner countries, a premise supported by the close to 10 percentage point drop in the export share of such goods in 1993 (most likely in the first half of the year) in response to the economic slowdown in Europe, and especially Germany, and the subsequent reversal in late 1993 and 1994.

Lessons from Poland

The lessons I would draw from the Polish experience are that structural reform can be introduced at the same time as a stabilization program. The Fund's staple advice on the importance of a quick liberalization of the trade and payments system is still valid for countries in transition and can quickly lead to export-led growth. Nevertheless, the role of EU Association Agreements should not be underestimated. The implementation of the Uruguay Round, however, should reduce the need for such reciprocity in trade liberalization for other countries that are planning trade liberalization in the future.

It is difficult to choose the initial level of protection. Poland had to raise its tariff rates from the initial levels. However, the system should be transparent, that is, tariff-based, have very limited, if any, recourse to quantitative restrictions, and have a clear and credible timetable for future liberalization.

There is always a political aspect to trade reform. Thus, a window of opportunity should not be missed to clean up the trade system to the extent possible. As interest groups become more entrenched, it becomes harder to pursue reform.

Trade Liberalization Issues in Industrial Countries 7

Robert Z. Lawrence

My presentation consists of the major policy challenges in the trade policy area that I see facing countries. The way I have structured my presentation is first to make some comments about the general economic environment in which trade policy is currently taking place; second, to think about major trends in the agenda, which are confronting trade policy; and then to turn more specifically to some issues in trade policy.

I shall begin by making some comments about the general economic environment within which the discussion about trade policy is taking place, because I think it is important to bear in mind that trade policy often gets the credit and takes the blame for changes in our economies, many of which may have nothing to do with trade. For instance, while economists agree that the high protection during the 1930s contributed to the Great Depression during that period, they also believe that there were many other factors that caused that depression, and yet people who look at the 1930s blame protectionism for the Great Depression. Protectionism did contribute to it but certainly was not the only source of the difficulties. Similarly, trade policy gets the credit for a lot of the dramatic growth that was recorded in the postwar period; people associate liberalization with strong economic growth. So whether we like it or not, trade policy is going to be blamed, or given the credit, for the broader economic performance in our economies, and that is in fact what we see taking place.

General Economic Environment

It is important for us then to pay some attention to what the broader economic performance is, and I would like to highlight basically three elements in that economic environment. The first is the emergence of a period of slow economic growth in the developed countries. Now, we have seen widespread economic recession over the last few years. But what else is very significant is that we look at the current projections for long-term potential growth across the developed world and see that those projections suggest that growth is going to be rather slow. For instance, in the case of the U.S. economy, traditionally, it was able

to grow at about 3 percent a year. A reasonable projection of the potential growth rate of the United States, once the economy reaches full employment, is probably just over 2 percent a year—basically, slow, long-term growth. A major source of the slow growth is the slow growth of productivity in the United States. There is some evidence of a small recovery in productivity growth over the last few years, but it is still growing much more slowly than it had in the 1950s and the 1960s, and as a result, the U.S. labor force is growing just over 1 percent a year. If we add in just over 1 percent for productivity growth, we get a rather slow potential growth rate in the United States. If we look at Europe, similarly, we see very high unemployment rates, but again projections that suggest a potential growth rate somewhere between 2 percent and 3 percent, again slower than it used to be. And, certainly, if we look at Japan, we see revisions downward in the potential growth rate of the Japanese economy. If you had asked a few years ago what the potential growth rate of Japan was, you would have been told that it was between 4 percent and 4½ percent. Today, the numbers are much closer to 3 percent. So we have slow, long-term potential growth rates in these developed economies. And what that means is that improvements in living standards will inevitably be slower in these economies than they have been in the past.

Second, in addition to the slow average growth, what we see, particularly in countries like the United States and the United Kingdom, is an increase in inequality in these economies. If you look at earnings of American workers, split according to any criteria you like, educational levels, occupational levels, or experience, you see a growing disparity. Basically, highly educated Americans have seen an improvement in their relative earnings; poorly educated Americans have seen a decline. To give you one number: if you were a college graduate with no experience, in 1980 you would have earned about 30 percent more than a high-school graduate with no experience. By 1990, a college graduate was earning about 70 percent more than a high-school graduate. So there is a growing disparity in earnings associated with skill and levels of education. Smaller increases in inequality also occur in other developed countries. Some believe that what shows up as an increase in inequality in the United States with its more flexible labor market shows up as an increase in unemployment in Europe. The unskilled workers in Europe are a disproportionately high share of the unemployed workers in Europe.

So we have a shock, or maybe a set of shocks, that is hitting the developed economies, causing increasing inequality, and in particular, the unskilled and the less educated are doing relatively poorly within the context of an overall growth rate that is relatively slow. Now, there

is considerable research as to what is causing this. Certainly one candidate explanation is international trade. Indeed, we have a theory of trade that does suggest that if we had liberalization in developing countries, if we got more developing countries to produce labor-intensive products, what we could expect to see is the price of those products falling and exerting downward pressure on the wages of workers who are relatively less skilled. So we do have an economic theory that suggests that growing inequality could result as a consequence of international trade. My own examination of the evidence—an area where I have done considerable research recently—suggests that there are much more powerful effects operating than international trade. Indeed, technological change in my view is skewing the demand toward more skilled workers and away from less-skilled workers. But, be that as it may, international trade is clearly a candidate here for taking the blame. And even if it is not, certainly it will become increasingly difficult, and it is already difficult, for policymakers to say they are liberalizing with respect to developing countries when there is growing inequality and, in particular, unskilled workers are doing relatively poorly for technological and other reasons. So, in addition to the environment of slow growth, I would add this issue of growing inequality.

A third key element in the environment is the revolution that is taking place in developing countries. Throughout the world, since the mid-1980s, we have seen an astounding movement toward trade liberalization in almost every country in the developing world. Emerging economies are coming out—formerly planned economies moving to market economies, and economies in Asia, Latin America, and Africa, are now all adopting more outwardly oriented policies. And, indeed, the striking feature of this environment, on the one hand, is that the developing countries are all counting on being able to sell to the developed economies, and on the other, the emergence of these trends is of concern to the developed economies. These are the elements of the environment that we should keep in our minds as we discuss the trade policy question as it relates to the developed economies.

Now, what is striking to me is that, despite this rather gloomy set of tensions that I have just described, if you look at what has been accomplished in the 1990s with respect to liberalization, I think from the standpoint of a free trader, the record is rather good. In fact, progress—considerable progress—has been made in liberalizing the developed economies. Indeed, if you look at the U.S. economy, for instance, a recent study by the Institute for International Economics shows that the impact of protection on the U.S. economy is virtually minimal. It is confined to the impact of textile protection. But other than that, in terms of formal border barriers, the U.S. economy is much more open

today than it has been over the postwar period. Second, we see Europe making efforts: having almost completed its program for the creation of a single market, which is an immense liberalization effort in that internal market, it has extended that arrangement now to three other countries of the former European Free Trade Association (EFTA). The United States, Canada, and Mexico have concluded the North American Free Trade Agreement (NAFTA). In the countries of the Asia-Pacific Economic Cooperation Council (APEC), we see pledges for free trade liberalization, and we have seen a successful conclusion of the Uruguay Round. So it is quite remarkable that liberalization has taken hold, despite the economic environment that I described earlier. It certainly was not easy, but nonetheless, we should take heart from the accomplishments that we have seen in the past.

Trade Policy Today

But where is the future going to take us? I would argue that there are two key features of trade policy today that are different from what they have been traditionally in the postwar period. The first difference is that we have a new agenda. By and large, particularly when it comes to developed countries, the agenda has shifted from issues of what one might call "shallow integration" to what one might call "deeper integration." And second, particularly when it comes to the United States, the approach to dealing with these issues has shifted from one that concentrated heavily on obtaining multilateral solutions to the agenda of what we now call a "multitrack approach," in which there is multilateral discussion but unilateral measures, bilateral measures, and regional measures. These are the two issues that I will describe.

I will address first the shift from the agenda of shallow integration to that of deeper integration, because it runs through many of the policy discussions in which the developed countries are today involved, and increasingly, even developing countries. Let us step back and think about what was the major challenge for the postwar period. In the early postwar period, the need was to reverse what had taken place in the 1930s, which was the erection of large barriers at the borders of most countries. The world was separated, if you will, by high tariff and nontariff barriers and by restrictions on capital movements. And so when I talk about shallow integration, I am really emphasizing the idea of removing these border barriers. That was the major task of the early postwar period: lower those tariffs. And in fact, we have seen over the postwar period spectacular success in accomplishing that goal. By and large, the border barriers have been lowered. When it comes to the developed economies, tariff rates are on average very,

very low. In some sectors, they have been completely eliminated. In some laggard sectors, the tariffs have not quite been lowered. But, by and large, through a process of multilateral negotiation and a series of trade rounds, success has been achieved. In fact, most of the analytical issues—most of the debates of how to go about doing this—have been resolved.

What is striking, and a second achievement of more recent vintage, is capital mobility. By and large, among developed countries, capital is free to flow; investors are, particularly in terms of portfolio investment, free to invest and to take their money and send it out of their own economies. So these are noteworthy achievements. In addition, in the 1980s, there was a major acceleration in direct foreign investment. In the 1950s and 1960s, American firms went out and invested heavily in Europe and in other parts of the world. The United States was the technological leader. The Americans had some know-how they could profitably exploit by investing abroad, and they did so. In the 1980s, there was an explosion in direct foreign investment coming from Japan and Europe into the United States and very strong flows of direct foreign investment throughout Asia and other parts of the world.

So a spectacular growth in trade occurred, and spectacular growth in investment and in the development of international capital markets. But what has been striking is that as we have removed those border barriers—as we have taken down the fences that have separated our economies—we have become increasingly aware of the differences in domestic policies that remain. The essence of the General Agreement on Tariffs and Trade (GATT)—and why I talk about it as a shallow integration approach, particularly in its earlier years—was that the GATT was not trying to harmonize domestic economic policies. It was trying to lower border barriers, and it strove to achieve national treatment, particularly when it came to goods trade, that is, treat foreign goods in the same way as you treat domestic goods. But the philosophy of the GATT is actually "let one thousand flowers bloom": countries can be different, the key is that they should not discriminate against foreign goods; having different policies is not a problem.

Indeed, what is striking about the GATT is that even when it came to tariff reductions, it was not striving for a level playing field in the sense that tariff levels had to be the same across countries. It was striving for equal concessions—what Jagdish Bhagwati calls first difference reciprocity: as long as you give up in some negotiated sense as much as I give up if I come from another country, that is reciprocity, even if our levels are not going to be the same. So that was the norm; that has succeeded very well, but increasingly there are pressures to move to-

ward deeper forms of integration. And we have seen these pressures emerging in a number of areas, for different reasons.

One major reason really comes from the growing role that multinational corporations are playing in international trade, and these are essentially functional demands. If a multinational company is going to set itself up in a number of countries, what it would like is, first and foremost, secure intellectual property rights. A company has know-how. That is the key to its competitive success. It wants to be sure if it goes and produces abroad its know-how will be secure, it will have property rights over it. Second, it would like compatible standards. If you are going to source in one country and then add value in a second, it would be very helpful to you if they have similar standards and norms. Otherwise it is going to be difficult and costly for you to do so. In addition, if you want to be secure in the ability to sell, to enter other markets, you want to be sure that your goods are going to be free to enter. It is not just the question of tariff or nontariff barriers, you do not want to be harassed by antidumping rules and other kinds of administered forms of protection. So what we see is a growing demand, which is functionally driven, by multinational companies for deeper forms of integration, and we saw this emerge very, very strongly in Europe in the call by major European companies for a single European market. Companies like Philips and Siemens in the early 1980s said they could not compete in world markets if they were going to be based in a fragmented European market. Even though we have removed the border barriers within Europe, there are still these major differences in standards and regulatory frameworks that do not allow us to fully integrate our operations to enjoy genuine economies of scale at the European levels. And so they said, we call for a single market form of deeper integration. That, I think, was strongly driven by the functional needs of those multinational corporations.

Second, in addition to those pressures, we also see political forces starting to respond and calling for deeper forms of integration. When competition gets tough, as countries open up to one another, many start to be struck by the fact that the foreign firm is operating in a very different economic environment from the domestic firm; calls to somehow "level the playing field of international competition" arise. So, some see unfair advantage given to foreign firms as a result of the differential treatments. We have three noteworthy words in the trade debate: dumping, ecodumping, and social dumping. These are words that people use when they do not like what is taking place because of differences, whether they are corporate differences (dumping), whether they are social rules and norms (social dumping), or whether they are environmental rules (ecodumping). Nonetheless, we see

groups who care about these issues, whether they are multinational companies who want that level playing field, or environmental groups, or labor; they are all saying, "In order for us to trade and expose ourselves to one another to the degree that we are now doing, we want to have more harmonized regulatory arrangements."

And so, whereas in the early postwar period we had a clear division and countries were sovereign with respect to their domestic issues, now it seems as though many more aspects of what countries once considered to be their sovereign policies are coming under fire in the international arena. The major tension in our world today, faced by developed and developing countries, is how to reconcile these demands. On the one hand we have a global economy, on the other, we have a world organized into nation states, and when that division was clear as to what the nation states were responsible for, we knew how to handle that. Now we are trying to rethink these issues, and we ask, how would you try to resolve some of these questions? We obviously do not have all the answers, but the key issue is how we deal with this transition from shallow to deep integration. If we look at the trade policy discussions and issues in the 1980s as they emerged, and now in the 1990s, they are certainly dealing with issues of deeper integration.

A second change in addition to this change from shallow to deep is from multilateral to multitrack. In essence, here we should focus on the United States, because the great change has been in the American approach to international trading relations. In the 1950s and 1960s, the United States almost solely, not totally but almost solely, conducted its trade relations using the GATT and in a multilateral arena; it was very wary of regional arrangements. One reason was the fact that the United States had had a very bitter experience in the 1930s. Indeed, a major motive of the United States was to avoid a repetition of the fragmented world in which American products had been shut out of other markets during the 1930s. And so the United States was intent on achieving a multilateral system rather than allowing regional arrangements, although the United States obviously tolerated, and indeed encouraged, the integration of Europe. Second, integration accorded very well with America's geopolitical interests. The United States saw itself engaged in a struggle with the Soviet Union. Its desire was to contain the expansion of communism. In that context it was very important to the United States that there be prosperity in the capitalist nations. Therefore, there had to be a systemic prosperity. The United States saw prosperity in Japan, in Europe, and in the developing countries as in its own geopolitical interests, because that would weaken the attraction of the United States' big geopolitical rival, the Soviet Union. So the geopolitical considerations of the United States led it to

stress very strongly a multilateral approach, seeking to obtain liberalization not only for itself and its own goods, but to spread multilateral liberalization so that its allies would also enjoy access to one another's markets.

Let me also say that it is important to appreciate that trade policy in the United States is not driven solely by the President of the United States. Indeed, the Constitution gives the U.S. Congress the final say in trade agreements. Congress keeps the President on a short leash. It says to him, "You can have a couple of years to go and negotiate, but we will not give up our final authority to provide a verdict on trade policy." So what you have to understand then is that U.S. trade policy is not the result of the conscious action of a single actor. It is much more the outcome of a political process. People analyze U.S. trade policy as if there is someone who makes it, but there is no single individual who makes U.S. trade policy. It is the result of a political process. One telling illustration of the importance of politics in U.S. trade policy is to look at who the U.S. special trade representatives are. If you go back and look at who has been chosen as the special trade representative, you will find two qualifications stand out: little prior experience in trade policy and a strong sense of the American political system. Understanding politics in the United States is desirable. If you go back, you will find that the U.S. special trade representative, Robert Strauss, had been the head of the Democratic Party, so he really understood politics. Bill Brock, a later U.S. special trade representative, became the head of the Republican Party. Ron Brown, who had been considered very seriously for special trade representative, was formerly head of the Democratic Party. So when the President of the United States thinks about his special trade representative, he is much more worried about how that person will represent him to the Congress than he is about representation to the rest of the world, because, quite frankly, that is really very, very important in getting trade measures through Congress.

What I would suggest is that in the 1950s and 1960s, by and large, trade was not a highly salient political issue in the United States, and so the President had considerable leeway in exercising his leadership role. And, indeed, when it came to most protection, which was administered when it came to antidumping and other kinds of rules, you could leave it up to the experts to take care of it. But what has happened over the postwar period is that the U.S. economy, like other economies, has become increasingly globalized, and so trade has become an increasingly salient political issue. And as trade has become an important political issue, Congress has wanted to play a more and more active role, and pressure increases on each administration to

come back to Congress and bring results. In this context, the United States has been forced to change its strategy from relying purely on the multilateral approach, which proceeded rather gradually, toward shifting to a multitrack approach, toward trying to come up with achievements in a multiplicity of forums. Now a major question is, Are these tracks all leading down to the same goal? Will they converge or will they diverge? There is a major management problem when you are pursuing a policy strategy on a number of tracks. But, nonetheless, what we see today is U.S. trade policy being pursued unilaterally, bilaterally, regionally, and multilaterally.

Trade Policy Approaches

I would now like to turn to the different tracks on which trade policy is being pursued. What is striking is that in each of these areas the issues are primarily those of deeper integration. There remain some issues about border barriers that are being dealt with, but increasingly, in each of those tracks, the questions relate to behind the border, to what was formerly thought of as domestic, policy practices.

Unilateralism

First is the unilateral approach. The United States has had measures in its trade rules, on the books since the 1970s. They take the form of so-called 301 Legislation, but they have only been implemented vigorously since the mid-1980s. Implementing these measures has meant that the United States has challenged foreign countries, in some cases, for not fulfilling international obligations, so-called unreasonable actions by foreign countries where there was an international agreement and now the United States argues that it has not been given what it had been promised, and so it goes to the country and says, "Give us what you promised us or else we will take some form of action or retaliatory action." Other kinds of actions, so-called unreasonable acts, are when the United States simply differs with the foreign practices. In these cases, the United States has sought to change practices that discriminate against American firms or products, but in which there has not been a GATT or international agreement. In addition, we have seen Super-301 legislation in which the United States has chosen some priority countries, and priority practices, and argued that countries ought to change their practices toward U.S. products, otherwise they would be subject to retaliation.

Some have looked at these American actions and have pointed to them as indicating growing American protectionism. I think that is

simply false. It does indicate growing American aggression, aggressive behavior, but it is important to appreciate that these are policy measures fundamentally designed to change the way foreigners are pursuing policies rather than to protect the American market, so it is a desire to open a foreign market. And, typically, although the priorities have been American, the idea has been that the market would be open to all. Nonetheless many see this, justifiably in my view, as a challenge to the multilateral system. It is partly because of this American action that the World Trade Organization (WTO) has been formed, with a much more credible dispute settlement mechanism than has been used elsewhere in the past. The idea would be to channel these disputes into that forum rather than to have them enacted unilaterally. All I would emphasize is that frequently the issues are those of deeper integration. The concerns are over such issues as intellectual property, like an insurance sector, which has been regulated in a protectionist way rather than over tariff barriers.

Bilateralism

A second area where we see this is in bilateral relationships; a big area is U.S.–Japan relations. Clearly, we have a controversy that does not concern border barriers. The United States has pursued a bilateral set of negotiations with the Japanese, which has taken many forms. One major concern has been the allegation by the United States that the Japanese market is unusually closed, that there is an asymmetry of access. American firms and American products find it very difficult to penetrate the Japanese market. Indeed, it is a perception shared not only by the Americans, but also the Europeans and other countries. The United States, however, has chosen to emphasize the bilateral route in dealing with its frictions with Japan, even though, again, once agreements have been achieved, they have been extended on a most-favored-nation basis to other countries. The major thrust is the concern about the allegedly closed Japanese market. There are several approaches to deal with this. First, the argument is, it is not border barriers in the case of Japan, rather it is more invisible barriers. One form of these has to do with government policies where there is a large amount of bureaucratic discretion, where regulations are allegedly applied in a discriminatory fashion. Second, these may also have to do with private practices, where firms tend to have very close relationships with one another, refuse to deal with outsiders, and in particular are grouped in close corporate groupings. There is also the interaction between public policies and private practices in the sense that antitrust or competition policies are barely enforced, and implic-

itly, or explicitly, this allows domestic firms to collude to keep foreigners out of the marketplace. These are the allegations that the United States makes about its problems in selling in the Japanese marketplace.

There have been negotiations over many, many years. The emphasis by the Bush administration took the form of trying to achieve an increase in the application of competition policies and antitrust policies in the so-called structural-impediments-initiative discussions between Japan and the United States, although there have been many sectoral discussions in which efforts were made to try to change the rules governing foreign participation and, indeed, general participation in the Japanese market. The argument in the United States is really a debate about whether the emphasis should be on changing the rules or trying to ensure results. One group says that the Japanese system is simply too different to have agreements on changing the rules, that these changes would occur too slowly, and what we need to do is to try to ensure results by actually negotiating something more objective than changing a rule. We have to deal with outcomes rather than simply changing the rules.

That is a very knotty problem. The first experience in this area, or what I would consider to be the seminal experience, has to do with semiconductors. In the mid-1980s, there was a semiconductor agreement, in which there was a secret side letter that was not so secret. In the American interpretation, the Japanese committed themselves to giving foreign semiconductors a 20 percent share of the Japanese semiconductor market; the Japanese disputed that interpretation. Nonetheless, there was an agreement that actually had a quota and was a form of managed trade. It involved setting a numerical target. Whether it was going to be mandatory or voluntary is debated, but there was a numerical target set, and what happened over a five-year period, to cut a long story short, was that eventually foreign semiconductors actually increased their share of the Japanese market, moving up from roughly 10 or 11 percent where they had been for many, many years, to around 20 percent. For both sides this was a seminal experience, and the Americans looked at that experience and what they learned was "Aha, results-oriented policies work!" and what the Japanese learned was "Aha, never again!" and that, basically, set the context for the subsequent discussions that occurred between the Clinton administration and various Japanese administrations. The Clinton administration came in, arguing in fact that the semiconductor agreement had been a success, and what we needed was more of them. The Japanese felt very embittered by this experience. They felt that it was wrong to hold the government responsible for the purchasing practices of private Japan-

ese firms, that in fact this policy was inducing an unwarranted intervention by the government into market practices, and so the Japanese government was intent on avoiding similar commitments in the future.

What actually happened was a long and protracted drawn-out battle on sectoral issues. There were many such negotiations. Both sides were forced to compromise and to give a little in terms of the final agreements that were reached. They discovered that it is very complex to carry out such negotiations. One of the lessons that we keep learning is that even the powerful United States is no longer able to carry out its policies independently in this world, that the international capital markets are increasingly looming out there and exercising powerful influences. As the talks between Japan and the United States seemed to be stymied, we saw currency markets reacting, we saw the yen strengthening very strongly. Some saw interest rates rising in the U.S. economy; the interpretation being that the Japanese would be more reluctant to invest in the United States. This was the invisible, if you will, counterweight that the Japanese had, and it did operate to put pressure on the American administration. I think what we had was an agreement originally in principle that objective indicators would be used to measure progress. The American interpretation was that this did not involve quotas or managed trade. The Japanese interpretation was that it could, and they wanted to avoid such use. What we have in these agreements is a commitment to measure progress by some kind of objective indicators. In that sense, some Americans were presumably successful, but it is not clear what the consequences would be if these objective measures did not turn out to be satisfactory. So we have got a rather vague agreement, in my judgment.

Another whole aspect of the U.S.–Japan difference has involved the macroeconomic question. In my view, this has been a greatly mistaken debate, a great error, particularly on the part of the United States, to confuse the discussion about the current account surplus of Japan in the context of a framework agreement that is also talking about a closed Japanese market. There is in economic theory no relationship necessarily between the size of a country's trade balance and whether or not it is open or closed. And yet, it is irresistible from the American side to use the size of Japan's trade surplus in making the argument that its market is relatively closed. I mean, we can think of countries—take Mexico in the early 1980s, take many developing countries, many from which you come—when you had highly protective policies you also had large trade deficits. So there is no reason why you cannot have those two things take place and have causal connection between them. And then we can think about countries like Germany, which is a

very open economy and has a high international participation both through investment and through trade, and we can see in the mid-1980s the Germans had a very, very large trade surplus, and nobody pointed to their surplus and said, "Aha! You have a closed economy." This is a macroeconomic phenomenon that reflects saving and investment behavior.

When the United States was trying a few years ago to get Japan to accelerate its economic growth, it should have taken place in the normal setting of the Group of Seven[1] discussions on macroeconomic policy rather than making it a bilateral issue. It was a long-run structural question, rather than a trade question. And, indeed, today, given an American economy virtually at full employment, there is no reason to seek stimulus through increased Japanese economic growth. In fact, that growth and a smaller Japanese trade surplus could mean higher interest rates both for the United States and for the rest of the world.

So it was an error—this is just purely my own subjective comment—to integrate these two and, indeed, it is a tragedy in a way that economic policy has involved these two countries like strangers passing in the night over the last few years—on the one hand, the Americans, or some Americans, trying to push for more managed outcomes, and on the other hand, for many Japanese to be arguing that what they need to do is to deregulate their economy. It would seem to me that there has to be more room for concurrence between the two and, indeed, between the developed countries more generally that the real emphasis of the policies has to be on strategies to achieve deregulation, which is a rules-oriented process, but which would open markets and make them more contestable. The Japanese have said they are interested in deregulation and are moving to a five-year program. Thus far, that program looks disappointing, certainly from an external viewpoint, but it does seem that that area is where we need to see more collaboration and discussion and, indeed, it is where we are going to see more collaboration and discussion. One of the striking changes in the United States has been the shift in the composition of the U.S. Congress. The Democrats have been basically beaten in both houses and Republicans are much more interested in pursuing an agenda of deregulation and much less interested in pursuing the alternative approaches.

[1]The Group of Seven industrial countries comprise Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

Regionalism

I will touch very briefly on regionalism, from my vantage point. It is clear that we have seen a proliferation in regional arrangements around the world, and the debate, as I like to frame it is, Are these arrangements stumbling blocks or are they building blocks? Are we seeing the fragmentation of the world economy à la the 1930s, or are we seeing integration in a way that finally combines the regional arrangement in a more liberal, open world economy? Those who see a reaction to the 1930s I think are absolutely wrong. Similarly, there are others who, particularly when it comes to developing countries, point to the experience in trying to have regional integration programs in the 1950s, which was not very successful, and they say these new arrangements that are emerging throughout the world are similarly going to fail. I think that ignores the basic motivations behind these new regional arrangements.

The old regionalism, particularly when it came to developing countries, was heavily driven by a desire to follow import-substitution policies at a regional level. In other words, they were fundamentally protectionist in orientation. The idea was that a group of developing countries could get some economies of scale so therefore they could engage in import-substitution policies more effectively. That, of course, meant that these countries were going to allocate their production on a political basis rather than on a market-driven basis, and they had great difficulty in implementing that approach.

What is striking about the new liberalization measures is that they are taking place in the context of countries who are trying to reinforce their outwardly oriented policies. Mexico is just one example. The Mexicans liberalized multilaterally first and then they joined the NAFTA, partly as a way to lock in those changes and partly to reinforce their domestic liberalization program. In that environment, countries are not trying to get economies of scale and shut the foreigners out of their marketplaces. They are opening their economies, and they see regionalism as a complementary approach. So that is broadly an accurate description of what is taking place and that means in a sense these are moves toward more liberal policies.

A second striking feature of these emerging regional arrangements is the strong role that multinational companies are playing, together with concerns about the role corporations and foreign investment are playing in all of these arrangements. The economic literature has not absorbed this sufficiently; there is still a tendency to look at these arrangements through the traditional prism of removal of all the barriers and to ignore the strong role that direct foreign investment flows are playing.

Certainly, as I mentioned earlier, the regional arrangement in Europe was very strongly supported by major European companies, by Philips, Siemens, and the European business roundtable. If we look at the NAFTA, what we find is strong support by Canadian business, by American business, and interestingly, by Mexican firms, all wanting to see an increased integration. It is a functional desire that the companies have to improve their operations on a regional basis. If we look at Asia, there is no doubt that the regional integration is being led by direct foreign investment, originally by Japanese firms in the mid-1980s moving out of Japan and investing in other parts of Asia, and later by Korean and Taiwanese firms going to invest throughout Asia. Indeed, in Asia, although arrangements are much less formal, regional integration is nonetheless taking place, led by multinational companies. This is a much more deeply embedded phenomenon. These companies are not simply concerned about the removal of the tariff barriers. In the case of Mexico and Canada, a major motive, so far not successful, was to get rid of the antidumping and the countervailing duties, where American trade rules harassed Canadian and Mexican products. So what actually happened in the NAFTA was not an agreement to remove those rules—and so an unsatisfactory resolution—but firms clearly driving and lobbying to try to integrate their economies.

That is actually the good side of the regional initiatives, but the fact that firms are playing a major role also has a dark side. It also means that when those rules are constructed, firms who have political influence try to tinker with them a little bit, so that those inside the arrangements get an advantage over those outside the arrangements. Most noteworthy has been the question of rules of origin. Basically, when you have a free trade agreement you have to come up with some rules of origin to define which products are going to be eligible for duty-free conveyance across internal borders. What has happened in the case of the NAFTA is that these rules have been carefully crafted, particularly in the area of textiles, in a very protectionist way and, indeed, even though the tariff barriers have not been changed, there is a much greater incentive today to use yarn and fiber that is North American. So we do not have an external tariff being raised against the outside world, but we could have serious trade diversion resulting as a consequence of those rules of origin. And so these regional arrangements have to be watched very closely, particularly when it comes to those rules of origin. In the European case, the abuses come to a much greater degree in the administration of the antidumping rules, where again pressures can be brought to get cases resolved in a way that hurts outsiders. Indeed, if we think about re-

form, it is not in changing the GATT rules that actually apply to regional arrangements, it is really in monitoring the practices on rules of origin and on antidumping.

So nonetheless we are seeing an extension of regional arrangements. The United States is now pledging in the Western Hemisphere to open up the NAFTA, and indeed, the United States, Canada, and Mexico are scheduled to start their negotiations this year with Chile, the next likely entrant into this arrangement. Subsequently, there is an agenda to incorporate other nations from the Western Hemisphere. We also see an APEC arrangement, and I will conclude with a few thoughts on that.

From my own perspective, we have a dramatic agreement at Bogor among the Asia-Pacific countries to achieve liberalization in trade and investment. Getting this vague agreement was politically quite easy, but we are a long way away from solid accomplishments that are going to make that agreement credible.

I can well see why an America that wants to show its desire to be part of the Asian scene would like such an agreement. I can well see why a Japan that is trying to make sure that NAFTA does not exclude it, and other Asian countries who do not want to be excluded, would like to commit themselves to an APEC agreement. We can well see why smaller Asian countries who would like both Japan and the United States to be involved in an agreement would commit themselves to such an agreement. There are strong political reasons why you could believe that the leaders could have come up with this pledge. But the difficult question is, How are they going to make it concrete? What will it all mean? And, quite frankly, there are major obstacles. Let me just say, if they can achieve a free trade and, in particular, if it is an open regionalism where other countries are invited to join on the same conditions—if an African country says, "Look, we will liberalize to the Asians if we are invited to join," that would be a wonderful achievement.

So as an economist, I am happy that they have come up with such an arrangement, but the political economist in me, looking down the road, is a little more skeptical about the ability to achieve this agreement. The way I understand the strategy that is being laid out is that rather than negotiate to incrementally liberalize as we have done in the series of Uruguay Rounds, the approach in the APEC is to sit down and negotiate an agenda that will take us fully to free trade by a certain date. In other words, we are going to have all the political battles today. If Japan is going to have to commit to free trade in agriculture by the year 2020, the current administration in Japan is going to have to tell the farmers what it is going to do. And we can ask our-

selves, "Why didn't the GATT do that"? Why did we not turn around when we negotiated the GATT and say, "Look, we want to get to free trade; let us all pledge to go to free trade, and we can implement that agreement gradually"? My argument is, it is a terribly difficult thing to do politically. You must pick your time when you choose to liberalize individual sectors, and this is a political judgment that countries have to make. And so in a sequential approach you wait until the group is weak, or maybe even strong and can withstand liberalization, and then you liberalize. But what you do in the context of a universal approach is politically much more difficult, because you will have huge battles: you are going to have all your battles sooner rather than later.

Now, you may well ask then, "Why do we get regional arrangements?" Well, the answer, in my view, is, there is usually a sweetener. Usually, when you say "The United States and Mexico have a free trade agreement," what is meant is that American firms have been told "You are going to have to liberalize, and you are going to full liberalization with respect to the Mexicans, but there is going to be a little trade diversion that is going to sweeten things for you." So the American textile industry says, "Yes, we will be happy because we will get free trade in Mexico, we will be able to sell in Mexico, and the Koreans may find it more difficult, or certainly, we will get an advantage over countries who are outside the agreement." So the trade diversion acts as a political sweetener to offset some of those political obstacles.

Now, think about the whole of APEC. How sweet is it for any individual group of firms, say, in the United States, to be told "Well, you are going to be able to go to free trade in the whole of the Asian region and, by the way, so are the Chinese, and so are the Japanese." That is not a very protective market for you, and so I believe that you do not have sufficient trade diversion to actually sweeten the deal for groups of firms when you move in such a huge way to APEC liberalization. Now, do not misunderstand me. I would love to see it take place, and I am only an economist who does not understand political forces. And I have been surprised in the past. But I am just saying that that is just one reason why I am skeptical.

I also believe there is a very strong debate between the United States and Japan as to what form this liberalization should take in APEC. As I understand it, the Americans are strongly emphasizing the removal of tariffs, and the Japanese have a different approach that emphasizes collaborative schemes and cooperative arrangements in functional areas in terms of trade facilitation and others, and would rely more on countries to liberalize unilaterally their border barriers. I actually think

while border liberalization is useful and important, a lot of the issues, even in Asia, are really about deeper integration. My own preference would be to see a much heavier emphasis on deregulation within the Asian area. We do see a drive for deregulation in Korea and in Japan and in other Asian countries. I would like to see deregulation play a much greater role in the APEC negotiations than it does currently, and I would put less emphasis on the border barrier approach. Anyway, I have not even touched on multilateralism, but it is clearly a complicated subject with which we have been dealing.

Conclusion

Briefly, what I have tried to do today is to argue about the environment in which trade policy is taking place and there I have sounded some alarms. There are worrying signs. Second, to emphasize that the issues are much tougher than they used to be, because we are moving behind the border barriers. And, third, that we are moving in this multitrack approach with initiatives taking place at numerous dimensions, and there, the open question is, Building blocks or stumbling blocks? Are the tracks going to converge or are we seeing fragmentation?

Regionalism in World Trade 8

W. Max Corden

Suppose a particular developing country (e.g., Mexico or Chile) joins in a free trade area (FTA) with a very large economy (e.g., the United States): what are the possible gains and losses to it? The first part of this paper provides a framework for analyzing this problem. The main theme is that there are three distinct aspects, namely, trade liberalization, trade diversion, and reciprocity. The developing country will be referred to here as the LAC (Latin American country) and the large country as the United States. Finally, the second part of the paper compares regional and multilateral trade liberalization.[1]

Effects on a Developing Country of Joining a Free Trade Area

A developing country joining an FTA can expect to have its present degree of liberalization locked in, with future governments having little ability to influence further change. It can also expect a greater degree of liberalization than would be the case in a unilateral effort; trade diversion; and reciprocity.

Liberalization by the LAC

The first of the components of an FTA is trade liberalization by the LAC itself. Tariffs are reduced and possibly removed completely, and quantitative import restrictions are ended or the range of imports to which they apply is reduced. There are the standard gains from trade creation as well as benefits through reduced rent seeking and admin-

[1]The first part of the paper is a somewhat condensed version of W. Max Corden, "A Western Hemisphere Free Trade Area: Implications for Latin America" in *Trade Liberalization in the Western Hemisphere* (Washington: Inter-American Development Bank and Economic Commission for Latin America and the Caribbean, 1995). There is a large literature in this field. Particularly to be recommended are Jeffrey Schott, *More Free Trade Areas?* Policy Analyses in International Economics No. 27 (Washington: Institute for International Economic, 1989), and Jaime de Melo and Arvind Panagariya, eds., *New Dimensions in Regional Integration* (Cambridge; New York, N.Y.: Cambridge University Press, 1993).

Table 1. Effects of Three Kinds of Liberalization

Effects	Liberalization		
	Unilateral	Multilateral	Regional
Liberalization by LAC	√	√	√
Trade diversion (adverse)			√
Reciprocity (favorable)		√	√

Source: Author's estimates.

istrative costs normally associated with quantitative import restrictions. Inevitably, there are both gainers and losers. Unemployment may increase in the transition. If tariffs have been high or import restrictions tight and widespread, the effects of trade liberalization on the pattern of domestic output and distribution of income as between different industries and workers may eventually be substantial.

Trade liberalization can actually take three forms—unilateral, multilateral, and regional, and it is worth comparing the effects of the three. Table 1 shows that they have some, but not all, effects in common.

First, liberalization can be unilateral: the policy is pursued because it is believed that it will benefit the country as a whole and that in the long run most citizens will gain even though there are likely to be some short-run losers. Hence, it does not need to be associated with any international agreement. Exchange rate adjustment will ensure external balance. Further, unilateral liberalization does not explicitly discriminate between different foreign suppliers, so that there is no trade diversion.

Second, liberalization can be multilateral. Hence, the country's own liberalization is supplemented by liberalization by others, thus opening up export markets for the country and improving its terms of trade relative to the unilateral alternative. This is the *reciprocity* effect. Clearly, a country benefits when a given degree of its own liberalization is associated with reciprocal liberalization by its trading partners, which causes their imports from it to increase.

Finally, there is regional liberalization, of which a bilateral FTA is a special case. In that case, the country's own liberalization does not necessarily apply to imports from all countries, but only to those from the region (the United States in our example). There will be the same general effects of liberalization: imports will increase, with the usual gainers and losers. But in this case liberalization is partial and thus discriminatory, hence creating *trade diversion* effects. In addition, regional

liberalization has a reciprocity effect: the other member of the FTA opens up its markets to the first country's exports.

One should distinguish between two groups of LACs. In the first, unilateral trade liberalization has already taken place to the point that quantitative import restrictions have been completely ended (sometimes with a few exceptions) and tariffs are quite low. This group consists of Chile and Mexico, and if one extends the group to countries where the unilateral liberalization process is well under way, or strong commitments have been made, it also includes Argentina and Colombia.

For these countries, one might ask what difference an FTA with the United States would really make to the liberalization process and ultimate situation. Obviously, if there were complete, unqualified, permanent free trade affecting imports of all kinds from all sources, forming an FTA with the United States would only have an effect through the reciprocity aspect, to be discussed below. But in practice this condition does not exist and is not likely to. Hence, forming a bilateral FTA would have two effects on the degree and effectiveness of the LAC's own liberalization.

First, the *locking-in* effect. The present degree of liberalization could always be reversed by a future government. On the other hand, an agreement to establish an FTA would not be so easily reversible, if at all. It is a way in which a present liberalization-inclined government can commit future administrations that may wish to revert to protectionism. The immediate benefit of locking in liberalization is that it is likely to provide a stimulus for investment. Indeed, even the expectation of an FTA may provide such a stimulus. Any arrangement that ensures that a particular structure of domestic prices and incentives will stay for a long time, rather than be changed unpredictably, is likely to encourage investment.

Second, an FTA would probably involve a greater degree of liberalization and of opening up the economy than would result from any degree of unilateral liberalization, even if the latter apparently leads to free trade. Trade can be fostered by various measures of harmonization and elimination of barriers to trade other than tariffs and quantitative import restrictions. Here, the example of the European Community can be cited. The first stage was to establish an area of conventional free trade (plus a common external tariff, which made it a customs union). The second stage was the "1992" program—the "completion" of the European market, which disposed of numerous barriers apart from tariffs. This second stage is likely to be substantially trade creating.

Let us now turn to the other group of countries—those where protection is still quite high and where it is unlikely that unilateral liberalization would go anywhere close to free trade. These are countries where currently either the political will to liberalize substantially, or the political ability to bring it about even if there is the will, does not exist. In these cases, the formation of an FTA would raise substantive issues for the LAC, namely, the very same issues that arise when considering unilateral liberalization.

Are there arguments for protection from a national point of view—for example, the (sectional) employment or the infant industry arguments? Are there significant rent-seeking and administrative costs of protection to set against these arguments? Even if an ultimate situation of trade liberalization were desirable, is the process of getting there too costly? Would powerful interest groups resist liberalization and make it politically impossible or at least very painful?

Trade Diversion

The principal negative aspect of an FTA is trade diversion. Trade diversion results from the discriminatory aspect of an FTA. If Mexico maintains tariffs on imports from Japan, and possibly even increases them, while removing tariffs on imports from the United States, there will be some tendency to divert purchases away from Japan toward the United States. The pattern of imports will change.

One can distinguish "Vinerian trade diversion," "trade contraction," and "trade deflection," beginning with the first.

Vinerian Trade Diversion

Suppose the LAC has a given tariff of 30 percent on all imports of a particular product to start with. It then joins the FTA and imports from the United States can come in without paying any tariff. But imports from Japan must still pay a 30 percent tariff. This external tariff does not change. There will then be some diversion of the source of imports from Japan to the United States. Excluding the tariff, the diverted imports will have cost less when bought from Japan than when bought from the United States, so that the LAC is now buying a product from a dearer source and thus incurring an extra cost. This trade diversion concept first introduced by Jacob Viner assumes that the tariff on imports from outside (Japan) remains unchanged when the country joins the FTA.

Vinerian trade diversion could well be significant when tariffs on imports from outside the FTA remain high. But the more the LAC has

followed a path of unilateral trade liberalization before joining the FTA, and hence the lower is the external tariff, the less the cost of such trade diversion will be. Nevertheless, some degree of trade diversion is likely even when a country has liberalized completely. This is because of the locking-in and completion effects discussed above. These will foster trade within the FTA relative to trade with the outside world, at least marginally.

Trade Contraction: Increase of Protection Against Imports from Outside

Trade contraction occurs if the level of the external tariff is actually raised as a result of the establishment of the FTA. In the example above, imports from Japan will decline even more than they would when there is only Vinerian trade diversion. In an FTA, unlike a customs union, the external tariff for a particular product does not have to be the same around the whole area; that is, the LAC does not have to adopt the U.S. tariff on imports from Japan, or to agree on a common external tariff. In principle, it is still free to choose its external tariff structure.

The external tariff might well increase as a natural response to domestic pressure groups seeking more protection from imports when they find themselves harmed by U.S. imports. Similarly, if there is a general loss of competitiveness by the country, possibly because the exchange rate has become overvalued owing to a burst of domestic inflation, the natural reaction will be—as it has often been in the past—to increase protection, and once the FTA has been established, this can only be brought about by increasing protection against imports from outside the FTA.

Trade Deflection: Free Trade Area Versus Customs Union

Suppose that the United States imposes restrictions on imports of a particular product from Japan while imports of the same products from Japan can enter the LAC freely. There will then be some tendency for goods to be imported from Japan into the United States via the LAC. This is trade deflection. It leads to unnecessary transport costs. More important, it defeats the purpose of the U.S. protectionist measures. The lower the transport costs, and the bigger the gap between the low tariff of the LAC and the high tariff of the United States (or the tariff equivalent of the nontariff device), the bigger this effect will be.

The problem is well known (and has presented problems in the Canadian-American free trade area). A country may import duty-free

components of a car from Japan, then assemble them, and export the assembled car to its free-trade partner—a partner that, itself, imposes restrictions on imports of components from Japan. Thus, the United States may wish to restrict imports from an LAC on the grounds that these embody components or inputs that are just "trade deflected."

The standard solution to this characteristic problem of a free trade area is to make "rules of origin" for trade within the FTA. This raises various technical problems—for example, the choice of the ratio of domestic component that is acceptable if intra-FTA trade is to be free. For a particular product, tariffs will be applied to a proportion of the value of imports from, say, the LAC to the United States, the proportions representing the part that is assumed to be of outside (e.g., Japanese) origin. The U.S. negotiating position with Mexico, as with Canada, has been to favor strict rules of origin, especially in the automotive sector. Such rules of origin mean that one of the main potential advantages of an FTA—the removal of formal barriers to trade within the area—cannot be achieved.

If rules of origin are ineffective, and trade deflection does take place, the net result is that countries that have high tariffs (or other restrictions) against imports from outside the area will find these tariffs evaded, and so will have an incentive to reduce them. In other words, the low tariff (or low protection) countries will tend to set the tone for the whole area. If one favors trade liberalization, one would regard such trade deflection desirable, but, naturally, it is not acceptable to the more protectionist country. Another possibility—which cannot be ruled out but would certainly be less desirable—is that the United States applies pressure on its LAC partner to increase its restrictions on imports from Japan to the U.S. level, so as to reduce the incentive for trade deflection.

The obvious solution to avoid all these complications is to convert the FTA into a customs union. This means that there would be a common external tariff, and possibly other common restrictions, such as antidumping duties. In a customs union there would have to be an agreement about common nontariff barriers. If we think specifically of Western Hemisphere free trade arrangements, a customs union would mean that the external trade barriers of the LAC would be determined in Washington, D.C., since it is inconceivable that the U.S. Congress would allow relatively small economic partners to play a significant part in determining its barriers against imports from, say, Japan.

Reciprocity

The most important gain that an LAC is likely to obtain from an FTA is the reciprocal opening—or commitment to continued opening—of

the U.S. market to the LAC's exports of goods and services. In this respect, the FTA is far preferable to unilateral liberalization. Essentially there are two trade-creation effects from the establishment of an FTA: first, the trade creation that results from the LAC's own liberalization (which could be greater under unilateral liberalization), and second, that which results from U.S. liberalization. If the general, comparative advantage gains-from-trade propositions are accepted, it follows that both countries gain from both forms of trade creation.

Extent of Gain from Reciprocity Effect

The extent of the gain to the LAC depends not just on the level of existing barriers to its exports in the United States but on what these barriers might have been in the future if no FTA were established. The attraction of an FTA is to lock in the present relatively open trade policies of the United States with respect to the LAC. This has been called the "safe-haven" effect.

For given initial and potential barriers, the extent of the gain from their removal depends, in addition, on the extent to which the types of goods and services that the LAC exports are substitutable with competing products in the United States. In many cases, this substitutability is likely to be high, so that considerable gains might ensue.

The central questions, of course, are how big the U.S. barriers are now, what they might be if no FTA were established, and to what extent they will be genuinely reduced in an FTA. For each LAC where the FTA possibility arises, a separate detailed analysis has to be made. Measuring existing barriers is usually difficult because the main barriers are nontariff ones, notably the threat of antidumping duties and various "safeguard" provisions. Estimates of what the barriers might be if no FTA were formed involve imaginative judgments. But it is also important to note that an FTA might allow many loopholes and special arrangements so that, in effect, assured free entry of LAC goods into the United States will not be provided. The U.S. market may not be so "safe" a "haven."

The value of an FTA to the LAC depends crucially on how the safeguard problem is handled. It is inevitable that some producers in the United States will be adversely affected by the FTA, or at least that they will expect to be adversely affected. Usually they have plenty of warning of what might happen, but sometimes the adverse impact can indeed be quite sudden. It is thus natural that they should seek temporary relief or "safeguards against market disruption" or through antidumping cases. Such measures have been allowed under the General Agreement on Tariffs and Trade (GATT) and also the U.S.–Canada

agreement. They represent the reentry of protection by the back door. Measures are not usually temporary and, above all, they introduce uncertainty.

Trade Diversion and the Bandwagon

One component of the reciprocity effect for the LAC is U.S. trade diversion. This refers to trade diversion *by the United States*, and benefits the LAC, although it harms both the United States and the other countries whose trade is diverted in favor of the LAC. It is to be distinguished from trade diversion by the LAC itself, discussed earlier, the effects of which are clearly adverse for the LAC. The effect of U.S. trade diversion will be greater the higher is the substitutability of the LAC's exports with those of competing countries. Considerable losses could be inflicted on the latter, for example, when Mexican labor-intensive exports replace those from Asia. It is part of the reciprocity effect because it results from the removal or reduction by the United States of its barriers on imports from the LAC while maintaining some barriers, actual or potential, against imports from outside.

This potential trade-diversion effect creates an incentive for other developing countries to join the FTA bandwagon. When LAC No. 1 forms an FTA with the United States, there could be an adverse effect on LAC No. 2 through U.S. trade diversion, so No. 2 now has a stronger reason than before to follow the leader. The more countries join, the fewer the gains for the early joiners.

Political Economy Arguments for an FTA

A country's own liberalization may be politically easier when it is part of a move to an FTA. Unilateral liberalization may be desirable from a national point of view but may be blocked either by domestic interest groups or by lack of popular understanding of the gains from free or freer trade. There are then strong political economy arguments in favor of an FTA.

First, when an FTA is in prospect, countervailing export interest groups will emerge that will expect to benefit from the reciprocity aspect of the FTA—for example, the opening up of the U.S. market. While such interest groups have also emerged in the case of unilateral liberalization when this is associated with devaluation, the benefits to potential exporters from a unilateral liberalization of imports associated with devaluation are more indirect, and sometimes hard to imagine in advance, compared with the benefits from direct opening up of a foreign market. Second, the sentiment in favor of liberalization will

certainly be strengthened by the reciprocal liberalization in the United States. Whatever economists may say—that unilateral liberalization is usually beneficial even when trading partners remain protectionist—the popular instinct is to think in terms of reciprocity and fairness.

Multilateral Trade Liberalization and Regionalism

In my view, multilateral free trade—or at least substantial worldwide liberalization supported by strong rules—is preferable to regional arrangements. But the prior issue is whether movement toward regionalism (e.g., NAFTA) is likely to foster or to discourage the success of multilateral negotiations and the rules and processes of the new WTO system.

How Regionalism Might Affect Multilateralism

Regionalism can be seen as a supplement to multilateralism, as an alternative or as a path toward it. The official U.S. position is certainly that it is a supplement, and that any FTA decisions must work within the framework of the WTO and the Uruguay outcome. Hence, regionalism is no obstacle to progress in multilateral liberalization. One can certainly conceive of various FTAs around the world being supplemental to a new multilateral system that strongly regulates trade restrictions and brings about a good deal of liberalization. The argument is that the FTA is likely to go further in liberalization, being then a true supplement.

But regionalism can also be an alternative to multilateralism. The members of the European Community seemed to have been less committed to ensuring the success of the Uruguay Round because of their preoccupation with the completion of the internal market (the "1992" program). More generally, given the large and expanding area of genuinely free trade that they are creating for themselves, they saw less need for making some politically painful concessions in agriculture to achieve a Uruguay Round success.

Finally, one can see regionalism as a path to multilateralism. One can imagine (with a great act of imagination) a small number of regional groupings—that is, FTAs—being formed (e.g., a European, a Western Hemisphere, and an Asian one), and then, the three would negotiate and in one grand bargain open up to each other—and so, there would be world free trade, or something close to it. This is surely unrealistic.

A more reasonable proposal is the "open club" idea. A free trade area, with the United States at its core, would be established among a limited number of countries—for example, the NAFTA—but any other

country, whether in the Western Hemisphere or outside, would be invited to join. There might be a standard agreement (with the usual safeguards and transition arrangements) that would provide the basis for negotiations with any new candidate. More and more countries would find it advantageous to join, if only to avoid trade diversion against themselves. If they were allowed entry, the FTA would grow and grow until eventually it embraced the whole world. The European Community has been somewhat like this, though the invitations have been rather limited and applications have not always been accepted. But I doubt that this process would eventually achieve world free trade, or at least a degree of liberalization and acceptance of international rules equal to what a continued multilateral liberalization process could achieve. It is more likely to end in a small number of complicated regional arrangements.

Multilateralism and Regionalism Compared

Consider now the interests of a particular developing country (LAC) and compare the effects of multilateral liberalization with regional liberalization (an FTA with the United States being formed).

First, the FTA would open up—or lock in—the U.S. market for the LAC's exports. By contrast, multilateral liberalization would open up and, hopefully, lock in, the world market. The latter is bigger, and hence preferable. But the strength of the locking-in effect might be greater in the case of the FTA, so that the balance might tilt in favor of the FTA.

Second, any agreement, whether an FTA or a multilateral agreement under the WTO, involves the continuous enforcement and interpretation of agreed rules, and inevitably negotiations. The bargaining strength of the developing country relative to its trading partners, and the strength of the rules set up, are then relevant. Here the developing country may be in a weaker situation in an FTA—where the United States would be dominant—than in a multilateral environment where none of the three big economic powers (the United States, the European Union, and Japan) have the same relative strength, and where more will have to depend on the enforcement of universal rules. Hence, from this point of view, multilateral arrangements are also preferable.

Third, the FTA gives the developing country the benefit of some trade diversion in its favor in the U.S. market. This effect is not in the U.S. or the general world interest, but it is a benefit to the developing country itself, and thus is an argument favoring the FTA relative to multilateralism.

Finally, consider the government of a developing country that wishes to liberalize but has a problem overcoming domestic pressure groups. It may be able to go a limited way in unilateral liberalization, but beyond that it requires the promise of reciprocal benefits, as provided either by multilateral agreements or by an FTA. The question is which one of these would be politically more persuasive. It is probable that an FTA would be more successful in helping along domestic liberalization.

Countries that are small in the world economy—like all countries other than the United States, those of the European Union, and Japan—have a great deal to gain from a new rules-based international trading system. If the choice were between regionalism and multilateralism, the first argument above—that the world market for their exports is better than the U.S. market—and the second argument—that they will be better protected by a rules-based system where there are several large actors, rather than a smaller grouping with one dominant member—must weigh strongly. Multilateralism is best. But in practice the choice is not necessarily as stark. A sound rules-based system may be established, in which case an FTA might be considered as a supplement. The important concern must be that the pursuit of regionalism does not slow up the strengthening of the multilateral system.

Comment

Jeffrey Schott

I should start by offering an apology. Although I was a student at the university where Professor Corden now teaches, I left the university and went into government, where I was totally corrupted! Trade negotiators are more mercantilist than trade theorists, and so, just to survive, I have had to temper my academic learnings with the lessons that I learned in the school of hard knocks in international negotiations. So I apologize if that offends economic theory, but I will try at least to convey some of my ideas based on practical experience.

Given the long, drawn-out process of multilateral trade negotiations, questions have been raised whether regionalism provides a more pragmatic, albeit second-best, approach to trade liberalization. The second-best argument is a variant of the question, Should regionalism be regarded as a complement to, or a substitute for, multilateral trade liberalization?

Let me put forward a stark response: in my view, multilateralism cum regionalism remains the best approach for global trade policy. I say remains, because regionalism and multilateralism have worked in lockstep since the founding of the GATT more than forty years ago. Regionalism in the absence of a strong multilateral system, however, generates protectionist pressures to maintain the discrimination inherent in preferential trading pacts (or even to raise barriers to third-country trade).

Throughout the postwar period, regionalism has advanced in the context of continuous multilateral trade liberalization, which effectively narrowed the gap between most-favored-nation (MFN) tariffs and preferential rates accorded regional partners. Indeed, parallel progress at both the multilateral and regional levels has reinforced the basic objective of the GATT, promoting stable growth and economic development.

One can summarize the basic benefits of regional integration by adapting a simple identity from Economics 101: $Y = C + I + G$. In this context, regional income (Y) should rise if regional pacts enhance com-

petitiveness *(C)*, provide insurance against policy reversals *(I)*, and establish good precedents for the GATT *(G)*.

First, the focus of regional initiatives should be on increasing the *international competitiveness* of regional industries, since the discriminatory regional preferences will be short-lived as multilateral negotiations succeed in breaking down border protection. Indeed, in countries where border measures are already low, the competitiveness rationale is central—and, for example, is a key benefit of U.S. participation in the NAFTA.

Second, regional pacts should serve as an insurance policy against reversion to interventionist and protectionist policies that have often disrupted regional trade and investment. The insurance policy both protects against changes in the partner countries and helps governments withstand the protectionist impulses of their own domestic lobbies. It should allow businesses to better plan their trade and investment strategies, and thus give impetus to the restructuring and rebuilding of industries along regional lines.

Third, regional integration reinforces existing multilateral disciplines and provides building blocks for new global accords. With a strong and effective multilateral trading system, regional initiatives can complement GATT reforms in several ways: they tend to be trade creating since regional partnerships usually generate positive income effects that outweigh the adverse effects of the trade discrimination; they tend to broaden and deepen GATT trade reforms so that regional industries can take better advantage of new trading opportunities around the globe; and they can serve as models for strengthening multilateral disciplines. Simply put, regional pacts often act as negotiating laboratories for new issues that have not yet advanced on the multilateral trade agenda.[1] In so doing, regional trade initiatives can "ratchet up" reforms to a broader multilateral accord.

Furthermore, regional pacts often produce deeper liberalization than multilateral negotiations, which involve a larger number of countries and thus must necessarily cater to a broader range of interests. The benefits of such regional reforms can be accorded to nonmember countries (as many countries have done with their unilateral reforms,

[1]For example, the Canada–U.S. FTA was designed in part to jump-start multilateral negotiations and to provide building blocks for broader multilateral accords. Similarly, provisions on trade in services in the U.S.–Canada and Australia–New Zealand Free Trade Agreements helped inform and guide the Uruguay Round negotiators; and the NAFTA investment chapter provides useful precedents for both the current development of investment guidelines in the Asia-Pacific region and for future negotiations in the WTO.

and as Mexico has done with key aspects of the NAFTA), or can be targeted for credit in future WTO talks.

Concerns About Trade Diversion

The GATT does not require countries to demonstrate that their regional pact will be, on balance, trade creating. Nonetheless, most GATT reviews of FTAs gauge the desirability of the pact on whether its trade-creating effects outweigh the trade-diverting effects. If the latter dominate, political pressures are likely to arise within the region to forestall MFN trade liberalization in the interest of preserving the protection implicit in the regional preferences.

First, let me start with an obvious point. A primary purpose of regional pacts is to improve the efficiency of local industries. It therefore is designed to make it harder for foreign firms to compete in the regional market—*not* because of higher barriers against third-country trade, but because of the heightened competitiveness of regional firms.

Second, any diversion will be partially offset by pressures that arise within an FTA (as opposed to a customs union) to reduce MFN tariff rates down to the level of the low-tariff country in the region. In contrast to a customs union, an FTA maintains competition among its partners since each country retains sovereign control over its trade policy vis-à-vis third countries. Member countries can thus lower their MFN trade barriers to promote the competitiveness of domestic industries in regional markets and to avoid potential investment diversion *within* the region.[2]

Furthermore, as FTA preferences are phased in, less-competitive industries will contract and thus over time lose political influence to lobby for the maintenance of high external tariffs. The combined result is continued support for multilateral trade liberalization, despite its eroding effect on regional preferences.

Concerns that regional preferences may distort trade and investment flows from nonmember countries are often exaggerated, for two reasons. First, the margin between the MFN rate that third countries pay, and the preferential (zero) regional rate, is very small in most sectors—and will be reduced further by the Uruguay Round reforms (with the notable exceptions of textiles and agriculture). Second, in

[2]Because of the threat of investment diversion, pressures build in high-tariff countries to reduce their MFN rates so as not to lose production to areas that charge lower duties on imported components. This concern was evident in resisting a restrictive NAFTA origin rule for computers, and requiring a common external tariff after the ten-year transition period. It also led Canada to move to cut its MFN textile tariffs to "aid" its apparel makers.

most instances, regional partnerships generate positive income effects that outweigh the adverse effects of the trade discrimination.

Conclusion

In sum, expanding regionalism should not pose a threat to the world trading system, especially if the WTO monitors these arrangements and strengthens its obligations under GATT Article XXIV (and Article V of the General Agreement on Trade in Services (GATS)). I should add one caveat to temper this otherwise optimistic assessment. One needs to ensure that regional trading rules do not create hidden protectionism, for example, through discriminatory rules of origin. The NAFTA falls prey to this abuse in the textiles sector, although the Uruguay Round reforms will reduce the negative impact of those provisions to some extent. To deter similar problems, all regional trading pacts should be subject to annual reviews by the WTO—perhaps using the new Trade Policy Review Mechanism established in the Uruguay Round.

Rather than distract attention away from the multilateral trading system, I believe regional pacts can and will complement and reinforce world trade rules. Because of the short half-life of regional preferences, regional industries need to restructure to promote the more efficient use of natural and human resources in the region so as to be able to compete more effectively against foreign suppliers at home and abroad. Countries thus pursue regional pacts to make their firms more competitive in world markets and better able to take advantage of the increased trade opportunities created by the Uruguay Round reforms.

How to Live Near Vesuvius 9

Patrick A. Messerlin

Allow me to narrow the topic of this seminar by focusing on one industrial group—the European Community (EC). The reason is that most of the trade flows from and to Central and Eastern European countries are going to or coming from the Community. The same reason implies that in what follows, more attention will be devoted to Central European countries than to the Baltics, Russia, and other countries of the former Soviet Union, the trade policy of which is still in the making.

The following remarks are divided into three topics: a global perspective, specific issues related to agriculture and manufacturing, and a short conclusion on services.

A Global Perspective

The title "How to Live Near Vesuvius" reflects the fact that the Central and Eastern European countries have relatively small economies, compared with the huge economy of the Community, as crudely illustrated by the fact that (at current exchange rates) the GDP of all the Central European countries is roughly equal to the Dutch GDP. This particular situation has to be taken into account. It is not specific to the Central and Eastern European countries. For example, Canada has a long experience of living close to a large country (80 percent of its trade is done with the United States). Most of the developing economies that have been successful in export promotion (Korea, Taiwan Province of China, and so on) have, at least at the beginning of their industrialization, faced a similar situation with most of their exports going to the United States.

If any trade policy requires a balance between three aspects—unilateralism, bilateralism, and multilateralism—the past experience of Canada and successful Asian countries suggests a few lessons. First, unilateralism and multilateralism—not bilateralism—should be the favorite trade instruments of countries near a large trading partner, and Vesuvius conveys the message. Near the volcano Vesuvius is Naples, a large town of more than one million people. Everybody in Naples knows that there is a very high probability that Vesuvius will erupt one day or another, making the bilateral relationship between Naples and Vesuvius somewhat difficult. A clever policy would be to build

highways giving the 15 minutes that the Naples population will need to be out of reach of an erupting Vesuvius. There are no such highways. Naples has decided to bet only on a purely bilateral relationship with Vesuvius and obviously it will be a wrong bet sooner or later.

But there are other reasons for making so important the unilateral and multilateral components of trade policy. The unilateral approach is necessary because it is the only one looking at the costs *and* the benefits of any trade measure from the perspective of the whole economy and the national welfare of the country in question. The unilateral approach shows that, in general, opening the domestic economy offers the best cost-benefit ratio and that liberalizing trade is friendly to growth.

Why then not just focus on the unilateral component of trade policy? It is what virtuous governments would do. But history and economic analysis show that such governments cannot exist for a long time. Governments have to face vested interests fighting for transfers. As a result, multilateral disciplines, like those of the GATT, are helpful to counterbalance the power of vested interests. Why? Because under GATT rules, a government has to balance the protection asked by domestic lobbies with access to foreign markets that will not be achieved or that will be lost if the government gives up to domestic lobbies and grants the requested protection. As a result, to focus on GATT is an essential instrument for locking an outward-oriented trade policy. Indeed, during the last five years, a few Central European countries have adopted a trade policy based on unilateralism. And this impetus was partly lost—leading to a partial reversal of the trade liberalization achieved—because of their inability to lock their nondiscriminatory reforms within the context of the GATT-WTO forum. To be fair, renegotiating protocols of accession during a Round proved to be almost impossible because of the short-term trade interests of a few, but crucial, trading partners of Central and Eastern European countries.

I would like to close this introduction on three remarks. First, to be close to a giant has positive aspects. Table 1 shows that the Central and Eastern European countries have benefited a lot from rapidly increased exports to the European Community. Exports to the Community have been an effective engine of growth for them. Except for Romania, annual growth of exports to the EC has reached two-digit figures. Obviously, percentages depend on the initial year, but it remains that the Community markets have been relatively friendly to many products coming from the Central and Eastern European countries. As a result, these countries have reached ratios of exports to GDP that are high by world standards. Perhaps, the most interesting columns of Table 1 are the last four. They show how large has been the restructuring of trade flows from Central and Eastern Europe to the

Table 1. A Few Indicators of Trade Restructuring in Central and Eastern European Countries

	Export/GDP 1993	Average Annual Change in Exports to EC 1989–93	EC Share in Total Exports 1993	1989–93			
				Changes in exported goods		New patterns in traditional goods	
				Expired goods[1]	New goods[2]	"Large" goods[3]	"Small" goods[4]
Bulgaria	35.1	15.9	30.4	23.7	31.8	–5.6	27.0
Czech and Slovak Republics	31.9	24.1	52.4	11.5	19.8	4.1	43.1
Hungary	23.4	11.1	51.8	18.6	20.7	–2.1	24.5
Poland	16.2	18.4	62.2	13.8	15.7	7.2	40.1
Romania	19.7	–9.9	40.0	23.9	18.0	19.4	13.1
FSU countries[5]	10.6	3.9	32.4	7.0	9.5	–0.8	54.6
China	17.7	21.1	9.6	7.9	10.8		
Korea	24.9	2.7	12.5	17.5	18.4		
Morocco	13.9	4.5	64.0	16.7	15.8		
Turkey	13.0	4.3	52.2	12.7	10.7		

Sources: B. Hoekman and G. Poh, " Enterprise Restructuring in Eastern Europe: Preliminary Evidence from Data" (mimeograph; Washington: The World Bank, January 1993).

[1]Share of 1989 exports that disappeared.

[2]Share of 1993 exports that is accounted for by "new" products.

[3]Annual average change in value of "large traditional" (greater than ECU 3 million in 1989) exports.

[4]Annual average change in value of "small traditional" (smaller than ECU 3 million in 1989) exports.

[5]The Baltic states, Russia, and other countries of the former Soviet Union.

rest of the world (i.e., essentially the EC). In particular, the columns under "Changes in Exported Goods" show that many products have disappeared from Central and Eastern European exports, and that many new products have emerged. That is the evolution one could expect for countries previously run by central planning (hence without comparative advantages driven by market forces) and then turning to comparative advantages determined by world prices. Even traditional exports have shown an ongoing restructuring, with traditional large exports decreasing, and traditional small exports increasing.

The second remark—important for the Central and Eastern European countries, but also for the European Community itself—is that the European Community is not as large as it seems. The Community and the member states love the fact that the Community is the largest trading power in the world. That is somewhat erroneous, and it will be more and more so. Table 2, which gives the index of 100 to the 15-member Community (hereafter EC-15), allows crude comparisons between the GDP of the EC-15 and the GDP of various subsets in the rest of the world. At the current exchange rates, it shows GDP of the United States at 85, of NAFTA at 97, and of the APEC at 166. At exchange rates adjusted for purchasing power parity, the changes are even more dramatic: the EC-15 "shrink" relatively to the rest of the world. In terms of population (which mirrors the world when GDP per capita will be the same, i.e., in the very long term), the Community comes back to the small continent it was three centuries ago, as estimated by Maddison (1995).[1] To keep in mind this long-term perspective should be essential for the Central and Eastern European countries.

Finally, the need of economically sound institutions is often too much neglected in trade policy. Because international trade involves losers and winners within the domestic economy (though the economy as a whole gains from trade), it implies particularly strong needs in terms of institutions able to cope with this feature. In a recent book, Winters (1995)[2] has emphasized a few crucial points. Among them, I would like to emphasize what I believe to be the crucial institution—an independent domestic body reviewing trade policy. Such an institution is best illustrated by the Australian Industry Commission; this role has also been played by the European Commission, during the first years of the Community. The Australian Industry Commission is devoted to an essential goal—to provide estimates of the costs and

[1]A. Maddison, *The World Economy, 1820–1992* (OECD, Paris, 1995).

[2] D.A. Winters, ed., *Foundations of an Open Economy: Trade Laws and Institutions in Eastern Europe* (London: CEPR, 1995).

Table 2. The European Community in the World

(EC-15 = 100)

	GDP		
	At current exchange rates	At PPP adjusted exchange rates[1]	Population
Europe			
EC-15	100.0	100.0	100.0
EC-15 and the CECs[2]	107.4	114.3	129.5
Pacific Asia			
Japan	49.1	39.8	33.8
Pacific Asia	66.8	111.4	449.5
America			
United States	85.1	101.6	68.4
NAFTA	96.9	121.7	99.3
Americas	106.6	146.9	172.8
APEC Region	165.7	241.0	569.5

Source: World Bank, *World Development Report*, 1992.
[1]PPP = purchasing power parity.
[2]CEC = Central and Eastern European countries.

benefits of protection for the whole economy and to publicize these estimates. A very protectionist country 40 years ago, Australia is now a very outward-oriented country, and one of the key factors behind this profound change has undoubtedly been these regular and independent reviews of the Australian Commission, that is, reviews by a domestic body revealing the costs of the protection for the economy.

Issues in Agriculture

Agriculture is essential for three reasons. First, the arable land available in Central European countries represents 40 percent of the arable land of the Community. Although there are question marks about the extent to which Central European countries have comparative advantage in agriculture, arable land available seems a trustable indicator—especially taking into account what tailor-made chemicals and biology could achieve. Hence, at the time Central European countries will join the Community, their agricultural output is likely to be a substantial portion of the EC farm output.

Second, the Uruguay Round has definitively changed the way agriculture is perceived in international trade. Although there is no real significant trade liberalization in agriculture to be expected for the next four years (i.e., until the next WTO negotiations scheduled to start in

1999), the Round has reintroduced agriculture into the normal GATT framework of multilateral disciplines. That means that the future negotiations will deal with tariffs instead of quotas. And negotiating decreasing tariffs is a well-mastered GATT-WTO technique, as shown by the last forty years of successful negotiations in manufacturing.

Last, there is an increasingly deep understanding, even among Western European farmers, that the EC Common Agricultural Policy (CAP) has been—and is—a perverse policy, with costs much higher than benefits. This evolution is an absolute prerequisite for deep changes in existing farm policies. Contrary to what is often argued, I see other pressures remaining marginal. For instance, shifting from export subsidies to domestic subsidies is unlikely to receive great support from treasuries, unless it means fewer subsidies, that is, a profound change in the current policy.

The reintroduction of agriculture into the global economy raises essential issues that have been ignored during the last fifty years of quotas and subsidies. The most basic question is the following: should one want to favor agriculture *or* the food industry? Working under market forces implies that favoring the agricultural sector necessarily harms the food industry (and other sectors in the rest of the economy). There is no escape from this economic law of protection—except, costly compensations. And indeed, it has been very expensive for EC budgets to compensate the food industry for the additional costs it had (and still has) to bear because of the CAP. Indeed, this first question should help to realize that there would no longer be one agriculture (as under the plannist CAP regime), but many agricultures, with conflicting interests. That was incidentally revealed by the negotiations of the Blair House agreement. During those negotiations, to hasten their successful conclusion, the U.S. government threatened to impose additional duties on French wine and cheese imported into the United States. French winegrowers and cheese makers started immediately to lobby much harder against the interests of French cereal growers or sugar producers who were inclined to block the emerging agreement. Trade conflicts between the industrial sectors—some of them asking for protection while others push for foreign market access—are routine. The same evolution (impossible under the previous outrageously high and regulated protection) is emerging in agriculture.

There are four basic constraints on the Central and Eastern European countries' trade policies in agriculture during the next years. First, the income share of agricultural products is large in Central European countries (and it is even larger in most of the countries of the former Soviet Union); for instance, 25 percent of the income in Hungary and 58 percent in Romania is spent on food. As a result, price increases in these agricultural sectors are politically explosive.

Table 3. GATT-WTO Commitments in Agriculture for a Few Selected Products, 1995–2000

	European Community	Hungary	Czech and Slovak Republics	Poland
Wheat				
Tariffs 1995[1]	83.30	50.00	25.00	120.60
2000[1]	83.30	32.00	21.20	77.20
Reduction[2]	0.00	36.00	15.20	36.00
Export subsidy 1995[3]	19.12	1.39	0.21	0.00
Sugar (white)				
Tariffs 1995[1]	214.60	80.00	70.00	208.40
2000[1]	171.60	68.00	59.50	169.10
Reduction[2]	20.00	15.00	15.00	18.90
Export subsidy 1995[3]	1.56	0.14	0.01	0.13
Butter				
Tariffs 1995[1]	205.70	159.00	81.50	160.00
2000[1]	131.70	101.80	68.00	102.00
Reduction[2]	36.00	36.00	16.60	36.30
Export subsidy 1995[3]	0.45	0.00	0.10	0.00
Beef				
Tariffs 1995[1]	194.90	112.00	41.70	278.60
2000[1]	124.70	71.70	34.00	178.10
Reduction[2]	36.00	36.00	18.50	36.10
Export subsidy 1995[3]	1.12	0.04	0.13	0.10
Pork				
Tariffs 1995[1]	87.50	61.00	45.80	118.50
2000[1]	56.00	51.90	38.50	75.90
Reduction[2]	36.00	15.00	15.90	36.00
Export subsidy 1995[3]	0.49	0.11	0.03	—

Source: S. Tangerman, T.E. Josling, and W. Münch, *Pre-Accession Agricultural Policies for Central Europe and the European Union*, Final Report to the European Commission, DG–1 (Brussels, December, 1994).

[1]Tariff bindings ad valorem equivalents in 1995 and 2000.

[2]Committed reductions (in percent).

[3]Commitments: quantities of subsidized exports (million tons).

Second, GATT-WTO commitments impose some limits on the degree of freedom for the immediate future. As shown by Table 3, which presents the commitments in terms of tariffs of the Community, Hungary, the Czech and Slovak Republics, and Poland, bound tariffs for Hungary and the Czech and Slovak Republics are much lower than the bound tariffs of the European Community. If these countries want to join the Community, they (and the Community) will have to pay the price for it under the form of concessions to trading partners, such as

the United States, that will ask for it. At the other end of the spectrum, the Polish government has bound tariffs at a level close to that of the EC. But, if Poland can join the Community quickly without any external problems for its bound tariffs, it has to face internal problems—to maintain a domestic agricultural sector behind high barriers, as shown by the next point.

Third, there is a large budgetary component in any agricultural policy. It is always nice to begin a policy like the Common Agricultural Policy: it is easy, because generous subsidies give the temporary impression that there are no marginal firms. The problem is that in economic terms, one never gets rid of marginal firms that constitute the hard core of lobbies. When one starts to subsidize, existing marginal firms are happy. But increased subsidized prices induce new marginal firms to enter the market, or existing firms to expand their activities. These new firms request additional subsidies in order to be or stay profitable. As soon as the growth rate of subsidies flattens, all these new marginal firms are in trouble. That explains why 25 years after the introduction of the CAP, EC farmers in financial difficulties riot regularly, even in a country with a comparative advantage in agriculture, such as France.

Fourth, Central and Eastern European countries will face the same problem—in particular, related to land prices. Because land is more or less a fixed input, subsidies to agriculture tend to increase the price of land. Farmers want to produce more in order to benefit from higher prices. For doing so, they need more land. In the early 1970s, when the CAP started to cover wines, the price of land in Languedoc (Southern France) for growing average-quality wines skyrocketed and became as high as the price of vineyards in the Bordeaux region for French best-quality wines. The unique reason was that the winegrowers in Languedoc were expecting increases in wine prices (once subsidies were included) and consequently were buying as much land as they could. Landowners were happy—indeed they have probably been the main beneficiaries of the CAP. But farmers were seeing their costs increasing as quickly as their (subsidized) revenues. It was not too bad, as long as farmers could sell their land at good prices (i.e., as long as they could enjoy their share of the benefits of being landowners). But when the CAP prices started to stabilize, or even to decrease, farmers who did not earn a good living as farmers began to lose money when they were selling land.

In the Central and Eastern European countries, this almost certain evolution (if a CAP-type of agriculture policy is implemented) could be worsened by political aspects. For instance, it seems that recently, much land in the former East Germany has been bought by Western European agricultural firms (from France, Germany, the Netherlands,

Table 4. Costs of Gradual Price Alignment (by 2000) Policy to EC Prices for the Visegrad Countries

	Net Surplus (Export) (In million tons)	Price Increases (In percent)	Budget Expenditure (In billions of ECUs)
Cereals	8.0		—
Wheat	—	0–10	—
Barley	—	10–85	—
Sugar	1.8	25–50	—
Dairy	0.4		—
Butter		30–130	—
Beef	0.6	155–215	—
Pork	1.0	115–150	—
Subtotal 1	11.8		3.3
Other products	—	—	4.3
Market management	—	—	1.4
Subtotal 2	—	—	9.0
With CP-SA[1]	—	—	4.3
Total	—	—	13.3

Source: S. Tangerman, T.E. Josling, and W. Münch, *Pre-Accession Agricultural Policies for Central Europe and the European Union*, Final Report to the European Commission, DG-1 (Brussels, December 1994).

[1]CP = compensatory payments; SA = set-aside.

and so forth). And, if the above-described evolution occurs in Central European countries with private farms (such as Poland), the happy farmers will be those who sell their land fast, and those farmers who suffer will be the ones who will stay in farming and will likely suffer from hard competition—an explosive situation, politically speaking, of a two-tier economy.

What are the options in agricultural economic policy? There are three. The first is to raise Central European prices to the level of the EC immediately. That seems almost impossible, however, simply because it is much too expensive. The second is to make prices in the Central European countries converge with EC prices in successive steps before the year 2000. That is a more serious option because, at that time, one could expect lower prices of EC farm goods, so that prices in the Central European countries could increase more moderately than in the first scenario. Nevertheless, it still seems an expensive option, as shown by Table 4, even limited to the Visegrad countries (including Bulgaria and Romania would add ECU 6 billion). For wheat, only a 10 percent price increase is needed to converge with Community prices; it can be much higher for other goods: according to Tangerman,

Table 5. Transition Economy Tariff Reductions on Industrial Products by Individual Country[1]

(In millions of U.S. dollars unless indicated otherwise)

		Trade-Weighted Tariff Averages		
Participants	Imports from MFN Origins	Pre-Uruguay	Post-Uruguay	Percentage reduction
Economies in transition	34,671	8.6	6.0	30
Czech Republic	8,862	4.9	3.8	22
Hungary	9,468	9.6	6.9	28
Poland	7,479	16.0	9.9	38
Slovak Republic	8,862	4.9	3.8	22

Source: WTO Secretariat, *The Uruguay Round* (Paris: WTO, 1994).
[1]Excluding petroleum.

Josling, and Münch (1994),[3] some prices could be increased by 100 percent or 200 percent for crucial products, such as pork or beef. The last policy option is that of last-minute increases. Central European countries join the Community, say in the year 2000, and they increase farm prices on December 31, 1999. Then, there is only the "last-shot" cost for the Community. According to Tangerman, Josling, and Münch, the six more likely candidates to join the Community in the early years of 2000 will still cost the Community ECU 20 billion—obviously not a small tag, even for the EC-15 budget.

Indeed, the cost of these options would suggest a fourth option—well within the EC tradition in case of a difficult situation: the introduction of a period of transition, as shown by the experiences of Portugal and Spain. For the Central European countries, the transition should be a long period indeed (twenty or more years), if one focuses on economic aspects. As a result, it raises the political problem: would the Central European countries feel fully integrated into the Community in such a scenario?

Issues in Manufacturing

Issues related to manufacturing can be organized around the four following points.

First, the Uruguay Round results leave an ambiguous message about the future trade policy of the Central European countries. Table 5 shows that Central European countries' average tariff will decline by more

[3]S. Tangerman, T.E. Josling, and W. Münch, *Pre-Accession Agricultural Policies for Central Europe and the European Union*, Final Report to the European Commission, DG-1 (Brussels, December 1994).

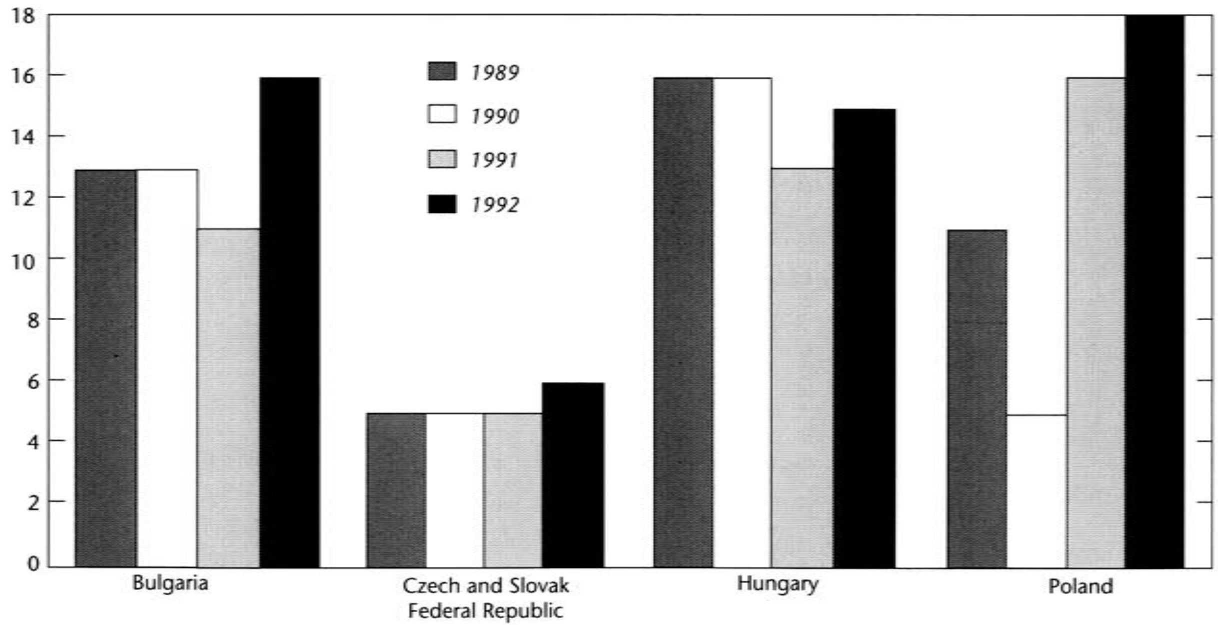
than 20 percent over the next five years, as a result of the Uruguay Round commitments. However, Figure 1 shows how much the tariff policy of the Visegrad countries has been reversed during the negotiations of the Uruguay Round. In 1990, these countries had—on average—very low tariffs, but in 1991 and 1992, these tariffs were increased by a substantial proportion. As a result, the Uruguay Round concessions to be implemented in 2000 correspond to a mere coming back to the situations prevailing in 1991. No more, no less. Moreover, this stabilization of the tariff protection has been accompanied by tariff peaks, especially in cars, consumer electronics, and chemicals. This unclear evolution in the long run generates serious questions about the capacity of all Central European countries (with the exceptions of the Czech Republic and Estonia) to join the EC in less than 15 years. Indeed, a detailed analysis of the Central European countries and EC tariffs under the Uruguay Round commitments (Messerlin, 1995)[4] shows that the spread between the two groups is 10–15 percent on average, with peaks at 30 percent for some industries—that is, the magnitude of tariff spreads that existed between the founding members of the Community, in 1958, at the start of the EC.

The second point concerns regional trade preferences. The many bilateral treaties between the Community and each of the Central European countries do not provide the stability required for sound trade policies. If it is difficult to withdraw preferences, it is easy to erode preferences granted previously: one only needs to grant more preferences to other countries. The Community, maybe unknowingly, has been (and is) a master at that, as shown by Figure 2, which illustrates the pyramid of Community preferences. Published in 1993, it is already partly inaccurate—a sign of how fast EC preferences can be eroded. It shows that countries can move up along the scale of preferences, meaning automatically that the other countries are moving down. For example, the Mediterranean countries have not seen their preferences changed, but those preferences have been largely eroded by the fact that the associated Central European countries are nowadays close to the EFTA status. As this uncertainty can be solved only by full accession to the EC, it may explain the race toward EC membership.

This problem raised by regional trade preferences is compounded by the fact that Central European countries are creating their own regional trade agreements among themselves. Such a move has positive aspects that may be endangered by the multiplicity of the agreements.

[4]P.A Messerlin, "A Note on Central European Countries' Trade Policies After the Uruguay Round" (mimeograph; Paris: Institut d'Etudes Politiques de Paris, 1995).

Figure 1. Average Tariff Levels (Unweighted)



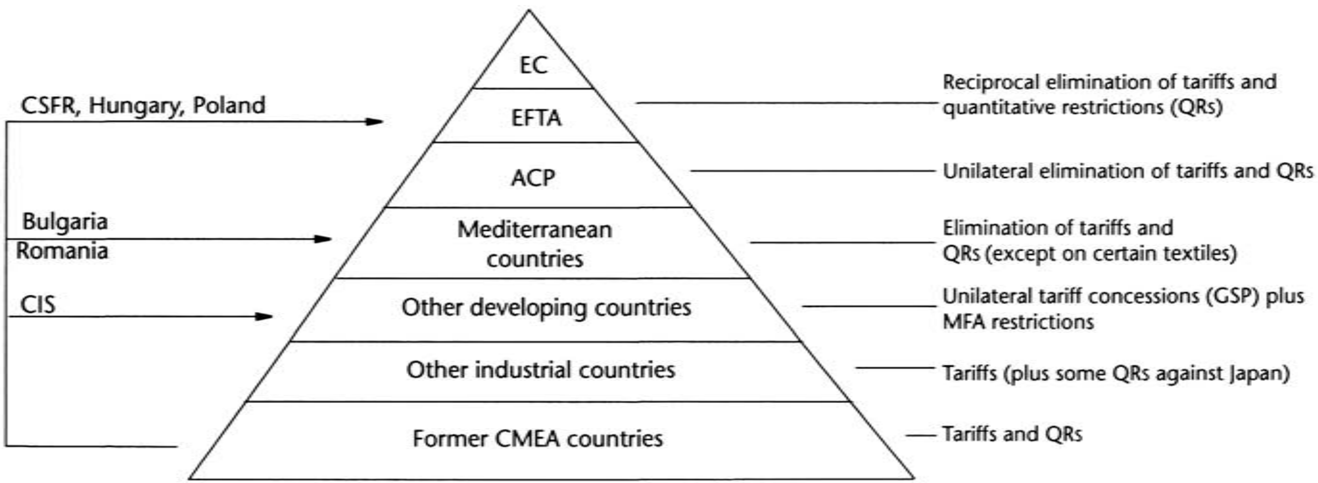
Source: M. Koteva, and M. P. Perreira, "Liberalizing East West Trade: Effects on the Regional Structure of Exports fromCentral and Eastern Europe," Norwegian Institute of International Affairs Working Paper 507 (September 1993).

This is not a new problem. In the late 1940s and early 1950s, the creation of the Community was preceded by a handful of agreements (e.g., Benelux, Francital) now almost totally forgotten. However, these agreements were quickly superseded by the Treaties of Paris and Rome so that the member states of the Community did not suffer from all those special "bilateral" preferences. The merger of all existing agreements between Central European countries in one general regional agreement (say, the Central European Free Trade Agreement (CEFTA)) is a much-needed move. As an illustration, let us take the problem of rules of origin, which is a source of permanent friction. The problem could be solved by Central European countries in one strike: by concluding a CEFTA including all associated and Central European countries, and consequently asking for one Association Agreement with the EC.

The third point concerns the "sensitive" sectors—apparel, steel, and certain raw materials (aluminum, uranium, and calcium) crucial for the Baltics, Russia, and other countries of the former Soviet Union—and antidumping enforcement. All these difficult problems are pending without any clear-cut trade liberalization from the EC. In textiles, essentially, most of the trade between Central and Eastern European countries and the Community is based on outward-processing-traffic trade, introducing a quasi-vertical integration of Central European countries' apparel firms by the Community's textile firms. If that is helpful for Central European countries' plants for solving immediate problems (making quicker and easier the trade restructuring outlined in Table 1), in the long run it can clearly limit the Central European countries' firms to a marginal role in terms of marketing—changing products, improving technologies, and so on. In steel, progress in restructuring is slow, including from the EC side. In particular, the EC steel industry has been very slow to introduce new technologies, such as mini-mill steel plants based on scrap and electricity. As a result, as soon as EC protection is released a little bit, rapidly reemerging pressures arise for protecting the EC steel industry from Central European countries' competition.

Last, antidumping enforcement deserves a few remarks. First, Central and Eastern European countries still represent 30 percent of the EC antidumping actions initiated in 1993–94. If they have preferential access to EC markets, Central European countries seem to have also preferential access to EC antidumping procedures. Traditional worries are still there—unchanged despite the Association Agreements. The EC-complaining firms are always the same. The "Who's Who" of these firms has not changed in the mid-1990s: for instance, in chemicals and synthetic fibers, Hoechst, BASF, Bayer, Montedison, Péchiney, Rhône-

Figure 2. Pyramid of EC Preferences for Trade in Manufactures



Note: ACP = African, Caribbean, and Pacific Countries; CIS = Commonwealth of Independent States; CMEA = Council for Mutual Economic Assistance; CSFR = (the former) Czech and Slovak Federal Republic; EFTA = European Free Trade Association; GSP = Generalized System of Preferences; MFA = Multifiber Arrangement.

Source: Peter Nunnenkamp, "World Trading System at the Crossroads: Multilateral Trade Negotiations in the Era of Regionalism, *Aussenwirtschaft*, Vol. 48, (June 1993), pp. 177–201.

Poulenc, and ICI; in steel, the EC cartel Eurofer; and in consumer electronics, Philips and Thomson. In addition, there are now clear examples of a worldwide use of antidumping laws by the same firm, as best illustrated by Rhône-Poulenc's complaint against Chinese exports of coumarin both in the United States and in the EC. Other worrisome evolutions are that antidumping margins are very large (50–70 percent) and increasing, and the fact that reference countries show clear biases (such as in the calcium metal case where the U.S. producer has been taken as a reference for Russian producers).

The final worrisome aspect is that Central and Eastern European countries have introduced antidumping enforcement between themselves. This dangerous shift is increased by the fact that Central European countries tend to enforce other procedures of "contingent" protection, which are close substitutes to antidumping, such as "safeguard" cases (in Hungary) or additional duties (in Slovakia). In fact, EC firms involved in EC antidumping actions seem implicitly present in these procedures and cases. All these evolutions, which suggest concerted efforts for slowing competition, are dangerous for the Central and Eastern European countries: generally, latecomers are not in the best situation in a collusion game.

Conclusion

Nothing has been said about services, although they represent 60 percent of a developed economy (one service sector, such as banking, has a value added six times larger than the basic steel industry in a medium-sized country like France) and although they are much needed in the Central European countries (for catching up with central planning, which has relentlessly discriminated against services).

This silence is due to the fact that services open a new set of issues, essentially related to foreign direct investment (FDI), and that it is too early for being able to make a global assessment of the FDI policies followed by the Central European countries. However, many observers have noticed a strong tendency among those countries to provide monopoly positions to foreign firms for a long period of time. This approach seems at odds with the more competition-oriented approach followed by the leaders (the United States and a few Asian countries) in this field, and by the EC itself. The next few years will be crucial in this large set of sectors.

Comment

Donogh C. McDonald

Among the points made by Messerlin, I would echo in particular the importance of a multilateral approach to trade liberalization. I would also agree that EU trade policies toward the transition economies are open to criticism in some respects. Nevertheless, the important contribution of EU trade liberalization in fostering the process of transition in Central and Eastern Europe should not be underestimated. To illustrate this, I will provide additional detail on the EU's trade policies and on the development of its trade with the transition economies. I will then turn briefly to some issues raised by Messerlin concerning the policies of the transition countries themselves.

In my comments, I will focus on countries with which the EU has negotiated Europe Agreements, admittedly a subgroup of transition economies that has been relatively favored in the EU's trade policies. These agreements are association agreements that aim to lay the foundation of eventual EU membership; they contain provisions covering a wide range of economic and financial issues, but the trade provisions are those with the greatest short- and medium-term effects. A first round of Europe Agreements was signed at the end of 1991 with Czechoslovakia, Hungary, and Poland;[1] the trade provisions of these agreements came into effect in 1992.[2] Agreements were signed in 1993 with Bulgaria and Romania and in 1995 with the Baltic countries and Slovenia.

As the trade provisions are not easily summarized across all these agreements, particularly in view of their differing start dates, I will use as an illustration those whose trade provisions came into effect in 1992. The agreements were asymmetric in the pace of liberalization, with the EU liberalizing faster than the associated countries. Indeed, the EU's liberalization in the area of manufactures was quite rapid, with the no-

[1]The agreement with Czechoslovakia was subsequently replaced by separate agreements with the Czech and Slovak Republics.

[2]The trade provisions of the Europe Agreements have been brought into effect quickly as trade matters are within the competence of the European Commission, while other aspects of the Europe Agreements have required ratification by EU member states.

table exceptions of two sensitive product areas—steel and clothing and textiles. Thus, at the time that the trade agreements entered into force, the EU eliminated tariffs on a wide range of products and, by the end of 1994, tariffs had been abolished for all nonsensitive manufactured products. Any quantitative restrictions on these products had also been eliminated when the trade agreements took effect. Turning to sensitive products, while quantitative restrictions on steel products were also eliminated immediately, tariffs were not to be phased out until the end of 1995; as regards clothing and textiles, tariffs were to be eliminated by the end of 1996 and quotas by the end of 1997. The least generous provisions concerned agriculture, where there was not a major opening of EU markets.

The above does not touch on additional barriers to sensitive products that arise through the invocation of the safeguard and antidumping provisions that appear in the Europe Agreements (and of course are a typical feature in trade agreements generally).[3] Messerlin has provided a list of such measures taken by the EU. Countries with Europe Agreements seem to have come off somewhat better than other transition countries; nevertheless, there have been some notable recent cases. For example, restrictions put on EU imports of five categories of steel from the former Czechoslovakia at the end of 1992 covered products accounting for 4 percent of total Czechoslovak exports to the EU at that time. More generally, even if the number of measures actually taken has been limited, one must take into account how the threat of possible future measures may affect potential investors.

While there may be some reservations regarding sensitive products, the pace of liberalization under the Europe Agreements would seem quite impressive for most product categories. It is also striking that the EU market for the associate countries has grown considerably faster than their markets in other industrial countries. For the six countries that were first to have Europe Agreements,[4] exports to the EU doubled in U.S. dollar terms between 1989 and 1994. Their exports to the other industrial countries in Europe grew by a total of 20 percent over the same period and to the non-European industrial countries by only 5 percent. Moreover, exports to the EU of the industrial products that have been treated less liberally—steel and clothing and textiles—have grown at roughly the same pace as total manufactured exports to the

[3]In the Europe Agreements, the associate countries have undertaken to adopt the principles of EU competition law. It is envisaged that as competition law in these countries converges on that of the EU, concerns in the EU about the possibility of "unfair" trade will recede.

[4]Bulgaria, the Czech Republic, Hungary, Poland, Romania, and the Slovak Republic.

EU. Of course, the growth of sensitive product exports might have been faster still in the absence of restrictions.

Let me now make some brief observations on issues raised related to policies of the transition economies. First, Messerlin raises concerns about backsliding in liberalization efforts. For the countries with Europe Agreements, two features of the agreements may provide a bulwark against backsliding: tariffs under the agreements are bound; and consultation and monitoring under the agreements may be particularly influential in view of the keen interest of these countries in strengthening ties with the EU and ultimately in joining the EU.

Second, I would agree that the transition economies need to pay close attention to the quality of trade linkages among themselves, in order to avoid a "hub-and-spoke" system in trade relations, with the EU as hub. Inter alia, this is important for investment; a West European investor thinking of producing for markets in the transition economies may be discouraged from using one of these countries as a production base if good access to other target markets cannot be assured.

Finally, I would like to echo Messerlin's concern that the transition economies not take the EU's common agricultural policy as a model. The CAP may be substantially changed by the time countries with Europe Agreements accede to the EU; indeed, in addition to other factors that may foster reform, many commentators have judged that, given the potential budgetary costs, a significant enlargement of the EU to the east would be difficult in the absence of further substantial changes to the CAP. In view of the interests of consumers and the importance of providing appropriate forward-looking incentives for investment in fixed and, especially, human capital, it would seem advisable to set sights on a more liberal system than currently prevails in the EU.

Comment

Daniel A. Citrin

Messerlin has given you perhaps a multilateral perspective to a number of important issues. I thought I would make a few remarks from the perspective of the European II Department, which is the department in the IMF that has been responsible for assisting with the stabilization and reform efforts in the Baltic countries, Russia, and other states of the former Soviet Union. Trade liberalization, of course, has been a key element in the reform process in these countries. While a number of them have made important efforts on a multilateral basis, given the urgent need to reform a highly distorted system of trade policies and to introduce market signals as soon as possible, we at the Fund, and I would say at the World Bank as well, have concentrated our efforts on unilateral liberalization. The first few years in the transition represent a unique opportunity to replace the old with the new. Clearly, the benefits of a liberal trading system have been witnessed in the successes of many countries throughout the world, and so why not replace the old with a new that is as liberal and as efficient as possible.

In the trade reform process in these countries, a number of important issues have emerged. One of them is the removal of export controls, which are pervasive in a number of forms in these countries. A second issue is reducing tariff dispersion and eventually replacing tariffs with domestic taxes that do not discriminate between imports and domestic goods. Another broad issue is what would be the appropriate response to unfair trade practices. A fourth is the issue of economic union proposals, which have been periodically floated in these countries in the last few years. Are they welfare-enhancing or not?

I would like to concentrate on two specific areas, liberalization of export restraints and import protection on the agricultural side. First of all, export restrictions are what we at the Fund have identified as perhaps the most important issue on the agenda for these countries. In transition economies, export restrictions have typically played a much greater role than import barriers and tariffs. The reason, of course, is that unlike market economies, trade barriers have been designed to achieve a low internal price level for certain commodity groups, such as energy and food in particular, rather than to protect domestic industry. Export quotas and tariffs, therefore, were set to bring supply in line

with domestic demand at desired prices. The consequence of this has been that commodities subject to export restrictions are sold at prices way below their international market values, creating disincentives to production and investment and a severe misallocation of resources.

With regard to the status of export restrictions in the 15 countries that emerged from the Soviet Union, and looking at the situation that prevailed around mid-1994, roughly three years after the transition process began, only the Baltics, Armenia, and the Kyrgyz Republic were largely free of state-imposed export barriers at that stage. For all the others, substantial export restrictions remained, with some trade liberalization under way in only a few other countries. Because of the implications for domestic supply and domestic prices, export liberalization remained a really difficult and sensitive area for many of these countries. Indeed, even in countries in which major liberalization efforts were undertaken, such as Ukraine and Russia, the removal of export barriers has been a major sticking point throughout IMF program discussions. Within these countries where export restrictions were still substantial as of mid-1994, there have been large differences in the progress recorded in the last six months or so. Perhaps we can distinguish three groups of countries.

First of all, there is a group of countries where not much has changed. And I would classify in that group Azerbaijan, Tajikistan, and Turkmenistan. Then, there have been two countries where there has been some progress, Moldova and Uzbekistan. Of course, Moldova started from a much more liberalized situation than Uzbekistan, which has remained largely state controlled, nevertheless these two have made some progress. But encouragingly, there have been four countries where substantial progress has been made since mid-1994: Belarus, Kazakstan, Russia, and Ukraine. To review briefly, in Belarus, all export licenses, taxes, and quotas, except those mandated by international agreement, were abolished in December 1994. In Kazakstan, all export quotas and licenses, except for a small negative list that was retained for national security reasons, were abolished in February 1995. In Russia, all export quotas were eliminated on January 1, 1995, but were replaced by domestic measures that, in practice, retained control over the supply of exports. Under the new stand-by arrangement, however, which is now being finalized with the Fund, the situation has been corrected, and all domestic controls will be eliminated. The system of special exporters, which could be used to limit the number of participants in trade, will be eliminated, and all export duties are to be replaced by domestic taxes as of the beginning of next year. Finally, in Ukraine as well, under the program supported by the Systemic Transformation Facility of the Fund, which was agreed in October, about

half of the coverage of export quotas was eliminated in November, and under the new Stand-By Arrangement, which is just being agreed with the Fund, the remaining quotas on exports are to be eliminated by mid-March 1995, with the exception of grain, and with those on grain to be abolished by the end of June. So we see that there really has been a turnaround in this area and significant liberalization now seems to be within reach throughout the area.

Turning to imports, following a sweeping liberalization of import restrictions at the outset of transition in most countries, there has been a partial reintroduction of import barriers in a number of them. This renewed recourse to import protection is likely to reflect the real appreciation of exchange rates in a number of countries. In the initial period, imports were highly protected through highly undervalued exchange rates. In addition, a need to buttress revenue performance in the context of stabilization efforts was also important in several countries.

The increase in import barriers has applied across a variety of sectors and industries. One notable example has been the rise in agricultural protection in two of the Baltic states, Latvia and Lithuania, which together with Estonia have been the leading reformers among those states that emerged following the dissolution of the U.S.S.R. And in Estonia as well, there has been increasing pressure to protect agriculture, although so far it has been resisted. In Latvia, for example, following the adoption of a new law covering import duties in March 1994, intense lobbying by agricultural interests led to an increase in tariffs on a number of farm products in December. In Lithuania, following the introduction of duties in 1993 and various adjustments in the following months, agricultural tariffs were increased substantially in July 1994. In addition, in that country, import quotas were placed on a small number of agricultural products. Following these increases, the weighted average tariff on a broad range of agricultural products amounted to an estimated 52 percent in Latvia and around 40 percent in Lithuania. So that is not insubstantial.

Now, while the desire to provide protection to domestic agriculture over the transition process is understandable, we at the IMF have continued to argue strongly for the need to preserve the liberal import regime. In particular, given the problems of low productivity and inefficient farm size in both Latvia and Lithuania, import protection clearly sends the wrong message. Also, with the economy as a whole having to bear a significant adjustment burden during the transition, it seems inappropriate to grant special treatment to agriculture. Moreover, such protection both taxes other sectors of the economy and raises food costs for consumers, with potentially adverse consequences for the more vulnerable groups of society.

Officials in these countries often argue that every country in the world protects agriculture, so why should the transition economies not do so. Well, we would argue that while some richer countries might choose to afford the lost welfare associated with agriculture protection, the transition economies cannot. At this juncture, resources are precious, and it is crucial that market signals be aimed at encouraging their most efficient use as soon as possible. Thus, we also hope that integration with the EU will not imply the institutionalization of relatively high import barriers.

It is encouraging to note in this area that Lithuania's Extended Arrangement with the Fund agreed in the fall of 1994 included a reversal of the tariff increases that were put in place earlier. The weighted average tariff rate was reduced to 35 percent from around 40 percent, and a further reduction to 20 percent by the fall of 1996 is planned. At the same time, Latvia is expected to reduce agricultural tariffs over the course of the new stand-by arrangement with the Fund. So some reversal has taken place, but clearly this is an issue that is going to stay with us in these countries for a while, as exchange rates have appreciated in real terms and subsidies have been cut back to many sectors as part of the stabilization process.

An Overview of the Uruguay Round 10

Jesús Seade

This paper provides a brief historical sketch of the evolution of the multilateral trading system since its creation, seeking to place the role of the Uruguay Round negotiations in that context, and a qualitative overview of some of the most salient points of the outcome of these negotiations.[1] No economic evaluation of these results will be attempted here.

A Brief Historic Overview

The founding fathers of the General Agreement on Tariffs and Trade (GATT) in 1947 gave it three core functions, three personalities, which determined its evolution and which the World Trade Organization (WTO) now inherits. First and foremost was, and remains, its role as a legal contract: a set of agreed rights and obligations that apply among countries in various forms. Second, it provided for a juridical system that would allow the resolution of disputes related to the respect or otherwise of those rights and obligations. And third, the founding fathers decided to establish a negotiating forum to allow for the evolution and expansion of those rules and commitments.

The latter of the three functions (i.e., the negotiating forum) has periodically become dominant and then disappeared over the years, in a cyclical fashion, through so-called rounds of multilateral trade negotiations (MTN) organized under the auspices of the GATT. In total, seven such rounds were held prior to the Uruguay Round, which was launched in Punta del Este in September 1986. The previous rounds mostly focused on tariff negotiations, except for the Tokyo Round concluded in 1979. The latter was the first major attempt since the creation of the GATT itself to address its "rules" content, and negotiations in it led to a set of so-called Agreements on Nontariff Measures (often referred to as NTM Codes). But despite this partial exception, without

[1]This paper contains the main points made in Mr. Seade's intervention at the IMF seminar in March 1995. The views expressed are those of the author and do not necessarily reflect those of the WTO.

any doubt, a key function and result of the GATT-based process was to reduce tariff barriers to trade. On this it was quite successful: through tariff negotiations, industrial tariffs fell from an average of nearly 50 percent in industrial countries after World War II to just over 6 percent, the level prevailing at the end of 1994—prior to the implementation of the new Uruguay Round tariff commitments.

This is a major achievement in itself, by any standards. This massive global liberalization, underpinned by the confidence that the multilateral trading system represented, provided a powerful incentive to traders and investors and was the backbone of the huge expansion of trade the world has enjoyed. It also permitted and enhanced the major and sustained improvement in incomes and living standards that industrial economies and vast parts of the developing world have witnessed since World War II.

Alongside this secular trend toward reduced tariffs, three qualitative features of the evolution of the multilateral trading system are to be noted.

First, a gradual but continuous shift of attention by negotiators, from so-called border measures—trade policy issues that affect trade directly at the border, notably tariffs—to a collective effort to address issues that formally pertain to other areas of domestic policymaking, but which have a direct bearing on trade. The explanation for this can be found in the very success of the MTN rounds, which led to the sustained reduction in border barriers and which was the focus of attention at GATT's inception: with the reduction of tariffs, other issues affecting competitiveness in the marketplace gained in relative importance.

In addition, through an increase in globalization of trade and economic activities in the last ten to fifteen years, there has been a continuous and noticeable weakening of the concept of "separate markets"; the concept of what is "domestic" has correspondingly blurred. Thus, the gradual development of rules on norms and standards, internal regulations, subsidies (first industrial, now also agricultural), government procurement, and others emerged as equally important, aimed at leveling the playing field. This trend continues, as can be observed with the emergence of a new or proposed future agenda for the WTO, which notably includes such items as trade and environment, trade and competition, investment policy, and others. It would seem that the area of rule making in trade and trade policy is moving the boundaries once again, to widen and deepen the collective grip on what was often considered to fall exclusively under the competence of domestic policy.

Second, since the early days, the sectoral evolution of the trading system became increasingly unbalanced, excluding key difficult areas

that were swept aside from the mainstay of the system of rules and from the negotiations. Such was the case since the 1950s with agriculture, which the United States covered through a waiver and the European Union through the Common Agricultural Policy, better known under its acronym CAP. Another equally sensitive sector, textiles and clothing, was since the 1960s covered through special provisions followed by successive forms of the Multifiber Arrangements (MFA), sanctioned by the GATT but consisting of a mixture of market restraints that effectively impeded the smooth functioning of the trading system and distorted trade and investment. Equally, a large number of "gray area measures" in major industrial sectors such as cars, steel, and consumer electronics increasingly surfaced in subsequent decades and could not be addressed properly under prevailing rules, thus amplifying the distortions and the unbalanced evolution of the trading system.

Third, another main element in the evolution of the trading system was the numerous systems of special rules that were developed for particular countries (special protocols of accession) or groups of countries (notably developing countries) or otherwise to take account of special situations through sectoral exceptions and special regimes, country derogations and waivers, à la carte codes, and so on. In particular, the Tokyo Round contributed to this situation through the negotiation of the above-mentioned agreements on nontariff measures, which only applied to those countries that subscribed to them. The result of these developments was an absolute plethora of different legal systems applying to different countries and different goods under different situations. This affected the levels of rights and legal obligations of different countries, and of different sectors within different countries, in a way that gave good grounds for questioning the existence at all of a legal system for international (multilateral) trade. The case for establishing a more universal, uniform, and enforceable system of rules was paramount.

In this regard, I consider that the overarching and most fundamental implicit objective of the Uruguay Round was the replacement of this highly fragmented legal system by a more equitable, coherent, and truly universal one, attuned to the needs of today's more integrated global trading village.

This extension and essential unification of the rules took place along three different, mutually complementary slants:

- The extension of rules to all signatories, which would effectively bring to a halt the à la carte approach of the Tokyo Round, referred to earlier. This was achieved through the "Single Undertaking" approach that was adopted from the outset of the negoti-

ations in the Uruguay Round and that implies that all rules and obligations apply to all members.[2]

- The extension of rules to "old" sectors that were de facto excluded from the GATT system, even if in theory they were part of it, such as agriculture and textiles.
- The extension of rules to the "new" issues of the Uruguay Round, which had thus far not been included in the multilateral legal system for trade, but whose growing importance to international trade flows demanded it: in particular trade in services, and intellectual property matters related to trade.

Results of the Uruguay Round Negotiations

The results of the Uruguay Round negotiations can be grouped under eight headings: industrial tariffs, rules, agriculture, textiles, trade in services, trade-related aspects of intellectual property rights (TRIPs), dispute settlement, and the new World Trade Organization.

Industrial Tariffs

In noting as I do above that there has been a secular relative shift of attention from tariffs to other issues, I certainly do not mean to suggest that tariffs themselves have become unimportant as impediments to trade. Indeed, the Uruguay Round negotiations were as engaging and difficult in this area as in any and were very successful, with one of the largest sets of tariff cuts ever achieved. While the agreed objective had been to match the overall 33 percent reduction achieved in the Tokyo Round, a global tariff reduction of close to 40 percent was the final outcome. At the same time, and despite this successful result, it is true that tariff peaks remain in some sectors and for some products.

Second, a major increase of tariffs bound at zero was agreed, their coverage increasing from 20 percent to 44 percent of all trade, which effectively implied that nearly as much as half of the trade flows of industrial products would now be duty free. And third, a drastic increase in tariff lines bound in GATT must also be noted: from 78 percent to 99 percent by developed countries and from 21 percent to 73 percent by developing countries, which considerably enhanced secu-

[2]The exception being four relatively specific plurilateral agreements: the Agreement on Trade in Civil Aircraft, the Agreement on Government Procurement, the International Dairy Agreement, and the International Bovine Meat Agreement.

rity and predictability in the trading system, factors that in return were conducive to new trade and investment flows.

In relation to this, and to close my comments on the results on market access, it should be kept in mind that the virtual elimination of all industrial nontariff barriers (NTBs) not specifically provided for by GATT provisions[3] was agreed, in particular among industrial sectors. These include NTBs affecting textiles and gray-area measures, which alongside those in agriculture (to which I turn below) represent the vast bulk of NTBs in place.

Rules

The Uruguay Round negotiations led to a general clarification, improvement, and strengthening of trade rules. To mention a few: the agreement on Subsidies and Countervailing Duties now contains a definition of "subsidy" and clarifies and strengthens the disciplines and the conditions under which subsidies can be provided. It introduces the so-called traffic-light approach and devises different rules for different types of subsidies, which can broadly be divided into three categories: prohibited, "actionable" (i.e., susceptible to remedial action), and "nonactionable" subsidies. Another main feature of the agreement is the introduction of "de minimis" provisions, thus rendering rules again more predictable. Disciplines in the area of antidumping have similarly been strengthened, largely by reviewing definitions and by introducing new provisions, which should effectively reduce resort to this instrument under conditions that would not warrant their application. In the area of safeguards, the key objective was to eliminate gray-area measures, while at the same time introducing clearer conditions under which safeguard measures could be resorted to by members, which the new agreement provides. Last, the Trade-Related Investment Measures Agreement is equally important and significant, despite the wide gap that existed between different countries' perceptions and negotiating agendas in this area. The agreement clarifies the extent to which certain GATT articles have investment implications and, as a result, establishes clearly the inconsistency of certain trade-related conditions often placed on investment, such as domestic sourcing or trade performance.

[3]Such as those permitted to face balance of payments difficulties or under other general exceptions.

Agriculture

This is perhaps the area that attracted the most attention during the Uruguay Round negotiations. It is not uncommon to hear opinions to the effect that the results here were disappointing, a view that, in my judgment, is wholly and utterly incorrect. While it was understandable that efficient agricultural exporters, during the negotiations, would argue that the results taking shape were inadequate (their ambition was higher and, of course, they were negotiating), it is necessary to take a closer look at the achievements to have a better appreciation of the fundamental nature of the results that were reached.

First, perhaps it can be said that the relatively more modest component of the three-legged economic package that resulted from the negotiations in this sector is the fact that domestic support (as measured by the Aggregate Measure of Support) is to be cut by 20 percent "only." But the intention is to reduce trade distortions and not to affect domestic policies as such, unless and to the extent that they impinge on trade. It should also be recalled that this 20 percent reduction is accompanied by the introduction of the so-called Green Box, which allows for the maintenance of certain well-defined subsidies and thus protects less distortionary income-support measures decoupled from prices or volumes. This implies that the 20 percent reduction is bound to provide a powerful incentive for the redirecting of agricultural policies, which is precisely what is urgently needed to enhance overall efficiency in this sector.

The second main feature of the agreement relates to the reduction in export subsidies, which under the terms of the agreement are to fall (inter alia) by 36 percent of budgetary outlays. This is considerable and should, in return, contribute to reducing trade disputes related to distortions on world markets caused by subsidization.

And perhaps most important, the third main feature of the agreement was the decision to eliminate all NTBs in agricultural trade, which in recent decades became most pervasive in major agricultural subsectors of great economic importance. This plethora of import bans, quotas, and other impediments to trade was replaced by tariffs, which even if often very high, and in some cases arguably too high, are indeed more consumer friendly, transparent, and susceptible to gradual reform and negotiation. This process is generally referred to as "tariffication" of the NTBs. In addition to the elimination of the quotas through tariffication, all countries agreed to bind 100 percent of their agricultural tariffs. In fact, it implies that, in one stroke, the level of bindings in agriculture now is even higher than that for industrial products. These two elements together are no less than spectacular.

Above and beyond all these specific aspects of the agreement, the key accomplishment of the negotiations perhaps was the very return to multilateral rules of a major sector that was carved out of the GATT rules since the earliest days of the GATT, not least because of the exceptions introduced through the U.S. waiver and the EU's CAP. In fact, this sector was largely responsible for the Havana Charter and the International Trade Organization not coming into being, which is perhaps a good indicator of the importance of finding an agreed multilateral-rules-based outcome for it. It has also been a major bone of contention in various trade disputes. Agriculture is now back in the trading system and firmly established as an area subject to the law and its natural evolution as part of multilateral rules.

As a last point and related to the Agreement on Agriculture, I will only mention the Agreement on Sanitary and Phyto-Sanitary Measures, mostly referred to as the SPS Agreement. It contains disciplines that should prevent measures being taken by governments on safety or health grounds for protective reasons and is as such a valuable complement to the Agricultural Agreement.

Textiles

Textiles is a sector of great economic importance for many countries, developed and developing alike. The rapid surge in trade from east and southeast Asia in the 1950s led importing countries to introduce various types of import restrictions in the early 1960s. These were subsequently "formalized" through what became the first Multifiber Arrangement (MFA), which entered into force in 1974. What followed was what may be the most complex system of trade management the world has witnessed internationally or nationally, one that comprised an elaborate array of country-specific, product-specific, and year-to-year variable import quotas.

Obviously, this situation was considered most unsatisfactory by the growing range of textile and clothing exporters among developing countries, and remained so for many years. It remained very high on the agenda of the Uruguay Round. The result was the conclusion of the Agreement on Textiles and Clothing, which contains provisions through which this sector will progressively (in stages) be integrated into the multilateral trading system, meaning that, at the end of the day, textiles and clothing will be covered by GATT rules in the same way as any other industrial product.

An often-heard criticism here is that it will take ten years to conclude this integration process, as well as the back-loading of the agreement: nearly half of the integration of textiles and clothing (49 percent)

may be avoided by importers until the very end of the transition period. True, it would certainly have been desirable to achieve the integration in a shorter time frame and with a better early crop. But, as negotiators often said (as they would), and as experience did seem to confirm, politically it simply was not feasible to achieve better commitments at that point. This can be illustrated by the fact that the major difficulties encountered in closing the industrial products' *tariff* negotiation, to which I referred earlier, were in very good measure centered on textiles: more particularly on differences between major developed country players who on the MFA negotiation broadly sat on the same side. But as with agriculture, the key fact to be borne in mind is that after thirty years of rather endemic distortions and frictions, the sector is finally back in the multilateral fold—and for good.

Trade in Services

The General Agreement on Trade in Services (GATS) represents the first set of multilaterally agreed and legally enforceable rules and disciplines ever negotiated in the area of international trade and investment in services—indeed across all service sectors. In terms of potential economic impact over the longer term, this may well be the most far-reaching element of the Uruguay Round outcome, given the increasing importance of tradable services in the international economy and the growing awareness of countries of their potential comparative advantage in some services activities.

The GATS sits on three pillars. First, the Framework Agreement, the GATS proper, which establishes the concepts, principles, and rules adopted as the basic legal basis for trade in services. These are GATT-like principles such as, notably, MFN treatment as a general obligation (subject to certain negotiated exemptions, themselves subject to review and termination), and national treatment when access is granted (which is negotiated separately and subject to conditions established up front). These principles would ensure the best possible treatment in domestic foreign markets, once suppliers do enter.

Second, there are a number of sector-specific annexes—for financial services, air and maritime transport, telecommunications, and movements of natural persons engaged in providing a service—that deal with key peculiarities of those sectors, such as the right of governments to take prudential measures to protect investors and depositors and to ensure the stability of the financial system, to give one example.

And third, there are the commitments to engage in specific liberalization measures (or to bind such measures already in place on an autonomous basis), which are reflected in the country's Services Sched-

ules and which form an integral part of the results of the Round. These commitments are basically the services equivalent of the binding of tariffs. In addition to commitments already undertaken, participants agreed to launch supplementary continuation negotiations in several sectors so as to increase the early harvest, namely, on movement of natural persons, financial, maritime, basic telecommunication, and professional services, due for completion at various times within the first two years from the entry into force of the Uruguay Round Agreements. There are also other areas where further legal rather than sectoral negotiations are under way (on qualifications and standards, services trade and the environment, subsidies and safeguards) and there is also an engagement to conduct broad rounds of services negotiations periodically.

Trade-Related Aspects of Intellectual Property Rights (TRIPs)

Unlike in the area of services, international agreements providing for the protection of intellectual property predate the Uruguay Round, often by a wide margin (e.g., the Bern Convention on copyrights and the Paris Patents Convention). However, the majority of WTO members have not signed these and other key international conventions in the area of intellectual property. Participation has been rather partial, and surely a source of problems. For this reason, in addition to the equally important fact that these conventions do not provide for dispute settlement and say little about enforcement, the opportunity of creating a consolidated, global, and enforceable multilateral instrument attracted a great deal of attention and support in the negotiations of the Uruguay Round.

The TRIPs Agreement is broad and all encompassing, as it deals with all major categories of intellectual property: copyright, trademarks, appellations of origin, patents, industrial designs, designs of integrated circuits, and trade secrets. It establishes certain general obligations—notably MFN and national treatment—and sets high minimal standards of protection by members. On copyrights it establishes multilaterally the Bern Convention's protection of literary and artistic works but provides for the extension of protection to computer programs as literary works and outlines how databases should be protected, too. It deals with rental rights for the benefit of computer programs, recorded sound, and film rights-holders, and it lays out a 20-year patent protection on products or processes in almost all fields of technology.

Finally, the agreement contains very novel and interesting provisions concerning anticompetitive practices and has detailed obligations on enforcement.

Dispute Settlement

Dispute settlement has always been a central pillar of the GATT system. The law means nothing if it is not respected and made to be respected. The record of the GATT in this area was in fact rather good. A majority of cases historically came to a satisfactory resolution—often even before they were formally launched and as a result of the mere initiation of preliminary procedures acting as a catalyst. Nevertheless, a significant minority of politically highly visible and economically important cases was bogged down over the years by the nature of the procedures, most notably by the fact that a consensus was required both to set up a panel to look into a case and particularly to "adopt" (give an *official*, final character to) the panel's report and recommendations. In other words, the consensus approach related to all aspects in the procedures, which meant that parties had various opportunities to block the process. That is exactly what happened in some cases, few in number but sometimes quite important and rather visible, thus undermining the credibility and the deterrence power of the system itself.

The new system to settle disputes in the WTO is very different, mainly through the reversal of the consensus approach: under the new procedures, all steps that are foreseen in the agreement to carry out an investigation will be followed automatically, unless a consensus to block the process emerges. It is thus the right of any party to have a panel established—if and when the first phase of consultations is exhausted unsuccessfully—and this panel must operate within a set time frame and come up with its report, which is final except for the possibility that has been created to recur to an independent appellate body for appeal procedures. Moreover, all provisions related to the settlement of disputes have been strengthened with regard to the conduct of consultations, technical and other evidence, timely implementation of rulings, and so forth.

This new, much stronger, more reliable dispute settlement system is justifiably seen as one of the star components of the results. It consolidates the structures of the multilateral trading system and should ensure its functioning.

What Is The World Trade Organization?

As a first approximation, the WTO could be seen as a much-enlarged GATT, absorbing both the old areas that had de facto remained outside the system and the new subjects that were not part of it at all. Or it can be seen as a greatly reinforced GATT too, with better rules

overall and a much better system to deal with (or prevent) disputes. In reality, however, the WTO is much more than a "GATT-plus."

The WTO is a new and proper organization with a permanence and a life of its own, unlike the GATT, which was a temporary arrangement that merely stuck in place for too long. It also does away with the legal fragmentation of the GATT system—namely, the General Agreement proper plus the codes and protocols and understandings that coexisted but had no legal unity or coherence. In contrast, the WTO is a single agreement, with all other components being an integral part of it, all brought together also by an integrated dispute-settlement system. This legal and judicial unification of the old GATT, and with the new agreements, results from the key single undertaking that participants agreed to during the negotiations, whereby all the agreements would be open for subscription as a single whole, in one piece. And last, the permanent nature of the WTO, as a proper organization, and the depth and scope of the rules and the commitments that it embodies, are together bound to command, both de jure and indeed politically, a badly needed, altogether higher level of attention and adherence to the multilateral trading system by members.

At the same time, the WTO also is the appropriate institutional arrangement among our members to maintain the momentum of trade liberalization in the future. This is provided through the commitments it already embodies to revisit and review all kinds of matters within its provisions, and to pursue further negotiations in the future—the so-called Built-In Agenda, to some of which I referred earlier. It also provides us with the means to address, as and when necessary, the needs and the challenges of the evolving trading system. Certain topics, including trade and environment, trade and competition policy, investment, but also labor standards, have been proposed for future consideration in the WTO. Whether any will materialize cannot be anticipated at this stage, as it depends on the degree of support these proposals will find among the members of the WTO. These issues are clearly politically very sensitive.

There is on the other hand the need to develop, more fully than was necessary or possible with the GATT, the WTO's cooperative interaction with other intergovernmental agencies, so as to enhance collaboration, avoid when possible inconsistencies, and promote cross-fertilization in their work from their respective areas of competence. In particular, a mandate was given by ministers, as part of the Uruguay Round results, for the director-general to work with his counterparts in the International Monetary Fund and the World Bank in the pursuit of greater coherence in global economic policymaking, and indeed relations with

these organizations are viewed by our members as being singularly important.

The first ministerial meeting of the WTO, provided as part of the outcome of the Uruguay Round negotiations, will be held in December 1996—in Singapore. In addition to reviewing the state of implementation of the Uruguay Round Agreements, ministers will also make decisions with regard to the WTO's future direction and agenda. This institutional mechanism foreseen by the members, which consists of having ministerial meetings at the latest every second year, should allow the trading system to keep abreast of developments in the "real world." The WTO has thus reinforced the third, and in the end perhaps the acid test, function that the founding fathers of the GATT had initially foreseen for the GATT system, as I suggested at the outset of this paper—strengthening the role of the new institutional housing for multilateral trade as a consensual but pragmatic, forward-looking but sure-footed, negotiating body.

Impact of the Uruguay Round 11

Richard Blackhurst

I would like to preface my remarks by saying that I am here in a personal capacity, and not as a representative of the WTO.

The topic this morning is the impact of the Uruguay Round, with an emphasis on the impact on Africa. I shall talk about the impact in general terms; Chapter 12 covers four particular aspects that have come up in the context of discussing the impact on the African countries.

Before turning to the estimates of the trade and income effects, I want to give a few more details on the tariff reductions that were discussed in general terms yesterday. Most of the figures are taken from the GATT's November 1994 study, "The Results of the Uruguay Round." The data in the tables are taken from the GATT's integrated database. The import data are mostly from 1988 or 1989 and refer to imports from MFN or GSP sources. Excluded from the import data is all intra-area trade in free trade areas and customs unions because such trade was not a candidate for liberalization in the Uruguay Round. Also excluded from our data are imports that arrive under contractual preferential arrangements, in particular imports into the European Union under the Lomé Agreement (which is contractual, in contrast to the GSP, which is not) and imports into the European Union from a range of countries across North Africa, where there are contractual preferential arrangements with the European Union.

Table 1 looks at the tariff reductions by developed countries by major industrial product category. In the two broad right-hand columns are the pre– and post–Uruguay Round tariffs and the percentage reductions, weighted first by imports from all sources, and then by imports from developing countries. Weighted by imports from all sources, the reduction is 40 percent, whereas if we weight by imports from developing countries the reduction is 37 percent. One interesting thing to do with this table is to run down the percentage reduction column and see which figures are below or above the 40 percent average. In the middle three columns, under "Imports from all sources," where the average for all industrial products was 40 percent, one can see that there are some figures substantially smaller: fish and fish products, textiles and clothing, leather and rubber footwear, and

Table 1. Developed Country Tariff Reductions by Major Industrial Product Group[1]

(In billions of U.S. dollars unless otherwise indicated)

	Import Value		Tariff Average Weighted by: Imports from all sources			Tariff Average Weighted by: Imports from developing economies		
	All sources	Developing economies	Pre–Uruguay Round	Post–Uruguay Round	Percentage reduction	Pre–Uruguay Round	Post–Uruguay Round	Percentage reduction
All industrial products	736.9	169.7	6.3	3.8	40	6.8	4.3	37
Fish and fish products	18.5	10.6	6.1	4.5	26	6.6	4.8	27
Wood, pulp, paper, and furniture	40.6	11.5	3.5	1.1	69	4.6	1.7	63
Textiles and clothing	66.4	33.2	15.5	12.1	22	14.6	11.3	23
Leather, rubber, footwear	31.7	12.2	8.9	7.3	18	8.1	6.6	19
Metals	69.4	24.4	3.7	1.4	62	2.7	0.9	67
Chemicals and photographic supplies	61.0	8.2	6.7	3.7	45	7.2	3.8	47
Transport equipment	96.3	7.6	7.5	5.8	23	3.8	3.1	18
Nonelectric machinery	118.1	9.8	4.8	1.9	60	4.7	1.6	66
Electric machinery	86.0	19.2	6.6	3.5	47	6.3	3.3	48
Mineral products and precious stones	73.0	22.2	2.3	1.1	52	2.6	0.8	69
Manufactured articles, n.e.s.	76.1	10.9	5.5	2.4	56	6.5	3.1	52
Industrial tropical products	32.8	14.4	4.2	2.0	52	4.2	1.9	55
Natural resource-based products[1]	80.2	33.4	3.2	2.1	34	4.0	2.7	33

Source: GATT Secretariat, "The Results of the Uruguay Round of Multilateral Trade Negotiations" (November 1994).
[1]Excluding petroleum products.

Table 2. Tariff Reductions on Industrial Products by Developed Countries from Selected Groups of Countries

(In billions of U.S. dollars unless otherwise indicated)

		Trade-Weighted Tariff Average		
	Import value	Pre–Uruguay Round	Post–Uruguay Round	Percentage reduction
All industrial products[1]				
All sources	736.9	6.3	3.8	40
Developing economies (other than least developed economies)	165.8	6.8	4.3	37
Least developed economies	3.9	6.8	5.1	25
Excluding textiles and clothing, fish and fish products				
All sources	652.1	5.4	2.9	46
Developing economies (other than least developed economies)	123.7	4.8	2.4	50
Least developed economies	2.1	1.8	0.7	61

Source: GATT Secretariat, "The Results of the Uruguay Round of Multilateral Trade Negotiations" (November 1994).
[1]Excluding petroleum.

transport equipment (mainly motor vehicles). On the other hand, there are categories where the reductions were substantially larger, such as wood, pulp paper, and furniture; metals; nonelectric machinery; and the last category, manufactured articles not elsewhere specified.

In Table 2, we look at the tariff reductions on industrial products by developed countries weighted by different patterns of trade, that is, by imports from different origins. If you weight the tariff reductions on industrial products in the Uruguay Round by the industrial countries by imports from all sources, you see that you get the 40 percent cut that we have been talking about, and that the pre– and post–Uruguay Round average tariffs are 6.3 and 3.8. If you weight the tariff reductions by imports from developing economies other than least developed, you get only a 37 percent cut. And the pre– and post–Uruguay Round rates are higher. Finally, if you weight them by imports from the least-developed countries, the percentage cut in tariffs is even smaller, 25 percent instead of 40 percent, and the pre– and post–Uruguay Round rates are even higher. In other words, as you go down the development scale for the countries of origin, the level of

protection in industrial countries goes up, and the percentage cut in the Uruguay Round goes down. This was not a happy finding.

In the course of looking for the explanation, we discovered that if we took out two categories of trade—textiles and clothing, and fish and fish products—and recalculated pretending that those two categories of trade did not exist, the picture improved considerably. As you go down the development scale for the countries of origin, the percentage reduction in tariffs in the Round rises from 46 percent, if you weight by imports from all sources; to 50 percent, if you weight by imports from developing countries other than least developed; to 61 percent, if you weight by imports from the least-developed countries. What also looks good in Table 2 is if you look at the post–Uruguay Round tariff averages, they go down, from a 2.9 percent average tariff on imports of products from all sources, 2.4 from developing countries, and 0.7 from least developed countries.

This analysis focuses the concern with the figures in the upper half of the table, which are the real figures, on the two categories textiles and clothing, and fish and fish products. The change for textiles and clothing is better than Table 2 suggests because the tariff reductions in the table refer to cost from the current nominal tariff to the post–Uruguay Round nominal tariff. But since the Multifiber Arrangement (MFA) is being phased out, the relevant comparison is the reduction from the current tariff equivalent of the MFA quotas down to the nominal post–Uruguay Round tariff on textiles and clothing (when there will not be any quotas).

On fish and fish products, you do not have that option. In essence, fish and fish products are important to developing countries. They are particularly important to the least-developed countries, and the tariff reductions of the Uruguay Round in that category of trade were definitely below average.

Table 3 gives a brief look at what happened to tariff bindings by developing countries in the Uruguay Round. Here you can see pre– and post–Uruguay Round levels of tariff bindings by developing economies; expressed either in terms of the share of the lines that are bound, or the share of imports that come under bound tariffs. The Latin American countries bound essentially 100 percent of their tariffs. In other instances, there were fairly sizable increases in the proportion of tariffs bound. India, for example, went from either 4 percent or 12 percent bound depending on how you calculate it, to 62 percent or 68 percent bound. Indonesia went from either 10 percent or 30 percent to 93 percent or 92 percent, depending on the weighting, and so on. You will see that in Senegal there was virtually no change in tariff bindings in the Round and also virtually no change in Zimbabwe. That is, they

Table 3. Bindings on Industrial Products of Individual Developing Economies[1]

(In millions of U.S. dollars unless otherwise indicated)

		Percentage Bound			
		Pre–Uruguay Round		Post–Uruguay Round	
	Imports from MFN origins	Share of lines	Share of imports	Share of lines	Share of imports
Argentina	2,981	5	21	100	100
Brazil	11,409	6	23	100	100
Chile	1,838	100	100	100	100
Colombia	3,530	1	3	100	100
Costa Rica	840	100	100	100	100
El Salvador	557	100	100	100	100
Hong Kong	115,549	1	1	24	23
India	10,179	4	12	62	68
Indonesia	12,603	10	30	93	92
Jamaica	1,111	—	—	100	100
Korea	40,610	10	24	90	89
Macau	1,542	—	—	10	10
Malaysia	11,270	—	2	62	79
Mexico	10,988	100	100	100	100
Peru	1,399	7	20	100	100
Philippines	9,189	6	9	59	67
Romania	3,456	21	10	100	100
Senegal	613	29	40	32	41
Singapore	32,860	—	—	65	73
Sri Lanka	2,357	4	7	8	11
Thailand	14,555	2	12	68	70
Tunisia	2,976	—	—	46	68
Turkey	5,832	34	38	37	39
Uruguay	508	3	11	100	100
Venezuela	5,097	100	100	100	100
Zimbabwe	631	8	11	9	13

Source: GATT Secretariat, "The Results of the Uruguay Round of Multilateral Trade Negotiations" (November 1994).

[1]Excluding petroleum.

started from a low level of binding and did not agree to any significant increase in bindings in the Round.[1]

For the same group of countries, Table 4 shows at the pre– and post–Uruguay Round tariff averages. Consider, for example, the line

[1]The reason there are not more African countries on this list is because these are the developing countries that are in our integrated database, and very few developing countries in Africa are in the integrated database because they have not submitted their tariff schedules in a form that was easy to incorporate into the database.

Table 4. Developing Economy Tariff Reduction on Industrial Products by Individual Country[1]

(In millions of U.S. dollars unless otherwise indicated)

		Trade-Weighted Tariff Averages	
	Imports from MFN Origins	Pre–Uruguay Round	Post–Uruguay Round
Argentina	2,981	38.2	30.9
Brazil	11,409	40.6	27.0
Chile	1,838	34.9	24.9
Colombia	3,530	44.3	35.1
Costa Rica	840	54.9	44.1
El Salvador	557	34.5	30.6
Hong Kong	115,549	—	—
India	10,179	71.4	32.4
Indonesia	12,603	20.4	36.9
Jamaica	1,111	16.5	50.0
Korea	40,610	18.0	8.3
Macau	1,542	—	—
Malaysia	11,270	10.2	9.1
Mexico	10,988	46.1	33.7
Peru	1,399	34.8	29.4
Philippines	9,189	23.9	22.2
Romania	3,456	11.7	33.9
Senegal	613	13.7	13.8
Singapore	32,860	12.4	5.1
Sri Lanka	2,357	28.6	28.1
Thailand	14,555	37.3	28.0
Tunisia	2,976	28.3	34.1
Turkey	5,832	25.1	22.3
Uruguay	508	20.9	30.9
Venezuela	5,097	50.0	30.9
Zimbabwe	631	4.8	4.6

Source: GATT Secretariat, "The Results of the Uruguay Round of Multilateral Trade Negotiations" (November 1994).

Note: Pre– and post–Uruguay Round tariff averages are computed as the weighted average of tariff rates on bound lines and applied tariff rates on unbound rates. Because of the significance of ceiling bindings in post–Uruguay Round tariff averages, no reductions are reported.

[1]Excluding petroleum.

for Indonesia. You will see that the pre–Uruguay Round tariff average was 20.4 percent and that the post–Uruguay Round rate is 36.9 percent. Any normal person would conclude that Indonesia used the Uruguay Round as an opportunity to raise its tariffs, not cut them. That, of course, did not happen. The explanation for the figures is as follows. When we calculated the pre–Uruguay Round tariff averages, we used the bound rate. If a tariff was not bound, the applied rate was used. So if a country did not have very many of its tariffs bound before

the Uruguay Round, the majority of tariffs used to calculate the pre–Uruguay Round average were applied tariffs. When calculating the post–Uruguay Round tariff averages, the same routine was used. If the tariff was bound, the bound rate was used, and if it was not bound, the applied rate was used. Where a country engaged in "ceiling bindings," that is, where they agreed to bind a tariff, but at a level above the applied rate, our calculations used a bigger figure for calculating the average post–Uruguay Round rate than before the agreement. If Indonesia does not change its applied rates, then the pre– and post–Uruguay Round average for Indonesia in terms of applied rates would be the same, but there is a big jump in the security of access to the Indonesian market, because there has been a substantial increase in bindings (see the figures for Indonesia in Table 3). One way of describing an unbound tariff is that it is bound at infinity, because if a tariff is not bound, then a country is free to do anything it wants with that tariff.

Now, let me go next to the trade and income estimates. One model with three versions was used, where the underlying assumptions were changed from one version to the next. The model became progressively more realistic as one moved from version 1 to version 2 to version 3. In the paper from which the following tables are taken, there is a detailed explanation of the assumptions underlying each of the three versions.[2]

Table 5 provides estimates of the increase in merchandise exports due to the liberalization of trade in goods in the Uruguay Round (no attempt was made to quantify the impact of the GATS on world trade in services because there is nothing analogous to a tariff cut for services). Across the top row of Table 5 you will see that the estimated increase in the volume of world trade in goods ranges from around 9 percent for the first two versions of the model to 23.5 percent for the third version. And that would be in 2005 when the full liberalization in the Uruguay Round has been implemented.

Looking at the percentage increases for individual product groups, the two biggest ones you see are for textiles and clothing, by a wide margin. One of the things that comes out of the modeling exercises of the Uruguay Round is that the liberalization of the Multifiber Arrangement drives a lot of the results, because it is a major restrictive regime affecting important categories of world trade.

Table 6 presents the estimated increases in trade by geographic regions or groups of countries. While the world average increase under

[2] GATT Secretariat, "The Results of the Uruguay Round of Multilateral Trade Negotiations" (November 1994).

Table 5. Estimated Increase in Merchandise Exports Due to the Implementation of the Liberalization of Trade in Goods: Main Product Groups

(Percentage change in volume)

	Version 1	Version 2	Version 3	Actual value of exports in 1992 (In billions of U.S. dollars)
All merchandise[1]	8.6	9.6	23.5	2,843
Grains	4.1	4.4	4.6	24.2
Other agricultural products[2]	21.1	21.0	22.1	73.8
Fishery products[2]	13.0	12.9	13.5	26.5
Forestry products	3.7	4.1	5.6	7.7
Mining	1.6	1.8	3.1	328.4
Primary steel	8.3	8.4	25.5	76.7
Primary nonferrous metals	3.6	3.9	14.2	52.4
Fabricated metal products	5.3	5.4	16.0	57.2
Chemicals and rubber	5.2	5.4	21.4	251.3
Transport equipment	11.7	13.6	30.1	320.2
Textiles	17.5	18.6	72.5	93.9
Clothing	69.4	87.1	191.6	105.6
Other manufactures	4.7	4.7	12.7	1,425.1

Source: GATT Secretariat, "The Results of the Uruguay Round of Multilateral Trade Negotiations" (November 1994).

Note: Version 1 assumes constant returns to scale (no economies of scale) and perfect competition; Version 2 assumes increasing returns to scale in industrial sectors and perfect competition; and Version 3 assumes increasing returns to scale and monopolistic competition in industrial sectors.

[1]Excluding intra-European Union trade, and including trade in petroleum.

[2]The marginally smaller gains under the second version of the model, relative to the first version, are the result of resources shifting into production of those product groups whose production was stimulated by the introduction of increasing returns to scale.

the third version of the model is 23.5 percent, the increase for the group called "Developing and transition economies" is 36.7 percent, or roughly 50 percent more. That is, the projected increase in exports, for that group of countries is 50 percent more than for the world as a whole. The grouping that gets the smallest boost to its trade from the Uruguay Round in our table is EFTA. That is because a lot of their trade is already duty free because of preferential arrangements with the European Union.

In Table 7, we switch from looking at increases in trade to looking at increases in world income or world welfare. This becomes a little more complicated because the three versions of the model are subdivided into two groups. Concentrating on the far right-hand column where the first number is $510 billion—the largest number we have for the in-

Table 6. Estimated Increase in Merchandise Exports Due to the Implementation of the Liberalization of Trade in Goods: Main Economies and Country Groups[1]

(Percentage change in volume)

	Version 1	Version 2	Version 3	Actual value of exports in 1992 (In billions of U.S. dollars)
World	8.6	9.6	23.5	2,843
Canada	5.3	6.1	16.6	134.1
United States	7.5	8.2	21.7	448.2
EFTA	3.2	3.3	6.3	226.9
European Union	7.3	7.8	19.4	568.7
Australia and New Zealand	8.4	9.0	24.0	52.3
Japan	7.5	8.0	18.3	339.9
Developing and transition economies	13.7	15.3	36.7	906.4
China	6.1	8.4	26.5	85.0
Taipei	4.5	5.7	14.4	81.5

Source: GATT Secretariat, "The Results of the Uruguay Round of Multilateral Trade Negotiations" (November 1994).

Note: Version 1 assumes constant returns to scale (no economies of scale) and perfect competition; Version 2 assumes increasing returns to scale in industrial sectors and perfect competition; and Version 3 assumes increasing returns to scale and monopolistic competition in industrial sectors.

[1]Excluding intra-European Union trade and including trade in petroleum.

crease in world income—we believe it is the most plausible. Sometimes when people do these kinds of estimates they have three scenarios, pessimistic, normal, and optimistic. This was not that kind of exercise. The intention was to make the models progressively more realistic.

Although the $510 billion figure is the largest of the various estimates, it almost certainly is a very big underestimate of the likely gains from the Round. It does not take into account any of the dynamic gains that economists have identified but have difficulty quantifying. It assumes that the status quo would have been maintained if the Uruguay Round had failed, and most important of all it does not capture at all that part of the agenda that dealt with services, with intellectual property, with stronger rules, with better dispute settlement, and so on.

The biggest gainer in Table 7 is the European Union with $163.5 billion. Then the United States and the developing and transition economies are fairly close at around $120 billion. There are two reasons why the United States and the European Union gained as much as they did. One is that they are big traders and the other is that they also

Table 7. Estimated Increase in Annual Income in 2005 Due to Uruguay Round Liberalization of Trade in Goods: Main Economies and Country Groups

(In billions of 1990 U.S. dollars)

	Static Specifications			Dynamic Specifications		
	Version 1	Version 2	Version 3	Version 1	Version 2	Version 3
World	109	146	315	184	218	510
Canada	2.3	3.0	8.0	3.8	5.0	12.4
United States	30.4	35.9	75.6	49.2	59.5	122.4
EFTA	10.1	13.4	23.1	17.5	18.0	33.5
European Union	47.7	58.6	103.3	78.5	87.2	163.5
Australia and New Zealand	1.5	1.9	3.1	2.4	3.6	5.8
Japan	11.9	15.2	17.0	21.2	19.3	26.7
Developing and transition economies	–1.9	4.1	70.2	–0.7	2.7	116.1
China	4.1	8.9	10.1	6.9	14.3	18.7
Taipei	2.6	4.7	4.5	5.1	8.4	10.2

Source: GATT Secretariat, "The Results of the Uruguay Round of Multilateral Trade Negotiations" (November 1994).

Note: Version 1 assumes constant returns to scale (no economies of scale) and perfect competition; Version 2 assumes increasing returns to scale in selected sectors and perfect competition; and Version 3 assumes increasing returns to scale and monopolistic competition in selected sectors.

liberalized the most, not just with fairly substantial tariff cuts, but also by agreeing to get rid of the MFA. More generally, the gains shown in this table for the different groups of countries are a combination of gains that come from getting better access for their products abroad and gains that come from opening up their own market. And, in fact, what drives the gains for the European Union and for the United States is the opening up of their own market. It is not gains that come from better access abroad for their exports.

That the welfare (income) gains that countries get from the Uruguay Round are determined to a large extent by their own liberalization, and not by the better access to their exports abroad, needs to be stressed because the negotiations themselves are carried out largely on exactly the inverse presumption. Reductions in your own barriers are described as "concessions." When you reduce your own barriers, it is considered a concession, which you are willing to give in order to get better access for your exports abroad. So clearly, from this perspective the goal is better access to your exports and the price that you have to pay is the reductions in your own barriers. But when it comes time to

add up who has gained what from the Round, the principal determinant is what you liberalized yourself, not your better access abroad. There are obvious political economy reasons for this apparent inconsistency that everyone here would be familiar with.

Let me conclude with a few general points about the gains to developing countries from the Round and in particular, Africa. Two background comments. One is that the GATT—now the WTO—is not primarily in the business of promoting free trade. Countries are allowed to protect, to have tariffs, and all the WTO says is that if you are going to protect, use a tariff rather than quotas or some other kind of quantitative limitation. The principal function of the WTO is to provide a set of rules and disciplines governing countries' trade policies, in order to make future market access more predictable. It is the security of future market access that is important. And that brings into the picture the whole set of rules and disciplines and dispute settlement that were key parts of the Uruguay Round.

Under the WTO, all countries have to submit schedules. They have to submit a schedule in goods indicating the tariffs and which ones are bound, and also a schedule of concessions on services indicating their commitments. But the other rules and disciplines in the GATT and the WTO, covering measures that are not in the schedule, are equally important because if you did not control these other kinds of measures with rules and disciplines, then people could get around the bindings by going home and giving generous production subsidies and other things. So, it is these other sets of rules covering other kinds of measures that complement what is in the schedule with the bindings. The goal is predictability of future market access. This is the way that the WTO reduces the degree of uncertainty surrounding transactions across national frontiers. By reducing the uncertainty surrounding transactions across borders, you encourage trade-related investment, and that is where a lot of the gains from trade liberalization come from. Since the gains from trade liberalization depend heavily on the stimulus it provides trade-related investment, the security aspect of the liberalization is crucial. The Uruguay Round was only partly about cutting tariffs and phasing out quotas.

One way mercantilist thinking can creep into the picture is to view the bindings and the requirement to adhere to stronger rules and disciplines as burdens on the countries that agree to them. The African countries that are members of the WTO have to agree to all the rules and disciplines. It is a single undertaking. There is no longer a menu from which you agree to some rules and not to others. You have to sign on to the whole package. Some observers describe that as being a burden for the African countries. My view is that not only is it not a

burden but, in fact, it is one of the most important sources of gain for African countries in the Uruguay Round. Governments gain because the reduced discretion over trade policy reduces the political cost of saying no to constant demands for protection. Domestic consumers gain. Domestic firms that use tradable inputs gain, as well as domestic firms more generally, because with the additional rules and restrictions on the trade regime they can plan their future investments better. And by locking in reforms of the trade regime, the bindings and the acceptance of the rules and disciplines enhance the credibility of reforms among domestic and foreign investors. One of the things that people talk a lot about is the need to find ways to increase inflows of foreign direct investment into developing countries and into Africa in particular. One of the benefits to the African countries, as well as other developing countries having to sign on to the whole package of rules, is that it should give more confidence to foreign investors and stimulate inflows of foreign direct investment. This is particularly true, I would say, for commitments in the services schedules, which is one of the reasons a lot of developing countries have agreed to put the tourist industry in their schedule of commitments under the GATS. They wanted to increase the policy security of the environment of the tourism industry to attract foreign direct investment.

The various considerations outlined above explain why it is difficult not to be impatient with claims that many African countries will lose from the Uruguay Round. When those claims take into account only the projected reductions in margins of preference and higher prices for imported food, they neglect all of the other results of the Uruguay Round—for example, more opportunities to diversify exports—but in particular, the gains to African WTO members from the increased transparency and stability in their own trade regimes.

12 Four Aspects of the Uruguay Round for African Economies

L. Alan Winters

This paper addresses aspects of the Uruguay Round of particular concern to Africa. It covers four areas. First is preshipment inspection. This is an aspect of the Round about which little has been said and yet is one of some significance to African negotiators. Second is the erosion of preferences: the fear that, as most-favored-nation tariffs came down, the degree of preference that Africa received in markets of the Organization for Economic Cooperation and Development (OECD) would be reduced. This was perhaps the major concern expressed by African commentators. Third is the nontariff barriers affecting African exports and the abolition of the Multifiber Arrangement from an African viewpoint. Fourth is the effects of the liberalization of agriculture on food prices.

Preshipment Inspection

Preshipment inspection (PSI) is the practice of asking private companies to inspect OECD goods that are destined for certain African markets before they are dispatched.[1] It is, perhaps, like a private sector equivalent to customs activities, designed to ensure the quality of the goods and that the revenue collected from tariffs approximates what should be collected. This practice has raised a number of complaints and concerns among industrial country exporters (see Table 1): for example, at a practical level, it imposed extra costs on them; it imposed delays on exports; it lacked natural justice in not having any appeal; it ran the risk of companies having to disclose confidential information; it lacked transparency, accountability, and agreed standards; it was applied in a discriminatory fashion, and there were weaknesses in the ways PSI companies verified prices. There were also more philosophical points: it interfered with the freedom of contract between buyers

[1]This section is based on the paper by P. Low, *Preshipment Inspection Services*, World Bank Discussion Paper No. 278 (Washingtoon: World Bank, 1995.)

Note: The author is grateful to Merlinda Inges for help with certain sections of the paper. The views expressed are the author's; they do not necessarily reflect those of the World Bank or its member governments.

Table 1. Exporter Complaints Against Preshipment Inspection

Complaints made against the operations of PSI companies in the context of ECE, USITC, and ICC discussions have been summarized under ten headings:	
1.	Extra costs to producers of complying with PSI requirements.
2.	Shipping and payment delays caused by PSI procedures.
3.	Absence of recourse or appeals procedures against PSI decisions.
4.	Commercial risk from inadequate protection of confidential information.
5.	Lack of transparency and accountability in PSI criteria and procedures.
6.	Absence of agreed standards for PSI work.
7.	Discrimination among countries and exporters.
8.	Inadequate price verification methodologies.
9.	Interference of freedom of contract between buyers and sellers.
10.	Infringement of export country sovereignty.

Source: P. Low, *Preshipment Inspection Services*, World Bank Discussion Paper No. 278 (Wahington: World Bank, 1995).

Note: ECE = Economic Commission for Europe; ICC = International Chamber of Commerce; PSI = preshipment inspection; and USITC = United States International Trade Commission.

and sellers, and it infringed on the sovereignty of nations. The last two are essentially unfounded, for much commercial law has those effects. But the first set of points were serious and legitimate concerns for the industrial countries.

At the outset of the Round there was some uncertainty about the legitimacy of PSI activities. Switzerland and Germany had acted against the preshipment inspection companies, and other industrial countries had wondered whether they should also do so. The issue was put on the Uruguay Round agenda by Indonesia, but thereafter became an issue quite closely associated with the African states. Thus the very fact that we have an agreement on preshipment inspection, and an agreement that I shall argue meets many of these worries that the industrial countries have, can be counted in some sense as a victory for Africa, for it quite clearly legitimizes the practice, so long as it is conducted subject to various controls and regulations.

In return for this legitimacy, the user countries, that is, the importing (African) countries, have to undertake a number of obligations about the way in which their preshipment inspection companies will behave (Table 2). First, preshipment inspection should be applied in a nondiscriminatory fashion. That does not mean that every consignment has to be treated identically but that the rules that determine how a consignment is treated are objective and are uniformly applied. Second, government requirements on PSI must satisfy national treatment so far as laws, regulations, and requirements are concerned. That is not exactly the same as national treatment under the

Table 2. User Country Obligations Under the WTO Agreement on Preshipment Inspection

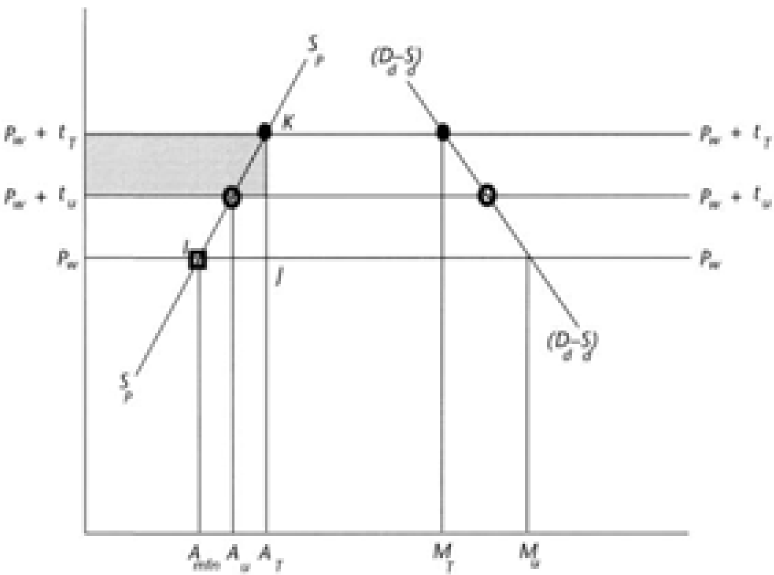
	Obligations
1. Nondiscrimination.	Procedures and criteria to be objective and applied on an equal basis to all affected exporters.
2. Governmental requirements.	National treatment to be guaranteed in respect of all laws, regulations, and requirements.
3. Site of inspection.	Services to be performed by country of export, and only exceptionally in country of manufacture (if different).
4. Standards.	Inspections to be in accordance with standards defined by seller and buyer, or in the absence of such standards, relevant international standards.
5. Transparency.	User governments to ensure that PSI companies are fully transparent and willing to supply information on procedures, government laws and regulations, inspection and verification procedures and criteria, the rights of exporters, and appeals procedures.
6. Protection of confidential information.	All confidential business information to be adequately protected. PSI companies are not permitted to see information on data covered by intellectual property rights or unpublished data other than those necessary to demonstrate compliance with regulations and standards, internal costs and pricing, profit levels, and contract terms (unless essential for inspection).
7. Conflicts of interest.	Conflict of interest to be avoided within PSI firms and between firms and other entities.
8. Delays.	PSI firms must respect agreed inspection dates, issue report of findings within five days of receipt of final documents, and if requested by exporter, perform preliminary price verification prior to physical inspection and immediately inform exporters of the result.
9. Price verification.	Price verification is undertaken to prevent over- and under-invoicing and fraud. In relation to customs, the WTO's customs valuation rules are to apply. The basis for price comparison is the price of identical or similar goods offered for export from the same country of exportation at or about the same time, under competitive and comparable conditions of sale, in conformity with customary commercial practices and net of any applicable standard discounts. Only prices providing a valid basis of comparison are to be used, and PSI companies shall not rely on the price of goods offered for export to different countries of importation to arbitrarily impose the lowest price.
10. Appeals procedures.	PSI companies must establish specific appeals procedures and inform exporters of them.
11. Derogation.	PSI companies can establish thresholds below which goods are inspected only if they are split consignments or in exceptional circumstances.

Source: P. Low, *Preshipment Inspection Services*, World Bank Discussion Paper No. 278 (Washington: World Bank ,1995).

GATT, but it is something approximating it. Third, the PSI agreement states that goods should generally be inspected in the country of export rather than the country of manufacture, and, fourth, that inspection should be designed to discover whether the goods meet standards that have been agreed between the seller and the buyer. A fifth requirement is an obligation to have transparency in PSI practices; that is, to ensure that the laws, regulations, inspection procedures, and so on, are all published. Sixth, there is provision for the protection of confidential information. This means that PSI companies are committed not to ask for information that is not pertinent to their contracted duties, and that they are responsible for the maintenance of the confidentiality of the information they are given. Seventh, there are procedures for handling conflicts of interest within the PSI companies. Eighth, to counter delays, there are agreed inspection dates, and a commitment that the report by the preshipment inspection company will be made within five days of its receiving the final paperwork. For exporters, a critical part of the agreement concerns methods of price verification. The agreement states that the price comparison should be for identical or similar goods offered for export from the same country of exportation at or about the same time, under competitive and comparable conditions of sale, in conformity with customary commercial practices. In other words, price verification is very narrow. The PSI companies cannot be asked to find the lowest knockdown price that some other country is selling to some other partner. The comparison has to be pretty much specific to the contract that is being reviewed in terms of timing and size, for example. Finally, there is now an appeals procedure and a brief addendum about a derogation. Countries can set consignment size thresholds below which there will not be inspections unless there are suspicious circumstances.

Does the agreement match the aspirations of the proponents and critics of PSI? Fairly well. It is true that delays will probably still continue somewhat and that there will still be costs to permitting the preshipment inspection. But according to work done by the U.S. International Trade Commission (USITC) these costs are not generally very large. On the positive side, the appeals procedure, the protection of confidential information, the transparency, and the agreement over standards are all steps forward. In addition, discrimination is now explicitly forbidden and price validation must be "relevant" as well as honest. So, all told, the agreement largely meets the industrial countries' concerns. On the other side, the developing countries now have recognized rights to undertake preshipment inspection that was, for them, an important goal in the negotiations.

Figure 1. Erosion of Preferences



Preference Erosion

Figure 1 demonstrates one important point about preferences. When one is talking about trade policy, at least in some rather loose sense, trade creation (imports replacing costly domestic outputs) is a good thing and trade diversion (preferred imports displacing cheap imports from nonpreferred sources) is a bad thing. *Tariff preferences divert trade*: they shift trade from the lowest-cost supplier to a less low-cost supplier. When preferences are eroded, we are essentially undoing that trade diversion. Trade moves back toward the sort of pattern that it would have had under free trade. This is an important perspective on the erosion of preferences. Preferences are, on the whole, distortionary. They may benefit the recipients of the preferences, but in terms of world welfare, they are not smart policy.

Figure 1 applies to the market for a particular good and has prices on the vertical axis and quantities on the horizontal axis. *I* represents the demand for imports by the curve $(D_d - S_d)$ domestic demand minus domestic supply. That is, imports are what you need to buy from the rest of the world when your domestic suppliers have satisfied the part of domestic demand that they are willing to meet at the ruling price. *I* as-

sumes that the rest of the world comprises two parts. First, a very large part that can supply any amount of the good, at least so far as this market is concerned, at a fixed price, P_w, the world price. Second, there is a small preference-receiving country whose supply curve to the market is S_p. It slopes up to show that higher quantities can be obtained only in return for higher costs (higher prices). The case I have in mind is of a good that the EU is buying from the rest of the world, but on which it gives preferences, say, to the small ACP countries.

Imagine that we start off with an initial tariff that everybody pays. I have called t_T the Tokyo Round tariff before preferences were granted. The world price is P_w, and so the internal price in our market is $(P_w + t_T)$. At this price, the demand for imports is M_T. But how much of this is imported from the ACP countries? That depends on the price they receive when they sell. This is P_w, the world price, because in order to sell in the internal market at $(P_w + t_T)$ they get P_w and the government gets t_T. The ACP supply curve tells us how much they will supply at P_w; and I have called that amount A_{mfn}. The remaining imports $(M_T - A_{mfn})$ come from the rest of the world.

Now let us give the ACP preferences, so that they no longer have to pay the tariff. When the good sells at $P_w + t_T$ internally, all of that amount passes back to the ACP exporter: the government does not take a cut anymore. Now that the ACP countries face price $(P_w + t_T)$ they are happy to produce some more, and so they expand their sales to A_T. The total amount of imports and the internal price are exactly the same, as before: the latter is still $(P_w + t_T)$ because, on the margin, supplies still come from the rest of the world (ACP cannot meet the whole demand for imports) and if the price is the same, so is demand. All that has happened is that we have moved from $M_T - A_{mfn}$ being supplied by the rest of the world, and A_{mfn} being supplied by the ACP countries, to a smaller supply from the rest of the world $(M_T - A_T)$ and a larger supply by ACP (A_T). That is trade diversion. It is wasting real resources so far as the world is concerned, because the rest of the world can produce this good at cost P_w but it costs the ACP countries more than that to produce units beyond A_{mfn}. Trade of $(A_T - A_{mfn})$ is diverted and the lost welfare is area IJK—the sums of the amounts by which ACP costs exceed world costs for the units between A_{mfn} and A_T. Now let us have the Uruguay Round and reduce the MFN tariff to t_u. The internal price falls to $(P_w + t_u)$ and the demand for imports expands. But the fall in internal price also reduces the price that the ACP suppliers receive. Hence they cut back, moving sales from A_T to A_u. They get a lower price from the EU market because there is less protection and they were previously beneficiaries of EU protection. This change in exports $(A_T - A_u)$ is the most obvious consequence of prefer-

ence erosion. But it is not a cost to the world—just the opposite. Instead of paying extra to get the ACP to supply A_T of imports, we now pay extra only to get them to supply A_u. The trade diversion implied by preferences has gone down.

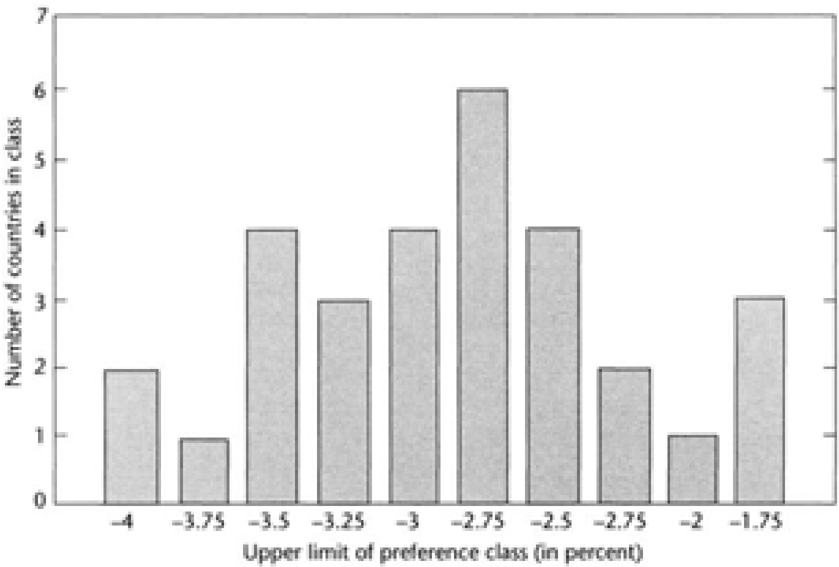
In addition to the change in the quantity of exports that the ACP countries send to Europe, they also lose some export revenue. The price they receive within the EU has fallen, so instead of earning $(P_w + t_T)$ on their exports, they earn only $(P_w + t_u)$. This is essentially a cut in the income transfer they receive from EU preferences. Preferences essentially allow the preferred exporters to collect the tariff revenue on their exports: when tariffs fall, so do the revenues they collect.

It is important to keep in mind these two effects. Preferences are usually justified as an incentive for industrialization: that is, the benefits are held to be a result of the quantity changes that preferences induce. They are not usually justified just in terms of a straight income transfer, for an income transfer to the producers of a particular set of goods is often held just to encourage them to be inefficient. Thus it is usually declining exports rather than declining prices that people are concerned about when they worry about preference erosion.[2]

I am not keen on preferences as a means of aiding African countries' development. Nonetheless, should I not be concerned that they might lose some exports as a result of the Uruguay Round? In fact, not really, for in the end it turns out that, at least so far as the least developed countries in Africa are concerned, there are virtually no losses. The fact is that preferences never were very much use for increasing exports from most preferred countries. They are subject to very tight rules of origin. There are considerable exclusions, the United States excludes textiles and clothing, for instance. There are limits on the amount that may be sold duty free. Preferences are unilateral concessions that can be withdrawn by their donors at any time. It turns out that only relatively small proportions of the trade between the OECD countries and the preference-receiving countries actually qualified for preferential treatment. Figures from the United Nations Conference on Trade and Development (UNCTAD) indicate that in 1992 only 18 percent of exports from GSP-receiving countries to OECD countries qualified for GSP treatment. Probably an even smaller percentage of them actually used those preferences, because it required extra paperwork to make use of them.

[2]This is rather perverse, for in most cases one suspects that the straight income transfer is worth more than the profits on the additional exports. Note, it is the profit (surplus) on exports that affects welfare not the total revenue, because the extra exports incur costs of production.

Figure 2. Preference Margins for African Exports in EU Markets, by Exporting Country



All these factors discourage developing country entrepreneurs from investing to exploit their markets access. The returns are frequently constrained and almost always too risky. Thus, by and large, preferences have failed to foster industrialization, and, therefore, if they are lost, that is not such a disaster.

It is also the case that the margins of preference are generally very small. For example, within the EU, something like half the imports from the ACP countries already face a most-favored-nation tariff of zero. In other words, there is no preference to be had because the MFN tariff is zero. The WTO Secretariat suggests that of sub-Saharan Africa's exports to the EU, 56 percent have MFN tariffs of less than 3 percent. And, if you have to fill out a lot of paperwork and bear a lot of uncertainty just to get a preference of 3 percent, then it is quite unlikely that you will bother.

Figure 2 presents the average preference margins for all exports to the EU for the set of least-developed African countries. It is measured in a slightly unusual way: for example, for three African countries, the average tariff paid by exporters is between 2 and 1¾ percentage points lower than the average tariff paid by other exporters, for one

country, between 2 and 2¼ percentage points lower, and so on. Most countries get average preference margins of less than 3 percent within the EU, and these averages are much lower in Japan and the United States. Four percent is the largest average preference margin that we came across.

Moreover, when we come to the Uruguay Round, not only are we talking about small tariff preference margins, but many of the preferences were offered on agricultural goods for which preferential quantitative restrictions are more common. The Uruguay Round protected most of those rights of preferential access. Indeed, the tariffication whereby nontariff barriers were converted into tariffs has actually made duty-free access more valuable in some parts of agriculture, because "duty-free" did not mean "free of all variable levies." Now that these have been converted into tariffs, which are then remitted on preferred exports, the value of preferences is increased. The average reduction in the preference margin as a result of the Uruguay Round was 23 percent in the EU, 9 percent in the United States, and 15 percent in Japan. This means that even for the two most preferred countries, with average margins exceeding 4 percent, the new average margin is about 3 percent—a loss of competitiveness of about 1 percentage point.

To summarize, preferences never did much in the first place. Lots of them were not affected by the Uruguay Round; those that were, suffered very small changes. The largest average change you might find in the rents to exporters is losses of ½ of 1 percent of the export revenue.

When it comes to the quantities, the story is, in fact, even less dramatic. Preliminary work in the World Bank has analyzed tariff change item by item for least-developed countries. This is more straightforward than for developing countries as a whole because least-developed countries are generally granted totally duty-free access to OECD markets and for any amount that they can sell. If we look up the changes in MFN tariff rates and the volumes of trade occurring in a base year, and then make some assumptions about elasticities, we can estimate the effects of the Uruguay Round on trade.

We find that, as a group, the least-developed countries will lose something like $6 million worth of exports to the EU, and $3 million worth of exports to Japan, but gain $52 million worth of exports to the United States. The reason for the last figure is that developing countries do not receive preferences on textiles and clothing exports to the United States, and the liberalization of the Multifiber Arrangement plus the reductions in the United States' MFN tariffs will allow them to compete more effectively, not against third-country suppliers, but against U.S. producers.

For the least developed countries in Africa, we estimate approximately a $4 million gain in the United States, a $5 million loss in the EU, and a $6 million loss in Japan. Figure 3 graphs these data in terms of percentages of total exports, excluding textiles and clothing. It also estimates the effects of abolishing all preferences. The first two columns of each block are very small. By far the largest is a loss approaching 1 percent in Japan, but Japan is a small market for African countries' exports. The overall loss is on the order of about ⅕ of 1 percent of exports.

One should not rely too much on the precision of these figures, but the general message is quite clear. Preferences were not doing much for you. Do not shed too many tears that they have been eroded.

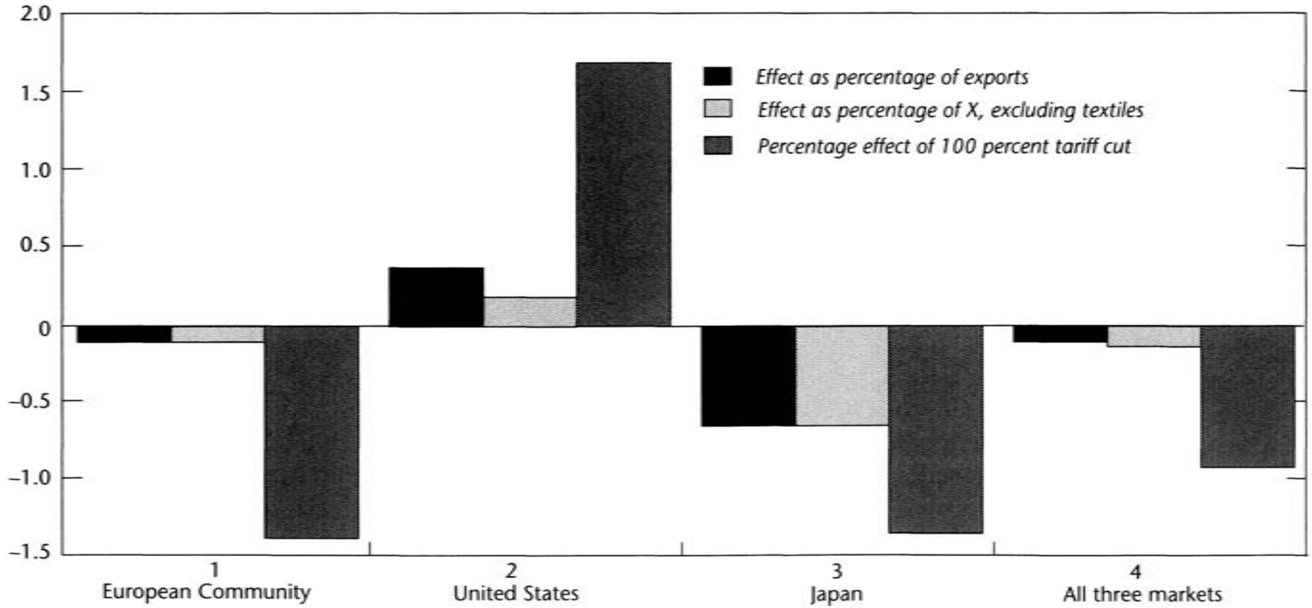
The Multifiber Arrangement

The Multifiber Arrangement, rather like the agricultural preferences, is essentially a quantitative preference. It has the effect of keeping, say, Korean and Chinese textiles and clothing out of the OECD markets. That has two effects, each of which rebounded to the advantage of African countries. First, it has opened up market "niches" in the OECD markets, which African suppliers might be able to fill, and second, it has encouraged Hong Kong, Korea, Thailand, and so on, to sell those goods that they could not sell in the OECD elsewhere, including African countries.

Abolishing the MFA is going to undo these two effects. It is quite possibly going to reduce the supply of clothing to African consumers and hence drive up the prices they face. Second, to the extent that African producers are selling in OECD countries they will face extra competition. Work that is being done in the World Bank[3] suggests that there is a policy issue here that needs to be addressed. All such numbers are very doubtful, but as far as we can tell, the direct costs of production for clothing are rather higher in Africa than they are in some other low-wage countries—see Figure 4. The message is that the real problem that African clothing producers face lies in the cost of fabric, which is the major cost in producing low-quality clothing. This problem might arise from the efficiency with which the fabric is cut, but more likely, we suspect, it resides in tariffs and customs procedures, and so on, for importing the goods.

[3]T. Biggs, and others, *Africa Can Compete!* World Bank Discussion Paper No. 278 (Washington: World Bank, 1994).

Figure 3. Effect of Uruguay Round on African Exports



Source: Azita Amjadi, and Alexander J. Yeats, *Nontariff Barriers Africa Faces: What Did the Uruguay Round Accomplish and What Remains to Be Done?* Policy Research Working Papers 1439 (Washington: World Bank, 1995).

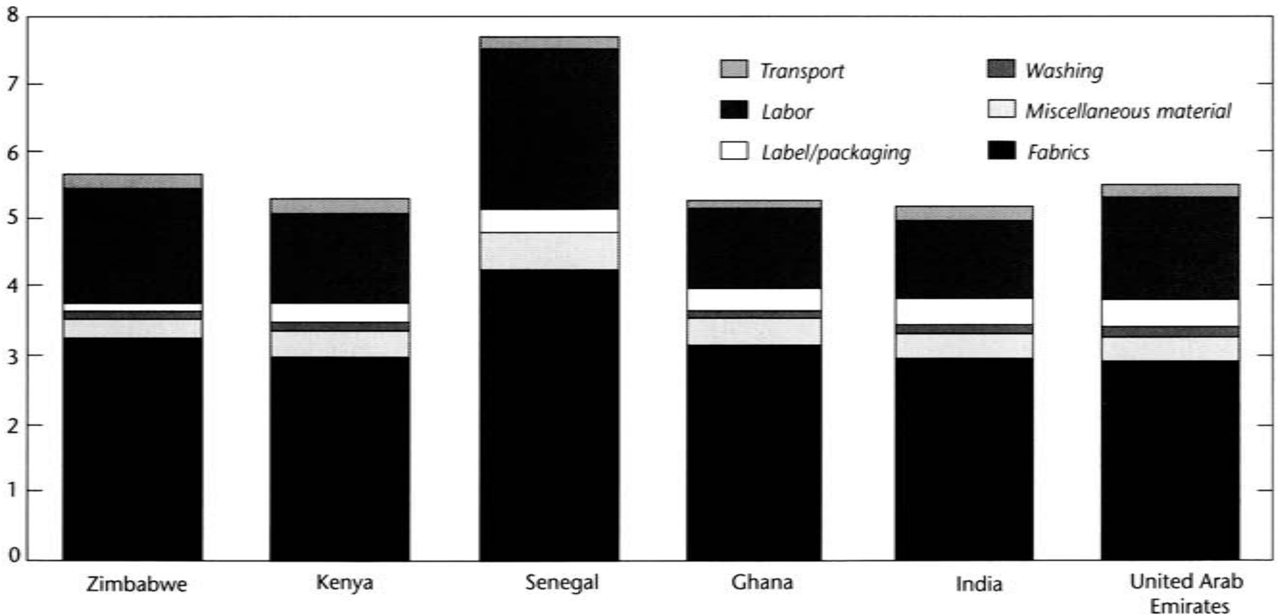
Against the difficulties that I have just noted one must remember that the MFA always threatened to put a cap on any successful exporter. The way the MFA worked was, of course, that you had free trade until you got too good at it, at which point the OECD governments would suggest negotiating a friendly little quota with you. Just as I said about preferences, this is no basis for an industrialization drive. Entrepreneurs will not invest if they think they will be hit as soon as they get good at something. Thus, by removing this threat, the abolition of the MFA, albeit somewhat delayed, is going to be a significant benefit to Africa in the long run.

The critical point to recognize in all this is that the abolition of the MFA is moving us from a managed market to a market that is free. The people who benefit from free markets are those who are flexible enough to expand output. At present, African producers face rather few actual, as opposed to potential, barriers to clothing exports. Indeed, they benefit from barriers on other producers and, because of these, are able to stay in business even if they are allowing difficulties to emerge in getting decent fabric into the firms where the shirts can be produced. In the long run, African governments must address these supply problems not only to expand where the MFA might once have stopped them, but to hang on to their existing market shares.

Food Prices

A big worry for African countries about the agricultural liberalization intended in the Uruguay Round was that by cutting export subsidies, domestic protection in the OECD would drive up the price of food on world markets. For poor countries that imported a lot of food this could be serious, and during the Round commentators were talking about possible increases of 10–15, or even 20 percent in some food prices. These estimates, however, were predicated on the assumption that the liberalization of agriculture achieved in the Round would be at least as deep as foreshadowed in 1991 by Mr. Arthur Dunkel, the former GATT Director General— namely, 36 percent cuts in protection levels, 21 percent cuts in quantities of subsidized exports, and 20 percent cuts in domestic support. However, in terms of the erosion of industrial countries' agricultural protection, the Round was very very much less successful than that. Agriculture has not been liberalized very much at all. That is bad news for the world economy and for the countries that export those goods. It is not, however, bad news for the countries that import food, because the corollary of weak liberalization is only small increases in world food prices.

Figure 4. Direct Cost for the Production of Casual Long Sleeve Shirt



Source: Azita Amjadi, and Alexandr J. Yeats, "Nontariff Barriers Africa Faces: What Did the Uruguay Round Accomplish and What Remains to Be Done?" Policy Research Working Papers 1439 (Washington: World Bank, 1995).

Table 3. Terms of Trade Effects of the Uruguay Round

	World Prices Index (1990 = 100)		Change in World Price 1992–2005 (In percent)	Price Change Due to Uruguay Round
	1992	2005		
Wheat	166	147	–11.45	3.8
Rice	270	267	–1.11	–0.9
Coarse grain	98	91	–7.14	2.3
Sugar	187	235	25.67	1.8
Beef, etc.	230	280	21.74	0.6
Other meat	1,128	858	–23.93	–0.6
Coffee	132	196	48.48	–1.5
Cocoa	103	147	42.72	–0.7
Tea	188	179	–4.79	–1.4
Oilseeds	112	108	–3.49	–0.3
Dairy	1,661	1,066	–35.78	1.2
Other food	83	86	3.48	–1.4
Wool				–0.9
Cotton	120	146	21.67	–1.2
Other agriculture	88	96	8.60	0.8

Source: I. Goldin and D. van der Mensbrugghe, "An Assessment of Economywide and Agricultural Reforms," Chapter 2 in *The Uruguay Round and the Developing Economies*, ed. by W. Martin and L.A. Winters, World Bank Discussion Paper No. 307 (Washington: World Bank, 1995).

Goldin and van der Mensbrugghe[4] estimate the effects of the Uruguay Round on a selection of food prices. Table 3 gives four sets of figures: the world price in 1992, the World Bank's forecast of prices in 2005, the percentage difference between those two figures, and, finally, Goldin and van der Mensbrugghe's estimate of the effect of the Uruguay Round. The Uruguay Round effects are small, both absolutely and relative to what we think was going to happen in prices anyway.

Table 4 illustrates the effects of these price rises on the Central African Republic, assuming that quantities do not respond at all. Column 2 gives the value of net exports of each of the products in 1990 to 1992. Column 3 values these net exports at the prices that we project in the absence of the Round, and Column 4 repeats this at the prices projected allowing for the Round. The difference—the effect of the Round on Central African Republic's food net export bill—is given in column 5. The numbers are tiny: in total, half a million dollars. That is, the

[4] I. Goldin and D. van der Mensbrugghe, "An Assessment of Economywide and Agricultural Reforms," Chapter 2 of *The Uruguay Round and the Developing Economies*, ed. by W. Martin and L.A. Winters, World Bank Discussion Paper No. 307 (Washington: World Bank 1995).

Table 4. Effects of World Price Changes Due to Agricultural Liberalization in the Central African Republic

(In millions of U.S. dollars, unless otherwise noted)

Commodity	Predicted Price Change from Round (In percent)	Value of Net Exports 1990–92	Value of Net Exports (No Round) 2002	Value of Net Exports (With Round) 2002	Terms of Trade Effects[1]
Wheat	3.8	–6.41	–5.47	–5.67	–0.21
Rice	–0.9	–2.65	–2.64	–2.62	0.02
Coarse grain	2.3	–0.07	–0.06	–0.07	0.00
Sugar	1.8	–3.47	–4.29	–4.36	–0.08
Beef, etc.	0.6	–0.10	–0.13	–0.13	0.00
Other meat	–0.6	–0.90	–0.69	–0.69	0.00
Coffee	–1.5	6.02	9.07	8.93	–0.14
Cocoa	–0.7	–0.20	–0.28	–0.28	0.00
Tea	–1.4	–0.02	–0.02	–0.02	0.00
Oilseeds	–0.3	0.00	0.00	0.00	0.00
Dairy	1.2	–2.92	–1.85	–1.87	–0.02
Other food	–1.4	–5.90	–6.19	–6.10	0.09
Wool	–0.9	0.00	0.00	0.00	0.00
Cotton	–1.2	13.20	16.26	16.06	–0.20
Other agriculture	0.8	1.97	2.12	2.14	0.02
Total agriculture GDP (1990–92)	1,305	–1.45	5.83	5.32	–0.51
Net loss relative to GDP	–0.039				

Source: World Bank calculations.
[1] $Q'P(WR) - Q'P(NR) - 2002.00$

Uruguay Round will worsen Central African Republic's terms of trade for food by $0.5 million, or 0.039 percent of GDP.

The cost of the agricultural liberalization to the Central African Republic is around four ten-thousandths of the GDP. It is real. If you took four ten-thousandths of GDP away from me I would feel pretty aggrieved. But it is by any standard small: much smaller than all the other things that are happening to the economy, and small enough that if only one gets one's own policy right by improving small things, like customs administration or the distribution of the agricultural inputs, one could easily offset it.

Table 5 repeats this exercise for every net food importer among the least-developed countries in Africa. The figures are small throughout. For example, Egypt, is estimated to lose 11-thousandths of GDP. To be sure, this is a real cost, not a transitional one, in the sense that it will not go away by itself. But it is a small cost, a small shock, that it is eas-

Table 5. Estimates of the Effects of the Uruguay Round on Net Food Importers' Terms of Trade

(In millions of U.S. dollars, unless otherwise noted)

Countries	Value of Net Exports (1990–92)	Value of Net Exports (No Round) 2002	Terms of Trade Effects[1]	GDP 1990–92	Net Gain/Loss in 2002 Relative to GDP in 1990–92 (In percent)
Central African Republic	–1.45	5.83	–0.51	1,305	–0.039
Comoros	–4.81	1.96	–0.17	249	–0.070
Egypt	–2,359.30	–2,252.93	–40.24	34,583	–0.116
Equatorial Guinea	–10.42	–7.95	–0.10	141	–0.071
Ethiopia	–54.23	32.23	–3.31	6,445	–0.051
Gambia	–72.82	–75.56	–0.54	337	–0.160
Guinea	–17.74	–17.02	0.01	229	0.003
Mauritania	–101.67	–93.76	–1.25	1,114	–0.112
Mozambique	–179.75	–165.03	–1.26	1,387	–0.091
Niger	–56.12	–55.13	–1.46	2,384	–0.061
São Tomé and Principe	–3.13	–1.90	–0.08	48	–0.161
Somalia	–52.19	–46.91	–0.94	917	–0.102
Togo	–1.50	24.29	–1.71	1,604	–0.107
Yemen	–746.95	–727.52	–8.85	8,595	–0.103
Zaire	–98.71	–49.80	–1.69	8,769	–0.019
Zambia	–36.19	–28.60	–0.92	3,286	–0.028

Source: World Bank calculations.
[1]*Q'P(WR) – Q'P(NR) – 2002*

ily handled by better economic management; it is a very very small shock in a rather noisy system.

What conclusions do I draw from this? I do not say that we need not worry about these numbers, but I do conclude that to put effort into seeking compensation for it is a waste of time. Everybody suffers shocks of this size in the course of everyday economic life. The answer is to offset them through the benefits of liberalizing your own markets and domestic policy stances.

Conclusion

This paper has considered briefly four aspects of the outcome of the Uruguay Round of interest to sub-Saharan Africa. The first represents a clarification of the trading rules—on preshipment inspection—that Africans had desired. The remainder comprise two areas where the

costs to Africa were much less than feared—preference erosion and food prices—and one that laid longer-term gains against shorter-term competitive pressure. What is conspicuously missing is any unambiguous gains. The reason is that African countries generally stayed on the margins of the Uruguay Round's main business—exchanging market-liberalizing concessions. The Africans had relatively little to gain from other countries' concessions, for they already have fairly good access to OECD markets, but they had large amounts to gain from liberalizing their own markets for imports. That they generally chose not to reap these gains sets them apart from very many other developing countries. Thus, while the Uruguay Round represents something of a shot in the arm for many developing countries, for most African countries it represents more of a self-inflicted shot in the foot.

The Role of the World Trade Organization and Post–Uruguay Round Issues 13

Frieder Roessler

The architects of the postwar international economic order had foreseen the creation of three institutions: the International Monetary Fund (IMF), the World Bank, and the International Trade Organization (ITO). The IMF and the World Bank were established, but the ITO never came into existence. All that remained of the ITO was its chapter on commercial policy, which entered into effect for 23 countries in 1947 as the General Agreement on Tariffs and Trade (GATT).

The Need for the World Trade Organization

The GATT was originally conceived as a provisional agreement to be reconsidered upon the establishment of the ITO. As a result, the original text of the GATT does not contain a complete institutional design. Over time, however, the GATT acquired many of the attributes of such an organization. On the basis of a general clause providing for the contracting parties to "meet from time to time to give effect to those provisions of this Agreement which involve joint action,"[1] the GATT contracting parties developed organs through which to act, concluded treaties with sovereign governments (e.g., protocols of accession), and acquired the services of a Secretariat.

Since the GATT already functioned as an international trade organization, why did the Uruguay Round negotiators consider it necessary to create a new organization to replace the GATT? Having successfully overseen the Uruguay Round, why was the GATT not entrusted with the management of the results of this Round?

The answers to these questions are to be found in the lessons the negotiators learned from previous rounds. Prior to the Tokyo Round, the major result of multilateral trade negotiations was the lowering of tariffs undertaken by participants, mainly the major traders, whose benefits were extended to all contracting parties under the GATT obliga-

[1]Article XXV(1) of the GATT.

tion to accord most-favored-nation treatment. In addition to such tariff commitments, the Tokyo Round produced a set of agreements governing the use of nontariff measures. These agreements were separate from the GATT, whose contracting parties were under no legal obligation to sign them. Fewer than one-third of GATT contracting parties accepted these agreements, and most developing countries chose not to.[2] This experience raised serious questions about the GATT's ability to adapt to new needs by simply adding to its legal system new agreements among which each contracting party can choose.

More generally, the experience of the Tokyo Round reinforced the perception among trade policymakers that the operation of the MFN clause made it more difficult to achieve results in multilateral trade negotiations. While the MFN clause had a trade-liberalizing effect since new market access opportunities were made available to all exporters, the automatic extension of these benefits reduced the capacity of governments to make liberalization commitments. Since a country's exporters could reap these benefits irrespective of their government's trade policies, there was little leverage that could be applied on protectionist lobbies to argue in favor of domestic liberalization.

To resolve this dilemma, the Uruguay Round negotiators decided to make the benefits of the multilateral trading system available only to those who accepted the totality of the results of the round as a "single undertaking," replacing all previous undertakings. This new treaty would be presented to GATT contracting parties on a "take-it-or-leave-it" basis. The management of the single undertaking could not, however, be entrusted to an organization—the GATT—whose members were not bound by the new rules. If the substantive rights and obligations under the GATT were to be replaced, the GATT as an institution had to be replaced as well. These considerations gave rise to the creation of the WTO.

Structure of the Agreement Establishing the WTO

The Agreement Establishing the WTO is a short one, containing just 16 articles. These provide for the establishment of an organization, attribute certain competencies to that organization, and set out its institutional and procedural structure. Attached to the Agreement are the substantive results of the Uruguay Round in the form of "annexes";

[2]A decision of the GATT's contracting parties in 1980 confirmed that contracting parties implementing the Tokyo Round Agreements were required to extend the treatment provided therein even to contracting parties that had not signed them.

Annex 1 covers the multilateral trade agreements in the areas of goods (1A), services (1B), and intellectual property (1C); Annex 2 covers the dispute settlement procedures; Annex 3 covers the trade policy review mechanism; and Annex 4 covers the plurilateral agreements on government procurement, civil aircraft, dairy, and meat.[3]

The tasks of the WTO include overseeing the implementation of the agreements reached in the Uruguay Round, the administration of the dispute settlement procedures and the trade policy review mechanism, and cooperation with the IMF and World Bank. The WTO's supreme organ is the Ministerial Conference, composed of representatives of all member governments. The Conference is required to meet at least once every two years; the first such meeting is scheduled to take place in Singapore at the end of 1996. In between meetings of the Ministerial Conference, its functions are carried out by the General Council.

The General Council convenes as the General Council or as the Dispute Settlement Body or as the Trade Policy Review Body. Under the General Council are the three specialized councils overseeing the multilateral agreements in the area of goods, services, and intellectual property protection. In addition, the Agreement Establishing the WTO provides for three committees—already in existence under the GATT 1947—to cover Trade and Development, Balance of Payments Restrictions, and Budget, Finance, and Administration. The institutional structure of the WTO is serviced by a Secretariat headed by a Director-General.

The Ministerial Conference and General Council have the authority to make decisions on all matters not specifically assigned to other organs of the WTO. The governing body of the WTO may also take decisions on any matter assigned to a subsidiary organ at the request of a WTO Member. This ensures that matters that cannot be resolved in their assigned forum are passed on to a higher level; at the same time, the principle of subsidiarity is respected in order to prevent the higher-level body from interfering with the functions assigned to the lower-level body.

The Agreement Establishing the WTO states that the practice of decision making by consensus under GATT 1947 shall be continued in the WTO. This provision does not, however, imply that consensus is necessary for decisions to be made in the WTO; it simply states that recourse to voting should be avoided whenever possible. When a con-

[3]The plurilateral agreements are binding only on those WTO members that have accepted them. The "single-undertaking" approach thus does not apply to the plurilateral agreements.

sensus cannot be reached, the agreements contain rules for decisions by vote on the basis of one vote per country.[4] Waivers, for instance, require approval by at least three-fourths of the members.

Of particular significance in the WTO's decision-making rules is the fact that amendments to the WTO Agreement that change the substantive rights and obligations of its members are binding only on states that have accepted them.[5] This aspect of the WTO means that no new policy obligation can be imposed on a WTO member without its consent. This feature leaves the WTO in a very similar position to the GATT in the Tokyo Round with respect to achieving multilateral acceptance of the agreements reached in future rounds of negotiations: new agreements reached under the auspices of the WTO will be binding only on those countries that have accepted them. It is therefore likely that trade negotiators will find it necessary to end a major future round of negotiations with a new "single undertaking" replacing that of the WTO.

Legal Issues in the Transition from the GATT to the WTO

Annex 1A of the Agreement Establishing the WTO incorporates the GATT and the legal instruments and decisions adopted by the contracting parties up until January 1, 1995, the date of the entry into force of the WTO. The GATT and the legal instruments and decisions adopted under it, as well as six understandings on GATT provisions negotiated during the Uruguay Round, and the Uruguay Round protocol on market access are referred to as "GATT 1994" in the WTO Agreement.

The WTO is, however, legally distinct from the existing GATT, referred to as "GATT 1947." The old GATT will remain in existence until the end of 1995 in order to permit its contracting parties to finalize the domestic ratification of the WTO Agreement and become WTO members. Those contracting parties that have not become WTO members by the end of 1995 will then be left without the protection of the multilateral trading rules. Fortunately, most of the GATT contracting par-

[4]The European Community is a WTO member, as are its member states, reflecting their shared competence in the areas covered by the WTO Agreement. When the European Community exercises its right to vote, it has the number of votes equal to the number of member states that are members of the WTO.

[5]Amendments that do not alter the rights and obligations of members, such as in the procedures, are binding on all members, including those voting against.

ties have already ratified the WTO Agreement within a surprisingly short period of time.

The legal coexistence of GATT 1947 and the WTO is not without its problems. Since the WTO incorporates the GATT, it also incorporates the GATT's cornerstone principle of nondiscrimination. Since the MFN clause requires the benefits of trade negotiations to be extended to all contracting parties without conditions, it would therefore have required WTO members to extend benefits in the goods area even to GATT contracting parties that had not become WTO members. Overcoming this possibility of "free-riding" was the reason for the creation of the WTO; at the same time, a period of legal coexistence was required to permit the completion of domestic ratification. To overcome this problem, the GATT contracting parties decided to accord each other a waiver permitting the withdrawal of WTO benefits from non-WTO members.

Another issue raised by the legal coexistence of GATT 1947 and the WTO is the different scope of rights and obligations in the area of trade in goods under these two instruments. For instance, the WTO Agreement provides for the phase-out of import and export restrictions affecting trade in textiles and clothing that are illegal under GATT 1947. Similarly, the tariffication of import restraints affecting agricultural products has required the lifting of tariff rates subject to bindings in previous GATT negotiating rounds. While the overall purpose of these WTO provisions is a laudable one—to permit the liberalization of trade in textiles and clothing and in agricultural products—their effect is to provide a legal cover for some measures that are illegal under GATT 1947. To overcome this dilemma, GATT contracting parties decided to grant a waiver permitting contracting parties to take those measures that they are permitted to take under the WTO Agreement.

A third problem that was identified for the transition from the GATT to the WTO was the potential for disputes to be brought separately under each forum, a form of double jeopardy. Here, the contracting parties decided that rights under the GATT dispute settlement system would not be available if a dispute was already being pursued under the WTO.

Conclusion

The WTO has been described as an enormous change in the institutional framework for international economic relations. However, to a large extent, the WTO represents a formalization of the practices that emerged under the GATT. This continuity is evident in the area of decision making, but also in other areas. For instance, the WTO has taken

over as its own the staff of the GATT Secretariat and has adopted the same financial regulations.

The major change the WTO represents is the unification of all trade policy and trade-related matters under a single institutional framework. The multitier multilateral trade order that emerged from the Tokyo Round, under which different contracting parties were bound by different rules, has been replaced by an order under which, in principle, the same rules apply to all. Subject matters that were linked in the negotiations have now been legally linked as a balance of rights and obligations across goods, services, and intellectual property protection. Violations of the rules in one area can now be responded to by suspensions of obligations in another area. This is likely to raise the issues arising in the WTO to higher political levels and foster decision making less influenced by sectoral interests.

This unification of subject matters will have a profound impact on the manner in which governments decide trade policies. Each action taken, each position adopted, and each noncompliance contemplated will now be viewed not only in the light of the constellation of interests in one particular area but in the light of the interest of the system as a whole. This in turn is likely to raise the issues arising under the WTO to a higher political level and foster decision making less influenced by narrow sectoral interests. The historical significance of the WTO Agreement may therefore lie not so much in the institutional changes it brings about but in the integrated trade order and decision-making procedures it makes possible.

Comment

Ellen Frost

When the GATT was created in 1947–48, its scope was more or less limited to things that happened at the border, namely, tariffs and quotas. Over time there has been an expansion of the scope of trade rules, and each new topic added to the trade agenda has required a fairly lengthy period of time before it was ready for formal negotiations. So fifteen or twenty years ago in the OECD there were discussions about services, and there were discussions about intellectual property protection. In each case people said, "Oh no, too vague, you cannot possibly discuss this." Today we have agreements in both areas. So the topics I am going to talk about are not necessarily ready for discussion in the WTO; in fact, most of them are not. But I think in a historical context they are coming to our agenda. The expansion of the scope of trade rules has received a sudden new emphasis, a twofold stimulus.

The first is, of course, the so-called globalization of business. What does that mean? Everyone talks about it. It means typically that companies locate their activities in a number of countries; they may produce one part in one country and another component somewhere else, and assemble somewhere else, and they may add services from the United States. They do all of this for a global market. Clearly, the old paradigm of products made in one country, put on a ship, and shipped to another country is very much out of date. Nowadays, how companies compete against each other depends a lot on the domestic policies of those countries in which they are located. So domestic policies have become more important from the perspective of globalization.

Second, thanks to the Uruguay Round, tariffs and quotas have been diminishing considerably, exposing domestic policies as occupying a more central place. So there is a kind of government reason and a private sector reason why these new agenda items are surfacing. Characteristically, the United States and the developed countries have been relatively more in the lead in formulating this new agenda. It is not surprising in that their companies tend to be the most active in overseas markets, but in some cases, we are joined by a number of the dynamic developing countries as well.

We have in the United States a particular dynamic that is pushing us to explore these new issues. We measured trade as a percentage of

GNP, in 1994 exports, imports, and earnings on investment, that is, the current account minus unilateral transfers, and found that it is equivalent to 27 percent of our GNP, up from 13 percent in 1970. So there has been in the last twenty-five years a doubling of the world trade in our economy. There is no going backwards for us as a country, and that is why I think that despite individual pressure groups the momentum is in the direction of market opening.

What is the best way to carry out the new agenda? In terms of process and location I might say a quick word about the OECD. As you know, the OECD is a forum where issues can be "cooked," so to speak, in advance of negotiations, where consensus can be formed, where principles can be devised, and then an issue can be turned over for more formal negotiation. The obvious limitation of the OECD to date has been its industrial country nature: it consists of 25 countries, of which only two are not classified as industrial: Mexico and the Czech Republic.

The OECD has recently entered into dialogues with so-called dynamic nonmember economies including Brazil, Singapore, Korea, and most recently China. It still remains valuable as a place to discuss emerging trade issues.

If you look at the new issues you can divide them crudely into "old" new issues and "new" new issues. I want to spend more time on the "new" new issues. But let me just quickly list the "old" ones. By old new issues I mean post–Uruguay Round issues that are left over from the Uruguay Round, but they are not new in a conceptual sense. The main ones are investment and services, including financial services, telecommunications, and audiovisual.

In this new world economy, investment is now integrated very closely with trade. Far from exporting jobs, we find that investment is linked closely to the export of goods and is a net driver of global trade. In the United States, we find that investment overseas is linked positively with investment in this country and responds to new opportunities. It is a net job creator. It is likely that at the OECD Ministerial in May 1995 negotiations will be launched on a so-called Multilateral Agreement on Investment (MAI), trying to raise standards above and beyond what was negotiated in the Uruguay Round. This will be an exciting opportunity for OECD members and nonmembers alike—to aim a little bit higher than the agreement on trade-related investment measures (TRIMs) that was negotiated during the Uruguay Round.

Services is a very dynamically growing sector of world trade. I have read predictions that by 2005 trade in services could actually exceed trade in goods, considering the explosive growth of the travel and tourist business, not to mention insurance and accounting, and all the

other kinds of services. In the United States, the export of services is equivalent to about 40 percent of the export of goods and is growing very dynamically. I think we are going to see services catching up to merchandise exports rather quickly. The second biggest service exporter after the United States is France. Besides the United States and France, a number of countries have an interest in raising standards for service exports.

Another old new issue is standards. This has been touched on briefly in other presentations. The challenge is to harmonize or at least allow for some sort of mutual recognition of standards and conformity assessment and the like. A lot of trade in a nitty-gritty sense is bound up with standards.

But I want to devote a little more time to the so-called new new issues, many of which are not very new after all, but in a negotiating sense they are. I want to touch very quickly on five: environment, technology policy, competition policy, regulatory issues, and labor standards.

Trade and the environment is an issue that is here to stay, whether we like it or not. That is to say, there are a number of instances in which a country has acted unilaterally in the name of protecting the environment. The European Union has its problems with leghold traps and animal rights. We have imposed trade restrictions on particular countries for certain environmental reasons. You can look at the environment initiative in the WTO as an opportunity to step back from this growing unilateralism and try to reach some sort of broad consensus on how to address environmental problems outside of your jurisdiction, such as what happens when the trade provisions of an environment agreement conflict with the rights of membership in the WTO. It is a very long-term effort; a working group has been created in the WTO. I understand the concern of many in this group that there are protectionist forces at work here. Of course, one cannot deny that there are protectionist forces in the environmental community. But it is certainly the intent of most of the serious governments involved in this issue to try to devise some sort of broad framework for reconciling these different imperatives.

Technology policy does not arise in a single way. Sometimes it pops up as a research and development issue—denying a foreign company access to research and development, for example. The one rather new manifestation of technology policy as a trade issue is biotechnology, genetically modified organisms. In shorthand, we ask ourselves, "When is a tomato not a tomato?" In other words, at what point when you add a gene to a tomato does it cease to be a tomato and become subject to some special regulation that can easily lead to protection?

This could be a major issue in agricultural trade, especially between the United States and Europe. So there is a range of issues here that arise because governments realize that knowledge and technology are competitive advantages and they try through various means to subsidize technology development. That is why we have rules on subsidies and why we try to limit support in this area to basic research. But it is an issue that deserves a little more attention.

Next is the cluster of regulatory issues, broadly speaking. Excessive regulation can be a barrier to market access for a number of reasons. Sometimes the regulations are not open, so one solution is transparency. Sometimes the regulations lend themselves to bribery, a serious problem, so there is a need to discuss anticorruption measures. Again, transparency is one possible solution. Privatization is, of course, also helpful. Then there is the issue of good governance: how do corporations run themselves, how do governments run themselves, and how can we strike the right balance between the governments' need to regulate for purposes of protecting society on the one hand, and on the other hand opening their markets as fully as possible? We see the deregulation debate rather strongly developed now in Japan, where it is estimated that a combination of deregulation and open trade policies could cut consumer costs by as much as 50 percent. There are a number of estimates, but in general there is no real disagreement between American and Japanese experts on the costs of excessive regulations. The problem is the familiar "iron triangle" of regulated industries, members of parliament, and members of the bureaucracy that engage in regulations. And that so-called iron triangle is by no means unique to Japan; we have it here as well.

Regulation is a very significant topic, but once again the trading system right now is not particularly well designed to handle it. There is often criticism of the United States for its use of Section 301 or other unilateral measures. In the case of Japan, we find that some of the barriers that are very real do not lend themselves to WTO dispute settlement cases, because those particular practices are not named in the WTO as being actionable. So regulatory barriers to market access are a problem that I think requires a lot of thought.

Competition policy is, of course, closely related to the deregulation that I have just spoken about. In some ways competition policy is a paradigm for the future of the trading system as a whole. That is to say, in this model of the global economy that I have been sketching, the healthiest outcome, and the one that is best for both national welfare and consumer welfare, is competition. Here we are talking about something a little broader than just antitrust in the legal sense. This makes lawyers nervous, but from a trade policy perspective we do not

look just at antitrust and subpoena powers and access to proprietary data. We look more broadly on anticompetitive behavior with trade effects, anticompetitive behavior that has the effect of restricting market access.

The Uruguay Round agreements call for a review of "investment and competition policy" within five years. It is not too early to think about this now. In the United States, we do not have a consensus between our various government departments in this area, and we are somewhat handicapped in that respect. But other governments—I am thinking of Canada, for example—are really ahead of us both in thinking this topic through and promoting it. Clearly, competition policy is the long-run solution to antidumping. If you look at the Australia-New Zealand experience, if you look at the European Union, a long-run solution to the antidumping problem is to establish common competition policies, and that is the main reason why it is going to become so important. We are all very busy filing antidumping cases against each other in a downward spiral. In the North American Free Trade Agreement we are supposed to have a free trade agreement, but Canada and the United States continue to file antidumping cases against each other, which is really not sustainable in the long run. So there are lots of reasons why competition policy is really by far the most important of the various issues that I have named.

Last, but not least, is an issue I think has been exaggerated in importance, certainly exaggerated emotionally, and that is the labor standards question. I disagree with Mr. Blackhurst that this issue is a threat to the developing country workforce. If you formulate the issue in a certain way, that is correct. If you say the purpose of this initiative is to invoke sanctions against countries with lower wages, that is right; I would be the first to admit that. But that is not the intention. The intention is, in the case of the United States anyway, to build political support for the trading system. That may seem strange, but this motive has been around for a long time. Recall that the issue of trade and labor standards has been with us ever since the International Labour Organization (ILO) was formed in 1918.

One of our problems in the United States is that there is a widespread perception that other countries are somehow unfair. In our public debate we have a great deal of difficulty with this particular mood. We would like to be able to resist the worst forms of protectionism by pointing to a broad multilateral consensus on how to handle trade and labor standards. To the extent that there is any formal discussion of this topic, the internationally recognized labor standards at issue are limited to freedom of association, the right to organize and bargain collectively, a minimum age for the employment of children

(what that age is, what a child is, is not defined), and freedom from forced or compulsory labor, which is already in the GATT. Nowhere is there a discussion of the existence of low wages in the proposals that I am familiar with. There is also a very widespread acceptance that labor standards must depend on the level of development of a country.

Even so, trade and labor standards is a very sticky and somewhat dangerous topic. Again, like the environment, there are clearly protectionist forces on the political scene, but to put it bluntly, we Americans do not need labor standards to be protectionist. If we wanted to be protectionist, we have lots of ways of being protectionist, and lots of tools. We do not need this. Protectionism is really not our motive in raising this complicated issue. The consensus system remains in effect. There is no way that any country is going to force this issue down the throats of anyone else.

I would like to raise a distinction here that has not gotten attention in the debate, but I think it should. Speaking personally, I think there is a very important and basic distinction between low labor standards that result from low productivity and poverty, on the one hand, and, on the other hand, the deliberate suspension of basic labor laws in an export-processing zone. To my mind that is a very big difference. Those developing countries that are trying sincerely to raise their labor standards, because they want to create a middle class and create decent working conditions, have a reason to be concerned about a deliberate suspension of labor standards in an export-processing zone in a competing country. That suspension could have a trade-diverting or investment-diverting effect. So we look at the labor standards issue not in macro terms, because I do not think there is any evidence that it really affects the overall levels of trade, but in terms of certain industries, where it can be a trade-distorting factor. Should there not be some discussion of this? Should there not be some effort to prevent the competitive downward spiraling of labor standards by a particular government or two that are deliberately trying to distort trade and investment? And if there were such a consensus to develop—and perhaps it cannot be even discussed in the WTO for a long time—would it not make it easier for us as trading nations to resist the most protectionist voices, especially from our unions? We see the issue in that pro-market, pro-trade context, and we are talking about internationally recognized labor standards, not U.S. standards. We are talking very broadly about some minimal set of core standards that most of these countries have subscribed to in the form of the ILO conventions, one way or the other. Can it be abused in the future for protectionist purposes? Sure, just like a lot of things. But to keep it off the agenda en-

tirely just makes it more difficult for us to deal with this very emotional problem.

There may be other issues that you would like to suggest, but environment, technology, competition policy, regulation and labor standards would be the five that we think of as the so-called new new issues. We see a rather long period of time required to discuss these issues and build a consensus. We encourage all of you to try to take part in the debate about post–Uruguay Round issues earlier rather than later, to get in on the ground floor if you can with the concerns that you have. Some of you have sectors in your economy that have become very modern very fast, even if the overall level of development is still relatively low, so you can jump ahead a generation or two conceptually and help us think through these particular issues.

Comment

Grant Taplin

I would like to speak about the role of the Fund in the post-Uruguay Round agenda. These are more my personal views than official views.

The papers of Roessler and Frost are very interesting and cover a wide area. Frost has given us an extensive list of trade policy areas that emerged during the Uruguay Round negotiations, many of which undoubtedly will spill over in due course into the World Trade Organization. Which ones the WTO will pick up and when, and how they will be shared with other agencies, will be determined in large measure by political forces.

To repeat some of what has been said, the areas appear to be trade and trade-related agenda including environmental issues, competition issues, investment policy, technology policy, and free trade agreements. All of these are correctly advanced under the umbrella of globalization. I would like to pick up the discussion and comment on labor standards, as well as two more closely Fund-related issues, namely, capital flows and policy coherence.

Labor standards and trade liberalization. The issue of linkages between labor standards and trade liberalization falls outside the direct mandate of the Fund, but how it unfolds and whether or not it becomes subject to internationally agreed disciplines will undoubtedly have an impact on trade and investment, and therefore the balance of payments and growth prospects of Fund member countries. It should be noted that this is a highly political issue being pressed by a number of major players in the multilateral trading system and being strongly resisted especially, but not exclusively, by developing countries. Even those that are resisting trade-labor standards linkages are also arguing that the WTO should not be engaged to enforce labor standards; that this is the rightful domain of the ILO, but this raises questions about the strength of ILO enforcement instruments. The debate is further complicated by disagreement over whether countries with low wage rates and minimal labor standards do actually have competitive advantages. Lastly, the debate is murky as to what comprises "core" labor standards—those that should be respected as a minimum. In fact, some labor standards identified by some as core ones are actually human rights standards. But, then this would lead to a new trend of thought—

which actually has emerged—linking trade concessions to respect for fundamental human rights—economic, social, and cultural rights, including the right to development, and political rights. Some major players already link GSP privileges to human rights and labor issues. Thus one can ask if this is not an overload of the trade policy agenda.

Capital flows. As has already been noted, trade and investment are on the trade policy agenda. In concrete terms, this is reflected in the Agreement on Trade-Related Investment Measures. Of course, this is not a new item on the international agenda—after all the OECD Code of Liberalization of Capital Movements was adopted in 1961. Perhaps these issues have become more pressing in view of the increased globalization of the world economy, and with the modern communications network, capital can move from one country to another almost instantaneously. This volatility of international capital and the role of regulation has been examined by the Bank for International Settlements (BIS); and capital account liberalization is part of the Fund's policy dialog with member countries. We all recognize that capital surges can complicate economic policy management. With respect to developing countries, capital inflows (and reflows) require appropriate policy responses to safeguard gains made in economic and financial stabilization and establishing the foundations for high-quality economic growth. Depending on the circumstances and the type of flow, the appropriate response is a combination of sterilization, fiscal adjustment, and exchange rate appreciation. In most circumstances, capital flows should be avoided. An additional aspect is that there is no agreed enforceable set of rules covering capital flows (and investments).

In view of globalization, and also recent events, capital flows are on the global agenda. (I do not want to repeat what are widely accepted views that financial market deregulation and liberalization contribute to the efficient distribution of resources globally—as well as internally.) It could be noted that the Fund's jurisdiction over capital flows largely derives from its surveillance function under Article IV of its Articles of Agreement. I would also note that the Fund's Articles were framed at a time when capital controls were pervasive, and indeed the Articles permit the Fund to require a country to institute capital controls in certain circumstances—a provision that has never been used. With the experience of this clearly in mind, emphasis was placed on current account liberalization. In short, the Fund has the authority to approve restrictions on current account transactions—existing restrictions can be maintained under Article XIV, and the intensification of existing restrictions and the introduction of new restrictions are subject to Article VIII.

Consideration of capital flows is relevant to post–Uruguay Round issues precisely because commitments in services in the Uruguay Round create obligations to liberalize related current and capital account transactions. In view of this, can conflicts arise between a Fund member's rights and obligations under the Fund's Articles of Agreement and its undertakings in the WTO? And if they can, who is to adjudicate the matter? Presumably, a WTO (and Fund) member not fulfilling its WTO commitments can be the object of dispute settlement. Does this in effect transfer to the WTO what some would argue should implicitly be an issue in the Fund's jurisdiction? As you all know, capital account issues are regularly studied by the Fund staff, and the Fund's Executive Board will soon (in May 1995) have a new occasion to discuss the Fund's role. A question that will have to be confronted is whether there is a basis and a will to extend Fund jurisdiction over capital flows without an amendment to the Articles. Moreover, the WTO's role will have to await actual complaints, and the initiating of dispute settlement procedures—only concerned parties can make complaints and seek relief through dispute settlement, as indicated by Roessler. But it is clear that formulation for rules to govern capital flows will become more urgent. Also, it is an area that will require close cooperation and collaboration between the Fund and the WTO.

Coherence. It is worth recalling the WTO text, Article III, paragraph 2: "With a view to achieving greater coherence in global economic policymaking, the WTO shall cooperate, as appropriate, with the Fund and the World Bank, and World Bank affiliates." Elements are spelled out in the Declaration on the Contribution of the WTO to Achieving Greater Coherence in Global Economic Policymaking. The basic issue is how to promote improved policy coherence, but the precise meaning of this issue is elusive. Moreover, it has an international dimension as well as a domestic dimension. Let us all agree that we do not want a situation where the policy advice from the Fund to a country is contradictory to that provided by the WTO. Also, we are working out a framework for closer collaboration, to avoid conflict situations, which have been very infrequent in the past. It must also be noted that in certain circumstances certain contractual undertakings by members in the WTO are second-best economics, and that the Fund as the international body mandated to exercise firm surveillance over exchange rate policies of its members is obliged to offer first-best recommendations.

It should also be remembered that countries have the obligation to achieve greater coherence in domestic policies. It may be true that a member's trade policies can offset the intent of its exchange (and monetary) policies, and vice versa. It is also true that some members of the international community believe and assert that greater stability in the

system can be achieved by using the exchange rate as an anchor of policy, where others see greater exchange rates as derived from an appropriate macroeconomic and financial framework. It is likely that this debate will continue, with little meeting of minds.

An additional element of coherence in the minds of some is a closer association at the international level of officials responsible for monetary matters with those responsible for trade matters at the international level. Some of you will have undoubtedly seen the views of the WTO Director General on international policy coordination. I am sure that these issues will figure often in the international debate in the post–Uruguay Round context. But "progress" in this area, however progress is conceived, will once again be dependent on the political will of (the major) member countries.

Wrap-Up: Trade Issues in the 1990s 14

Patrick B. de Fontenay

The seminar has touched upon a number of issues, actually quite a wide range of issues, covering unilateral, regional, and multilateral aspects of trade policy. On unilateral trade liberalization, I think the seminar has spent some time on trade reform, and there I think the main issues identified were exchange rate policy, as well as sequencing. Then trade liberalization issues in industrial countries were covered, starting with the presentation by Professor Lawrence, who focused among other issues on the difference between what he calls "shallow integration," which is a reduction of trade barriers at the border, and "deeper integration," which is really an attempt to harmonize national differences in areas such as property rights and other issues.

Then the seminar moved on to the regional and multilateral aspects of trade policy, and in particular whether the Fund, the World Bank, and the World Trade Organization should be concerned about the proliferation of regional trading arrangements. Do regional trading arrangements complicate the trade dispute between countries that belong to different regional trading arrangements? What can be done to ensure that regionalism complements multilateralism? And what can be done about countries that are left out of regional trading arrangements?

The seminar also covered the trade liberalization issues in Eastern European countries and the Baltics, Russia, and other countries of the former Soviet Union, where the proliferation of antidumping has emerged as a major issue. Also discussed were the best ways of circumscribing the use of antidumping, and whether antidumping policy should be reoriented from its current sectoral perspective toward a national perspective, requiring stricter provisions in national antidumping legislation.

And finally, the seminar covered the impact of the Uruguay Round and post–Uruguay Round agenda. The discussion demonstrated that the benefits were the largest for those countries that liberalized the most. Also the potential losses for the least-developed countries in Africa were regarded as small in terms of preference erosion and food import costs. Some of the questions were how the Fund, the World Bank, and the WTO could help countries maximize the benefits of the Round and minimize the costs. And finally, among the post–Uruguay

Round issues that were identified, there was first the liberalization in services and foreign investment, as well as possible agreements in the areas of competition policies, environment, and labor standards. Many participants felt that the latitude might be used for protectionist purposes and raised the question of how legitimate concerns on environment and labor standards could be met without this being a clog for protectionism.

Comment

Masood Ahmed

I would like to focus my comments on three broad areas and in that context weave in some of the points that were raised earlier. The three points are, first of all, the importance of pressing on with trade liberalization of the good old-fashioned kind, particularly in many developing countries. Second, I want to pick up on the question of moving forward to implement trade liberalization in those areas that the Uruguay Round has now brought within the framework of international trading arrangements. That is a set of issues that was also raised here. And third, I will list some of the items of the new trade agenda, which I am particularly concerned about. In fact, those are also some of the concerns that were reflected in the papers.

The first point is trade liberalization, especially in developing countries. It is important to recognize that even after the Uruguay Round, trade barriers will remain a significant issue for many developing countries. It is certainly the case that they have made substantial moves to liberalize their trade over the past decade. But it is also the case that, particularly, say, in Africa and in South Asia, and in a number of countries in other regions, barriers are still quite high. The reason I am focusing on this is to go back to the point about the gains from the Uruguay Round. I think the point that Alan Winters was making (Chapter 12) was that one of the main reasons why the impact of the Uruguay Round on Africa is so marginal is because African countries have not liberalized very much in the context of the Round. If we believe that the main gains from trade liberalization come from what you do yourself rather than what your trading partners do, then it is very important to press on with reducing barriers in those countries where they are still high.

Some will argue that you need to go about this in a fairly gradual way, to provide enough time for industries and countries to adapt to the competition that would come from removing these barriers. That is certainly a valid concern, and every country ultimately has to figure out what is the appropriate speed for itself. But it is worth noting that there is now a growing body of evidence that suggests that the countries that have undertaken speedy liberalization are also the countries that have done better, and that, in effect, what starts out as an orga-

nized gradual process to reform trade barriers over time runs the risk of becoming a victim or captive of forces generated during the process that are against liberalization. One such study that has just been completed by some of my colleagues in the World Bank looks at eight republics of the Commonwealth of Independent States (CIS) and comes up with some quite interesting contributions in that regard.

The second point is the question of the unfinished agenda, and that is a point that has also been raised in the notes that you circulated. I think we all recognize that the main contribution of the Uruguay Round in agriculture and services has been to provide us with a framework for liberalization, but that the actual process of liberalization or a reduction of barriers is largely ahead of us. Similarly in other areas like the MFA, it is important to recognize that much of the estimate of gains that people talk about will really only accrue when what has been agreed is, in fact, fully implemented. The fact is that most of the numbers that you now see in terms of the aggregate gains from liberalization in the Round are numbers that will only become valid at the end of the process. And I want to stress that point, because I think there is a concern that there is a growing popular sentiment in a number of industrial countries that argues for more protectionism in the face of rising imports from developing countries. As the world economy becomes more integrated, as developing countries increase their share in the world economy, as the share of trade in GDP increases in both developed and developing countries, the process of this integration is bound to create some transition costs both in industrial countries and in developing countries. But every responsible piece of analysis that I have seen suggests that these costs are far outweighed by the gains that come from the process of integration and greater trade. Unless countries and governments recognize that some segments of society or industry will suffer adverse consequences—in both developing and industrial countries—and take pro-active steps to try and deal with this issue, those segments can become an obstacle to progressing with the liberalization and therefore to achieving the aggregate gains that everybody agrees on a net basis are positive and large. Thus, it is important to press ahead with the implementation of the agreements in services and agriculture, and for that matter, with the other agreements in trade-related aspects of intellectual property rights (TRIPs) and trade-related investment measures (TRIMs).

Finally, let me list quickly three or four areas of the new trade agenda that we are particularly concerned about. First of these is antidumping. Your reference is mainly to transition economies. My sense is that in a rather unfortunate illustration of technology transfer, antidumping has now migrated from industrial countries to a whole range of develop-

ing countries. We run the risk of seeing the effect of the abuse of antidumping as one of the issues in the next few years. Most of the evidence shows that antidumping is primarily used to protect a small group of producers at the expense of the economy as a whole. The real question is, how can one begin to put into place mechanisms that take a broader look at gains and losses, rather than to put into place antidumping laws and regulations that have the likelihood of being abused? I have recently gone through three or four countries where they have been trying to put into place antidumping legislation. In all of those cases these concerns surfaced. When you look at the industrial structure in some of those countries and find it is heavily concentrated, the risk of the abuse of antidumping is higher rather than lower.

The second issue is the question of regional trading arrangements, which have grown in number and changed in nature. It is generally accepted that once you start introducing deep integration into regional trading arrangements, then you need to rethink the analytical framework for trying to evaluate the gains and losses. You cannot do a simple analysis of the conventional trade-diversion/trade-creation type alone. It is also the case that right now one does not have an entirely satisfactory way of analyzing what the dynamic gains would be, what the magnitude of gains would be from, say, harmonization of standards, for example. But I am still a bit concerned that this fascination with regional trading arrangements may well divert energy and effort away from proceeding with further liberalization of the multilateral track. It is interesting that when you look at most of the analyses of regional trading arrangements they are compared with a counterfactual that is quite a different counterfactual from, say, proceeding down the multilateral track. It is important, when looking at these analyses, to take a hard look at what the counterfactual is against which the benefits are being assessed.

And then there are these rather difficult issues of how do you deal with environment and labor standards in relation to trade policy. In the case of labor standards, it is particularly seductive to set up a straw child, if you like, or rather a straw man, and say, "Look, you've got this poor exploited child worker and in some sense how can you be against using any instrument that you have, whether it is trade policy, or any other policy, to try and address that very real problem." The difficulty, I think, is that everybody agrees on the objective, which is to create conditions where this kind of violation of rights or, indeed, unacceptable living conditions or working conditions for children or other people, for that matter, are addressed. I think you can even make a case that some dimensions of these are legitimate to address through international policy. What I think is the problem, however, is that it is not

at all clear that trade policy is the most effective instrument for addressing them. The other concern is that there is a substantial risk that what starts out as being a completely well-intentioned exercise to use trade policy to address what most people would agree is a legitimate objective, even if you are not sure about the effectiveness of the instrument, becomes captured by people who really want to use it for protecting certain kinds of industries. All you would end up doing is giving protectionism a good public relations cloak rather than actually addressing the problem. There is a real dilemma. Now people are talking about whether one can have a set of core standards, which in some sense one should address through trade policy, and then some country-specific additional standards that one would not address through trade policy. I remain a little bit concerned about how effectively one can identify a set of common core standards and police them and use trade policy for that purpose.

Let me just pick up one additional point and that is the question on the impact of the Uruguay Round. The point that was raised was that there are real transition costs in the short term, and what can agencies like the Bank and the Fund do to help countries in dealing with these issues. I would argue that there are two kinds of things that one can do. One is to help countries identify what the transition costs are. The transition costs are not just transition costs for food importers or preference losses, but the costs of moving into an integrated economy. Unless one identifies where the costs are likely to be located, which segments are going to be adversely affected, and, as I said, move proactively to try and address those concerns, then there is a real risk that those segments will become a lobby against liberalization rather than have their legitimate concerns dealt with. Part of the issue is obviously financial. But the financial dimension is a small part of the larger issue that one has to actually create a framework within which one can deal with those things.

The second thing one can do is begin to identify some of the issues or constraints that impede countries from exploiting the opportunities that are provided in the new, more integrated, more liberalized trading environment. In that regard there is one example that I would like to speak on. It is the whole question of the liberalization of services in trade. One of the most remarkable recent phenomena is the increasing tradability of services, mainly as a result of the revolution in telecommunications and technology. So what you now have is a far greater use of long-distance services, where the traditional concept that services had to be consumed where they were produced is no longer valid for a much wider range of areas. Some countries have already begun to exploit the potential for exports in services that comes from this phe-

nomenon, but many others still have a whole set of regulatory or other impediments that prevent the exploitation of this new area. Agencies like the Bank, the Fund, the WTO, and others can help provide cross-country examples of how different countries are beginning to take advantage of the opportunities that are available and identify the common factors that appear to be the driving forces behind these successes and the impediments that appear to be holding back other countries from exploiting them. That contribution is likely to be as useful as the contribution of focusing on how to deal with the losses and how to compensate the losers for them.

Let me also pick up on a few points that were raised by the participants. On the point raised about the importance of having some concrete plans at the country level to try to exploit the gains: it is a difficult trade-off between recognizing that there are opportunities that need to be exploited and identifying what sort of generic or general conditions enable a country to exploit those opportunities, whether they are policies, a lack of infrastructure, or whatever; or going the extra step, which is to actually start identifying, ex ante, which are the specific businesses or industries in which a country has a comparative advantage and then trying to push for their development. Most of the evidence shows that when official agencies, whether national or international, have attempted to identify which industries are the ones that are likely to be the winners of tomorrow, and should therefore be pushed to exploit the opportunities that exist in the world, by and large they have not been very successful in doing so. Indeed, in some cases it has taken them a long time to recognize that what they are doing is not successful. In the meantime, resources tend to get diverted away from people who actually have pretty good ideas and want to exploit them but cannot because of this official focus on a particular set of industries. So, speaking from the point of view of the Bank, we think there is a lot to be done in trying to identify the obstacles at the sectoral level that are impeding the development of that sector in the country. For example, in the case of Morocco, there has been a very active dialog between the Bank, the private sector, and external consultants, who are looking at industrial competitiveness and trying to see what are the issues in the case of Morocco that need to be addressed to develop competitiveness at the national level. I will stop short of saying that what you really need to do in Morocco is put into place 16-inch textile loops because that is really where there is a market need that Morocco can comfortably exploit.

On the role of multinationals, it is true that they have an important role to play. It is already the case that overseas sales of multinationals are now, if I recall correctly, 2½ times the volume of trade. So, in some

sense, they are already having a greater impact by their presence in different countries rather than through the trade that comes from them, and more and more of the trade is actually sort of intra-multinational companies. But my sense is that the conditions that attract multinationals are frequently the same conditions that attract domestic industry, and in some sense trying to create a framework that is geared to attracting multinational corporations is unlikely to succeed unless you have a framework that is resulting in a thriving domestic private sector as well, and frequently there is a lot of overlap between what attracts the two.

On regionalism, I agree that open regionalism is better than closed regionalism. My concern is that when regionalism gets formalized in agreements, there is a danger that the base of further reduction of barriers of the group vis-à-vis the outside world will be determined as much by the laggards in that group as by the ones who want to liberalize faster. So the trade-off is, in the aggregate, by grouping together do you accelerate the pace or do you slow it down? That is the empirical question. I do not know the answer. Obviously, it varies from case to case, but that is the kind of concern that I wanted to raise.

On the question of taking appropriate measures to deal with sectors that are negatively affected by trade liberalization: it is certainly true that it is very difficult to identify and deal with issues of equity and issues of effectiveness. The fact of the matter is also that in a number of cases, particularly if you look at developing countries, you can start identifying fairly quickly some 20–30 large enterprises, many of which happen to be in the public sector, most of which would be hurt by a program of liberalization in the sectors in which they had been previously protected, and in many of those countries implementing trade liberalization programs is held back frequently as a result of the political pressure and lobbying that is generated by the managers and workers of those enterprises. In the first generation of reform programs in many developing countries, trade liberalization had difficulty being implemented through to the industrial-restructuring stage because people did not recognize upfront that there was a potential lobby that needed to be dealt with in one form or another. So the only point that I am making is that one has to recognize ex ante that if you implement a program there are certain groups that are going to be adversely affected and will therefore lobby against it. In some cases, there may be some ways in which you can help them because they happen to be in four enterprises and you can identify them, while in other cases where they are dispersed all the way through a large economy, it may be impossible to find appropriate ways to identify them, let alone help them. I do not know what the answer is going to be in each case.

It may well be that in 80 percent of the cases the answer is that you really cannot do anything specific for those people, but unless in the design of the program, one factors in that political economy, it makes the implementation more difficult.

The answer to the question of how to build consensus to bring about liberalization is not going to be that easy. It is certainly the case that at the end of the day, particularly now as societies become much more open across the world, the notion that you can reach agreements on important issues of economic policy and impose them by having a small group of officials within one ministry of the country agree with their external counterparts is no longer valid. One has to work much more to build a broad-based consensus among a range of stake holders who influence decisions, and that now includes, in many countries, much more active participation by parliamentarians, trying to get agreement of influential people in the press, and in some sense one is beginning to see this in many developing countries. But in certain other countries one has had those sets of issues for a while, and they do make reaching consensus on difficult decisions a more complicated slow process. That is just one of the facts of life one has to work with.

The real issue is, if you relate that to trade liberalization, do you believe that trade liberalization is a concession or do you believe that trade liberalization is a policy that improves your own economic performance? If you believe that it is a kind of bargaining game in which you give away a bit in exchange for somebody else giving away something, then the whole thing ends up being seen as a sort of zero-sum game in which one is constantly trying to justify that what was given away is in some sense compensated for by what one has got in exchange. It is tough to convince people that you are getting that, and then your focus shifts very much on what the other partner is doing and whether they are likely to actually live up to their agreements or not. In a recent book by Paul Krugman, there is an interesting sentence that says that one of the things that separates economists from other professions is that all economists see that trade liberalization is an obviously good thing, and all other professions think of trade liberalization as being a sort of giving away something in exchange for something else. Now, I suspect, I have been in Congress for too long now to change my perception, but I just cannot get used to the notion of thinking of trade liberalization as a kind of "I will stop shooting myself in my foot if you stop shooting yourself in your foot first," and then you sort of compare the size of your respective wounds and say you have a bigger wound so I am better off. I honestly think that one has to start thinking of trade liberalization as being a process that basically, whether somebody else does it or not, helps a particular country in any

given state of the world. So that is one starting premise. Now if one disagrees with that starting premise, obviously a lot of what I have been talking about is thrown out of the window.

Now that said, it is also the case that the state of the world matters. So the benefits that you accrue from your own trade liberalization are not independent of the state of the world in which one operates, and that is the reason why the complementary part of what I wanted to say, and that I would like to emphasize again, is that it is important to maintain the pressure to make sure that things like labor standards, environment, and antidumping do not become the new instruments of protectionism. I think you benefit from trade liberalization regardless, but the gains from that effort will be proportionately higher if you are not also faced with additional negative external conditions, which are the kinds of issues that are now coming on the table. That is why the role of agencies like the WTO, the Bank, the Fund, and other agencies is to work simultaneously on these two parallel tracks, to encourage countries to keep moving forward with their own liberalization efforts, and in parallel, to identify the issues that could reduce the gains from liberalization: unclear rules, arbitrarily applied rules, and procedures not working well, new forms like rules of origin or antidumping that reduce the benefits to people who are liberalizing. That is the basic intellectual framework within which I see this thing.

Now, just to come back and finish up on the first point, which is the issue of liberalizing one's own economy regardless of what happens in the world. It is in that context I think that we need to look at the political economy of how to bring about liberalization in your own economy. And that is where I come back to my earlier point. One needs to recognize that there are some people who are going to be against liberalization because they personally are going to lose from it, and then one must take steps to try and identify and isolate these losses. In a more and more open society where you can only make these decisions through consensus, you simply will not be able to impose these losses just because you have decided in your own mind you want to liberalize. And unfortunately if the two sides talking are economists from the ministry of finance and economists from the World Bank, then they may both see this as being an obviously good thing, but they do not realize that there are many outside who do not see this as an obviously good thing. It is a real effort that one needs to make to convince people that the benefits are there. And I would not do it by comparing it with a sort of three-hundred-year process of industrial countries so much, as between more of a cross-section analysis; I would say, "Look, here are some countries that have gone forward, liberalized their economies, these are the gains and losses that accrued, and here are

countries that decided not to, they basically grew at 3 percent a year for the last twenty years, and you know, they have taken that as a natural rate of growth." So here is the kind of comparison one can make and then see if there are some lessons to be drawn from a more comparable cross-country treatment rather than a historical one, which could easily become one that does not lead to any operational outcome.

List of Participants*

Ahmed, Masood
Director, International Economics Department, The World Bank

Blackhurst, Richard
Director, Economic Research and Analysis Division, WTO Secretariat

Boorman, Jack
Director, Policy Development and Review Department, International Monetary Fund

Brooks, Simon
Head, World Economy Division, International Finance Directorate, HM Treasury, United Kingdom

Buyandelger, Ayush
Special Appointee, Southeast Asia and Pacific Department, International Monetary Fund

Byrt, Andrzej
Undersecretary of State and Vice-Minister of Foreign Relations, Ministry of Foreign Economic Relations, Poland

Chambovey, D.
Deputy Head of the GATT Desk, Federal Office for Foreign Economic Affairs, Switzerland

Citrin, Daniel A.
Advisor, European II Department, International Monetary Fund

Collins-Williams, Terry
Director, International Economic Relations Division, Department of Finance, Canada

Collyns, Charles
Division Chief, Central Asia Department, International Monetary Fund

Corden, W. Max
Professor of International Economics, School of Advanced International Studies, Johns Hopkins University

* The titles and affiliations are those that were in effect at the time of the seminar (March 1995).

Custodio, Edsel T.
Assistant Secretary, Department of Trade and Industry, Philippines

de Fontenay, Patrick B.
Director, IMF Institute, International Monetary Fund

De La Calle, Luiz
Director, NAFTA Office, Embassy of Mexico, Mexico

Donnellier, Jean-Christophe
Chief Economist, Ministry of Economy, Finance and Budget, France

Dorsey, Tom
Economist, European I Department, International Monetary Fund

Eken, Sena
Advisor, Middle Eastern Department, International Monetary Fund

El Mossadeq, Abderrazak
Secretary General, Ministry of Commerce and Industry, Morocco

Ertlessova, Zhannat D.
Chief, Center for Economic Reforms, Kazakstan

Faranisi, R.
Deputy Director, Policy Administration, Ministry of Finance, Economic Planning and Development, Zimbabwe

Frost, Ellen
Counsellor, Office of the U.S. Trade Representative, Executive Office of the President, United States

Gebre-Ab, Neway
Economic Advisor, Office of the President, Ethiopia

Giarratana, Patrizia
Deputy Chief, Division of E.U. Trade Policy Issues, Ministry of Foreign Trade, Italy

Githinji, M.
Permanent Secretary, Ministry of Commerce and Industry, Kenya

Griffiths, Mark
Economist, European I Department, International Monetary Fund

Harahap, Bachrum
Assistant Minister for the Development of Bilateral and Multilateral Cooperation, Ministry of Industry and Trade, Indonesia

Hussain, Manzoor
Chairman, National Tariff Commission, Ministry of Finance, Pakistan

Hylton, Anthony
Parliamentary Secretary, Ministry of Foreign Affairs and Foreign Trade, Jamaica

Jirapaet, Krirk-Krai
Director General, Department of Business Economics, Ministry of Commerce, Thailand

Khanna, Tejendra
Secretary of Commerce, Ministry of Commerce, India

Kirmani, Naheed
Division Chief, Policy Development and Review Department, International Monetary Fund

Komsan, Sayed Aboul
General Director of Import, Ministry of Economy and Foreign Trade, Egypt

Lawrence, Robert Z.
Professor, John F. Kennedy School of Government, Harvard University

Lee, Suk-Young
Commercial Attaché, Embassy of Korea, Korea

Li, Zhongzhou
Director General, Department of International Trade and Economic Relations, Ministry of Foreign Trade and Economic Cooperation, China

Major, István
Deputy State Secretary, Ministry of Industry and Trade, Hungary

McDonald, Donogh C.
Advisor, European I Department, International Monetary Fund

Meredith, Guy
Division Chief, Central Asia Department, International Monetary Fund

Messerlin, Patrick
Professor, Institute of Political Studies (IEP), Paris

Michaely, Michael
Professor, Hebrew University

Mussa, Michael
Economic Counsellor and Director, Research Department, International Monetary Fund

Mylonas, Paul
Economist, European I Department, International Monetary Fund

Nashashibi, Karim
Assistant Director, Middle Eastern Department, International Monetary Fund

Ng, Kim Neo
Director, Singapore Trade Development Board, Singapore

Norberg, Helene
Head of Section, Ministry of Finance, Sweden

Owen, David
Senior Economist, European II Department, International Monetary Fund

Papageorgiou, Demetris
Economic Advisor, Latin America and the Caribbean Regional Office, The World Bank

Pereira, Ruy
Assistant Secretary for International Affairs, Ministry of Finance, Brazil

Potts, Gary
Deputy Secretary (Economic), Department of the Treasury, Australia

Roessler, Frieder
Director, Legal Affairs Division, WTO Secretariat

Sahouet, Valence
Director, External Trade Promotion Department, Ministry of Planning and Industry, Côte d'Ivoire

Salum, Jaanus
Head of Trade Policy Division, Ministry of Trade, Estonia

Schirmer, Ulrich
Division Chief, Federal Ministry of Economy, Germany

Schott, Jeffrey
Senior Fellow, Institute for International Economics

Seade, Jesús
Deputy Director-General, World Trade Oganization

Shimpo, Seiji
Vice President, The Institute of Fiscal and Monetary Policy, Ministry of Finance, Japan

Stuart, Brian C.
Deputy Director, Western Hemisphere Department, International Monetary Fund

Taplin, Grant
Assistant Director, Office in Geneva, International Monetary Fund

Williams, Richard C.
Senior Advisor, African Department, International Monetary Fund

Winters, L. Alan
Division Chief, International Trade Division, International Economics Department, The World Bank

Wong, Chorng-Huey
Assistant Director, IMF Institute, International Monetary Fund

Yokoyama, Yutaka
Economist, Southeast Asia and Pacific Department, International Monetary Fund