An Overview of Recent Trade Policy Developments 3

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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 system 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.