Toward a more open trading system

An open trading system is a key to sustained industrial expansion. With trade, enterprises are not limited to narrow domestic markets, but can expand to sell their goods and services around the world. Open trade, in turn, requires a framework of rules. Since 1948 such a system has existed in the articles and codes of the General Agreement on Tariffs and Trade. Ninety-three countries are full signatories; in all, about 122 countries follow the GATT rules in principle and receive GATT treatment from the signatories. About 80 percent of the world's trade is affected by, although not necessarily in conformity with, the GATT rules.

As Chapter 8 showed, the share of trade that is transparent and nondiscriminatory is shrinking. The international economic order has shown signs of weakening under the strains of stagnating growth and the need to adjust to international indebtedness and structural change. The symptoms of growing disorder show in the increased demands for protection, the shift from tariffs to discriminatory restrictions on trade, and the movement from transparent to opaque protective measures such as quotas, voluntary export restraints, and subsidies. The dangers in these trends are that protection will increase and that the fundamental principles of the GATT—nondiscrimination in trade and transparency in methods of protection—will be abandoned.

Such a breakdown in the "rule of law" is against the interests of all trading nations, but the developing countries would stand to lose most. In a world where bilateral arrangements became the norm, developing countries' lack of bargaining chips would place them in a weak position. Fear of losing access to adequate markets could undermine the drive toward outward-looking policies and turn many developing countries back toward autarky, which would damage their prospects of improved efficiency and growth.

Further erosion of the GATT rules would deprive governments of a useful appeal to external authority. Although the GATT has no direct sanctions to use against nations that break its rules, it provides a forum for dispute settlement. It also derives moral authority from its contractual nature. Governments can cite their obligations to GATT rules when resisting pressures for protection. This makes strengthening and, where necessary, reforming the GATT vital to all nations, especially the weaker ones.

Developing countries have powerful reasons for taking a more active part in the latest round of multilateral trade negotiations (MTN) than they have in the past. In previous rounds, few offered to reduce their trade barriers. They relied upon the most favored nation rule to bring tariff cuts as a byproduct of negotiations among the industrial nations, and they also relied on "special and differential" treatment accorded them in the GATT to gain additional tariff concessions. This may not have been the best strategy—witness their relatively small gains from the Generalized System of Preferences (GSP) and other preferential schemes for developing countries, the fact that tariffs on manufactures have fallen less on products of special interest to developing countries, and the increase in the breadth and severity of the nontariff barriers that discriminate against them.

The new MTN, the Uruguay Round (so named because the meeting of ministers which initiated the negotiations was held in Punta del Este), offers developing countries the chance to take a more active approach. That may involve identifying interests which they share with other developing or industrial countries, forming coalitions, and pursuing a common objective. Recently such coalitions have formed: one coalition of agricultural exporters, both industrial and developing countries, did so and showed it had the ability to bargain. Another group had an impact on the way in which the services issue is being handled in the Uruguay Round.

In the GATT the process of negotiating reductions in trade barriers is based on the principle of reciprocity. Nations reduce their tariffs in the knowledge that other countries are making equivalent cuts in theirs. This has clear political advantages: it seems fair and attracts the support of exporting industries. But the developing countries which sought and obtained special and differential treatment within the GATT are exempt from making reciprocal tariff cuts.

The combination of reciprocity for industrial countries and special and differential treatment for developing countries has meant that negotiations have focused mainly on items of interest to the industrial countries. When developing countries' markets for imports were small they had, in any case, little to offer. Now some developing countries' domestic markets are big and getting bigger. For them at least, some reduction and binding of their tariffs or other trade barriers could gain reciprocal concessions from the industrial countries. If they do not deal multilaterally through the GATT negotiations, some developing countries will find that industrial nations will press less advantageous bilateral deals upon them. Instances of this have already occurred.

Most developing countries would benefit by reducing their own levels of protection. But the costs of adjustment would be less, and the benefits even greater, if they could gain greater access for their exports to the markets of industrial countries. Indeed, to achieve faster growth they need access. This requires that trade barriers not increase and, preferably, that they decline. For developing countries, significant gains from the Uruguay Round will require their full and active participation.

Problems with the trading system

The main success of the GATT since 1948 has been the dramatic reduction in tariffs on trade in manufactures. Quantitative restrictions, however, have returned in new forms since the 1970s. Under GATT rules quantitative restrictions are permissible, but only on a strictly temporary basis, to deal with a balance of payments deficit or as an emergency safeguard action under GATT Article XIX. Another requirement is that they be nondiscriminatory. Most of the quantitative restrictions introduced in recent years have breached this principle. They have generally taken the form of selective restraints which have discriminated between imports from different countries.

For the developing countries this is sanctioned by the GATT on the grounds that their circumstances are special and that most developing countries tend to have chronic balance of trade deficits. But the industrial nations are either in breach of the GATT (for example, when they pay subsidies) or outside the GATT (for example, when they set voluntary export restraints or orderly marketing arrangements). The Multifibre Arrangement has an ambiguous position. Legally it is a separate instrument, but it was negotiated under GATT auspices and is administered by the GATT. Despite this, it is clearly inconsistent with the GATT principles (see Box 9.1).

A major failure of the GATT negotiations has been lack of progress toward liberalizing trade in agriculture. The industrial nations, for reasons discussed at length in *World Development Report 1986*, have kept and even increased their restrictions on imports and their subsidies to production and exports of agricultural products.

From the start, the GATT rules exempted customs unions and free trade areas from the MFN rule. Members of these groups are permitted to reduce or eliminate trade barriers against each other's exports, so long as they meet certain criteria (for example, they must not increase trade barriers against the rest of the world and should progress fairly rapidly toward substantially free trade within the group). Since 1979 the GATT has also allowed developing countries to receive special preferences or to extend them to each other. The degree to which customs unions, free trade areas, and other exceptions to the MFN rule have been exploited may not have been envisaged by the founders. Trade in services and trade between the subsidiaries of multinational corporations are also outside the GATT rules. The rapid growth of multinational corporations means that intrafirm transactions are now a large and expanding share of world trade. The trend has implications for taxation and foreign exchange control which are causing concern to many members of the GATT. Another development which has allowed a large

Box 9.1 Origins and objectives of the GATT

The foundation of today's international economic system was laid in 1944 at the Bretton Woods Conference when the World Bank, the IMF, and the International Trade Organization (ITO) were initiated. Together these institutions were intended to ensure a reconstructed Europe, stable international monetary relations, and an open and orderly trading system.

Because of objections that its enforcement provisions would interfere with the autonomy of domestic policymaking, the ITO charter was never ratified. Instead, the GATT, which had been drawn up only as an interim agreement to fill the gap until the ITO was ratified, became the framework for the international trading system in 1948. Today there is a small GATT secretariat, which is responsible for overseeing the settlement of trade disputes, serving committees on special trade issues, and monitoring compliance with GATT regulations. The GATT's membership has grown from twenty-three nations in 1948 to ninety-three full signatories today.

The main objectives of the GATT reflect the desire of the founding members to prevent a recurrence of the protectionism of the 1930s, which they believed deepened the Great Depression and helped give rise to World War II. First, the GATT embraced nondiscrimination or most favored nation (MFN) treatment to prevent the cycle of selective retaliations and countermeasures fostered by discriminatory trade. This means, for example, that footwear from Canada and footwear from Brazil or from any other signatory should face an identical tariff when imported into France. Because MFN rules prevent an importing country from using tariffs selectively, the country is less likely to raise its protective barriers and risk retaliation.

Second, uncertainty and lack of transparency in trade policies in the prewar period created tension between countries. Foreign producers could not be sure what kind of barriers they would face at the border and so were discouraged from exporting. Consequently, the GATT emphasized the use of bound tariffs over less transparent forms of protection such as quotas.

Third, the GATT adopted reciprocal reductions in tariff barriers as a means of mobilizing political support for reducing the worldwide level of protection. Countries could have some assurance that their exports as well as their imports would increase without causing a worsening of their terms of trade. The tariff cuts in turn were applied to all GATT signatories because of MFN treatment.

GATT regulations allow countries to use protective measures in case of balance of payments difficulties or as a safeguard against a sudden surge of imports which threatens a domestic industry (see Box 9.4). These measures, however, are supposed to be temporary, to conform to GATT provisions on nondiscrimination, and to be subject to compensation or retaliation by injured exporters. The GATT also permits the use of selective duties in cases where exporters are found to be subsidizing exports or dumping. In these cases the importer can raise the tariff on the individual exporter's product by an amount equivalent to the subsidy or to the difference between the exporter's home- and foreign-market prices (see Box 9.5).

Because the international economic environment is no longer the same as it was in the 1940s and countries have adopted new protectionist instruments, the GATT often seems inadequate for the task of promoting an open trading system. The GATT explicitly disallows many of the discriminatory quota restrictions and other trade barriers in common use by its signatories today. As with all organizations, especially those with no enforcement power, the GATT can only be as effective as its members allow it to be.

volume of trade to bypass the GATT rules is the growth of countertrade, in which goods are bartered for goods in bilateral arrangements. Long normal in the trading relationships of the centrally planned economies, the practice has now spread to many other countries.

The effect of these developments—continued protection in agriculture; the management of trade in textiles, clothing, and steel and similar tendencies in footwear, cars, and electronics; the spread of special trading relationships, the growing importance of multinational corporations; and the growth of barter—is that the share of trade which conforms to GATT rules is shrinking steadily. A set of laws which is more breached than obeyed is likely to lose all capacity to command respect.

Since the GATT was founded the players on the international scene have changed. In 1948 only the Western industrial countries were important in international trade. Since then Japan has become a major trading nation. Developing countries' share of world trade has increased. New trading blocs have appeared, of which the European Community is by far the most important. Most of these blocs conform to the GATT articles, but they do mean that a large volume of trade is not subject to the most favored nation rule. The Generalized System of Preferences, which grants developing countries some tariff preferences in industrial countries, and other preferential arrangements for developing countries, such as the Lomé Convention, also conform to the GATT. But they too involve discrimination in trade (see Box 9.2).

One cause of increased strain in trade relations has been the growth of government involvement in the management of the national economy. Governments have accepted responsibility for maintaining full employment and regional equity and for meeting other social objectives. Various industries were nationalized in many of the European nations. The growth of the public sector has increased the importance of government procurement. Such activities have been the breeding ground of nontariff barriers. Government procurement typically favors local suppliers. Nationalized industries attract subsidies and protection. Regional subsidies intended to attract new industries to areas of high unemployment can also affect the relative costs of exports or import substitutes and thus risk running afoul of GATT rules. A good deal of trade friction among the European nations, Japan, and the United States has arisen over such matters. Some developing countries have also attracted attention for their alleged subsidies to exports.

On top of these mounting tensions has come the shock of recessions, monetary instability, international debt, slow growth, and extremely high levels of unemployment in many industrial nations. In these circumstances, adjustment to surges of imports or to a rapid decline in certain industries' comparative advantage is difficult. The difficulties are particularly great in economies which may have ossified as a result of past protection, government assistance, and lack of labor mobility.

The attraction of nontariff barriers

Countries can restrict imports in many ways apart from tariffs—for example, by using quotas, voluntary export restraints, and orderly marketing arrangements. Antidumping or countervailing duty actions, surveillance, and health and safety standards can be used to create uncertainty and harass foreign exporters. In GATT parlance most of these are "gray area" measures, meaning that they are "either inconsistent with countries' obligations to the GATT or are of uncertain consistency with the GATT." Of these, the most frequently used today is the voluntary export restraint.

At first sight this is surprising. VERs are particularly costly to the country that uses them to restrict imports. Not only does a VER inflict the same costs as a quota, by raising prices to consumers and switching resources from more efficient to less efficient uses, it also transfers rents to foreigners by allowing them to raise their prices (Chapter 5). Often it has the additional effect of reducing the volume of cheap, lower-quality imports as exporters raise the quality of their products and their profits per unit in the restricted market.

Despite these disadvantages governments clearly prefer VERs to legitimate GATT instruments. Indeed, GATT statistics show that since 1978 VERs have outnumbered Article XIX safeguard actions by more than 3 to 1. (By value of trade affected, this actually understates the growth of VERs.) The reasons are largely political. Consider the pros and cons, as perceived by governments, of invoking Article XIX compared with negotiating a VER if a domestic industry demands protection.

Under Article XIX the importing country's government has to claim that the increase in imports is causing or threatening serious injury to its domestic industry (see Box 9.3). If the government is satisfied on this count, it can apply a tariff or quota to this type of import. But it must apply the restriction to all the nations which export to its market, not merely the offending country. This is a deterrent to the use of Article XIX not only because the restriction could harm the export interests of powerful nations, but also because nations which see their interests harmed can demand compensation in the form of the removal of restrictions on an equivalent amount of other imports. If they are not compensated, they are entitled to retaliate in a reciprocal manner for the injury done to them. Clearly, there will be many cases in which a government will hesitate before embarking on this dangerous route. How much better to call in the representatives of the "offending" exporter for a quiet discussion of the need for restraint on their "overenthusiastic" penetration of the domestic market.

Targets for reform

The weaknesses in the original GATT framework and major changes in the postwar international environment have undermined the liberal international trading system. The GATT faces a barrage of disputes. Without a new commitment to the principles of the GATT, the trading system will see an

Box 9.2 The Lomé Convention

The most important regional agreement providing special and differential treatment is the Lomé Convention. Signed in 1975 and renewed in 1979 and 1984, it gives a group of sixty-six African, Caribbean, and Pacific (ACP) countries preferential access to EC markets. The Lomé accord differs from the Generalized System of Preferences in that it encompasses more than simple tariff reductions. It includes the relaxation of some nontariff barriers, less stringent enforcement of some trade regulations, and exemptions from certain multilateral trade agreements such as the MFA. Like the GSP, however, the Lomé accord is subject to regulations which severely limit "free access" for beneficiaries' exports, including a safeguard clause which allows the EC to suspend any concession unilaterally.

One problem with all such preferential trade schemes is that they amount to a "zero-sum game": preferential treatment for one country or group of countries is gained at the expense of others. Christopher Stevens describes special and differential treatment as a "pyramid of privilege" where "those at the top receive more favorable treatment than those at the base" and where all those in the pyramid do better than other countries (see Box table 9.2A). The pyramid is in fact a shifting one. As one country or group advances toward the top, it necessarily pushes others down. Portugal, for instance, was once near the base. After joining the EC it moved to the top, above all non-EC members.

One would assume that the Lomé Convention, in granting preferential tariff rates and exemption from the MFA, would have to be beneficial to the ACP countries. On the contrary, empirical evidence shows that

Box table 9.2A EC trade arrangements with the developing countries in order of preferential treatment

	Country	*Trade agreement*
More favorable treatment	ACP: African, Caribbean, and Pacific countries	Lomé Convention
	Maghreb countries: Algeria, Morocco, Tunisia	Preferential trade and cooperation agreements
	Mashreq countries: Egypt, Jordan, Lebanon, Syria	Preferential trade and cooperation agreements
	Israel, Yugoslavia	Preferential trade and cooperation agreements with each country
	Cyprus, Malta, Turkey	Association agreements
	Other developing countries	Generalized System of Preferences
Less favorable treatment	Bangladesh, India, Pakistan, Sri Lanka	Nonpreferential commercial cooperation agreements with each country
	Association of South East Asian Nations (ASEAN): Indonesia, Malaysia, Philippines, Singapore, Thailand	Regional framework agreement
	Argentina, Brazil, Mexico, Uruguay	Nonpreferential commercial cooperation agreements with each country
	Central America	Regional framework agreement 1986
	China, Romania	Nonpreferential trade agreements with each country

Source: Stevens (background paper) 1986.

Box 9.3 Reform of the emergency safeguard code: GATT Article XIX

The existing provisions

Unforeseen emergencies can always arise, so most trade treaties make some provision for releasing a country from its obligations if damage to an industry may result from a surge in imports. The GATT is no exception, and Article XIX is its emergency safeguard code. A country may impose a tariff or a quota to restrain imports which "cause or threaten serious injury" to domestic producers, provided that:

- The development was unforeseen at the time of the tariff cuts.
- The country warns major suppliers and notifies the GATT.
- The country maintains the import restraint for only as long as "necessary to prevent or remedy the injury."
- The country seeks agreement from suppliers who may be injured, and if they are not satisfied (for example, by compensation such as cuts in tariffs on other products which they export to the country), they can retaliate with the withdrawal of an equivalent concession.

Proposed reforms

Two extreme positions can be held on reform of Article XIX. First there is the view that it is too easily abused. It does not define "serious injury," and including "threat of injury" makes it much too easy to claim an emergency. It allows either a tariff or a quota to be placed on the injurious imports. There is no time limit on the duration of the restriction. Supposedly temporary protection too often seems to become permanent. Finally, nations may find it difficult to make compensatory cuts in protection on other imports from the counthere has actually been a decrease in trade between ACP countries and the EC. In the pre-Lomé period 1970–75, the ACP share of EC imports from the developing countries was 20.5 percent. In 1975–84 the ACP share dropped to 16.6 percent. When oil exports are discounted, no significant change is found in the growth of trade between the ACP countries and the EC (see Box table 9.2B).

Although the ACP countries as a group have not done better under the Lomé, there have been gains at the margin. Among those countries which were "nonassociated" with EC members before the convention, there was an increase in ACP imports.

Analysis of the ACP exports by commodity shows some trade-creating effects. From 1975 to 1980, eleven ACP countries increased exports of manufactures and processed agricultural and temperate agricultural goods. These exports covered seventy-five product categories. Up until 1984, this process of diversification had continued: ACP exports were recorded in 128 categories. It is important to note that these diversifying countries included both middle- and low-income members of the ACP, for example, Benin, Central African Republic, Ethiopia, Mali, Tanzania, and Zaire. Just over half of the sixty-six countries diversified into at least four new products. Yet, one cannot be certain if this diversification was due to preferential treatment of certain goods or to developing countries' attempts to skirt trade barriers by diversifying into "free" products.

What then has been the net effect of the special and differential treatment of the ACP countries? It is difficult to state categorically where they would be without special and differential treatment. Perhaps, in the face of rising protectionism in the industrial countries, the very existence of an accord which promotes trade provides policymakers with a lever against future protectionist demands in the EC.

Box table 9.2B Trade shares: the EC and the ACP countries
(percent)

	Time period			
Share	*Pre-Lomé, 1970–75*	*Lomé I, 1975–79*	*Lomé II, 1979–84*	*Average*
EC share of ACP exports	45.6	38.7	36.7	37.7
EC share of non-oil ACP exports	46.3	47.1	41.9	44.5
ACP share of total EC imports from developing countries	20.5	16.4	16.9	16.6
ACP share of total EC imports from non-oil-exporting developing countries	27.3	22.8	20.1	21.5

Source: Stevens (background paper).

tries whose export is restrained by the Article XIX restriction.

On this view, recommendations for reform are as follows:

• There should be a time limit on the application of the import restraint.

• The restraint should be progressively relaxed (made degressive over time).

• The restraint should be a tariff; a quota should be permissible only in urgent cases.

• The restraint should be nondiscriminatory to conform with the general MFN rule of the GATT.

• Compensation, certainly in its current form, should be abandoned, although other forms of compensation could be considered.

• Retaliation by exporters should not be permitted so long as the country which invokes the safeguard conforms to the rules.

The second view is represented by those (mainly the European Community) who argue against applying the MFN requirement. They see no reason to injure exporters who are causing them no problems when there is a need to deal with one country whose exports are disrupting their domestic industry. They want to be free to take selective safeguard action against the disrupter. They buttress their argument with the point that the MFN requirement is the main reason for the drift to VERs. If the MFN requirement were abolished, the VERs would largely disappear, nations' safeguard actions would be brought back within the GATT, and the "rule of law" would be restored. This is rather like solving the drug problem by legalizing cocaine.

Box 9.4 The Multifibre Arrangement and a new exporter: Bangladesh

Article 13 of MFA IV reads in part: "The participating countries (are) conscious of the problems posed by restraints on exports of new entrants and small suppliers . . . They agree that restraints shall not normally be imposed on exports from small suppliers, new entrants and the least industrial countries."

There can be no question that Bangladesh fits this description. With a 1984 per capita income of $140, it is one of the poorest countries in the world. In 1978, when it began building a textile and clothing industry with the help of the Republic of Korea, there were less than a dozen textile manufacturers in Bangladesh. By 1985 the number had grown to about 450 operational companies; these employed a total of 140,000 people and produced more than 300 million pieces a year. With 300 more companies ready to start up, Bangladesh has the potential to produce and export much more, although it will remain a tiny supplier compared with such textile giants as China, Hong Kong, and Korea.

Despite the agreement not to restrain exports from countries like Bangladesh, France and the United Kingdom imposed quotas as early as 1984. The United States initiated an arrangement in February 1986 which restricted Bangladesh's textile exports through January 31, 1988. Although the industrial countries are allowed under the MFA to limit imports in the case of a sudden surge of imports and market disruption, there is no apparent justification for such limits on Bangladesh. In 1984, even after achieving spectacular growth, Bangladesh still held only 0.25 percent of the developing country share of clothing exports to the industrial countries. The four biggest Asian NIC exporters held 60 percent. In the United States, Bangladesh's market share was 0.32 percent while the "superexporters" held 66.7 percent. Bangladesh hardly posed a serious threat to the U.S. industry.

The bilateral agreement signed between Bangladesh and the United States allowed a mere 6 percent yearly growth rate in MFA imports. Between 1981 and 1983–84 Bangladesh had an unrestrained growth rate of 386 percent. Moreover, the agreement was extremely detailed: it restricted exports down to seven-digit SITC categories. This meant, for example, that Bangladesh had a quota not only on shirts but also on shirts made from dyed yarn in particular sizes. So detailed an arrangement would make diversification into uncontrolled goods well nigh impossible. Because of it, Bangladesh stopped expanding its textile industry and for a time had operational facilities standing idle. Since the most recent bilateral arrangement, the situation has eased somewhat. But quotas are still detailed, and Bangladesh has already (in May 1987) reached the ceiling on quotas for major categories. It is possible for Bangladesh to borrow, within limits, from other categories underused quotas from the previous year or the succeeding year's quota. But these complications create uncertainty, and the administration of the quotas absorbs scarce managerial ability and discourages investment in a subsector in which Bangladesh clearly has a comparative advantage.

increase in bilateralism, a further spread of nontariff barriers, more trade managed on the MFA model, and greater use of domestic trade laws to obstruct imports.

Agriculture

From its inception, the GATT has imposed little discipline on trade in agricultural products—reflecting the sensitivity of agricultural issues in domestic politics. The costs of protection in agriculture fall most heavily on the industrial countries themselves, but they also fall on some of the developing countries. Despite an increase in their manufactured exports, most developing countries still export mainly raw materials and agricultural products. They get some relief from preferential trade agreements, but still face severe problems. Access to the industrial countries is limited by import restrictions; in other markets the developing countries have to compete with subsidized exports from industrial countries. Sugar, for example, is highly protected in the domestic markets of the EC and the United States; these countries then sell their surpluses at subsidized prices.

Reduced barriers to trade in agriculture would also bring benefits to manufacturing in developing countries. As pointed out in *World Development Report 1986*, a prosperous agricultural sector fosters success in manufacturing. It creates demand for manufactures, generates savings, and earns foreign exchange.

GATT signatories have recognized that trade in agriculture is a primary concern and needs to be incorporated properly into the GATT. The GATT Committee on Agricultural Trade was established with that aim in 1982. In 1984 and 1985 it proposed reducing export subsidies and requiring a level of minimum access for exports to highly protected markets. This may be a modest start, but there are some other encouraging signs. The recent coalition between several major developing and industrial country exporters, such as Argentina and Australia, and the high and rising budgetary costs of agricultural support in industrial countries point to the possibility of a better outcome for agriculture in the new GATT round.

The Multifibre Arrangement

Trade in textiles and clothing has become the paradigm of managed trade. Its use of discriminatory quota restrictions, negotiated bilaterally, violates the most basic rule of the GATT. The history of the MFA has shown increasing coverage and stringency, and it has recently been renegotiated (in July 1986).

The importing nations and most developing countries have much to gain from dismantling the MFA. The past success of the newly industrializing countries in beating this system has been based mainly on their ability to diversify into new fibers and products which were not covered by the MFA. As each successive MFA plugs the leaks in the earlier version, however, it will become increasingly difficult to diversify into non-MFA products and to maintain export growth (Chapter 8). Under these conditions, it is likely that all developing country exporters will feel the effect of textile and clothing restrictions. The major Asian exporters will find all their exports bound by quotas, and relative newcomers may be held to tiny market shares despite the special provision for small suppliers in the new MFA (see Box 9.4).

Moreover, a system of managed trade in textiles and clothing bodes ill for free trade in other industries where industrial country producers are threatened by the exports of developing countries. The legitimacy of MFA protection for textiles sets a precedent. And, once established, such systems tend to become permanent. Protected industries use the help they receive not to move to other sectors but to introduce new technology and more capital-intensive methods to try to regain market share. Higher prices give some exporters a reason to support the scheme. The MFA was intended as a temporary measure, but instead has increased in scope and magnitude and become institutionalized. The expanding system of managed trade in steel seems to be following the same path. Eventually, the members of the GATT must grasp this nettle if the spread of managed trade is to be halted.

Table 9.1 Frequency of use of tariffs and quotas under Article XIX

Period	*Tariff measures*	*Quantitative restrictions*	*Total*	*Ratio of quantitative restrictions to total*
1949–58	13	3	16	19
1959–68	20	16	36	44
1969–78	15	28	43	65
1979–86	17	25	42	60

Source: Frank 1981; Anjaria, Kirmani, and Peterson 1985; GATT.

Safeguards

Safeguard actions under GATT Article XIX permit the use of either a tariff or a quota for temporary protection. The quota has been the instrument of choice (see Table 9.1). The trouble with safeguard actions, however, is that most of them are taken outside the GATT.

Developing countries are particularly vulnerable to industrial country safeguards. Their most successful exports are likely to be those that are produced by labor-intensive industries such as footwear and other low-skill manufactures. These are sensitive industries because of the social problems which their collapse can cause.

Developing countries are also quite unable to pose a realistic retaliatory threat, because of the relatively small size of their markets and their reliance on capital goods imports. Only a few of the larger developing countries—Brazil, China, India, and Indonesia—may be able to threaten to cut some import and thereby inflict damage on an industrial nation.

Changes in comparative advantage mean the decline of older industries in the industrial countries. Safeguard actions against the developing countries will continue. The GATT needs a new and strengthened safeguard code which allows temporary protection in the industrial countries, but encourages adjustment and stops the use of "illegal" and discriminatory barriers against exporters (Box 9.3). The Tokyo Round failed to achieve an acceptable solution. Assuring access for developing country exports to industrial countries' markets will depend on the ability of the participants to amend and strengthen Article XIX in the Uruguay Round.

Countervailing and antidumping measures

The countervailing and antidumping policies of the industrial countries are closely linked to the

Box 9.5 Antidumping and countervailing duties and subsidies in the GATT

The existing provisions

The provisions on antidumping and countervailing duties (CVDs) are contained in GATT Articles VI and XVI and a subsidies code added in the Tokyo Round.

"Dumping" is defined as exporting a product at a price below its normal value or below the comparable price of a similar product sold in the exporting country. An importing country can offset or prevent dumping by levying an antidumping duty not greater than the difference between the price of the exported good and the price of a similar good in the exporter's domestic market.

A government subsidy on the manufacture, production, or export of any merchandise which operates directly or indirectly to increase exports or to reduce imports may be subject to CVDs. A countervailing duty is levied by the importing country to offset the exporter's subsidy and cannot exceed the amount of this subsidy. The use of antidumping and countervailing duties is limited to situations in which the import is causing or threatens to cause material injury to a domestic industry.

The code on subsidies and CVDs was negotiated during the Tokyo Round with the aim of ensuring that subsidies would not harm the interests of trading partners and that countervailing duty procedures would not unjustifiably impede international trade. The signatories made a renewed agreement not to subsidize agricultural exports so as to gain "more than an equitable share of world export trade." They also agreed not to use domestic production subsidies which would seriously harm the trade of other countries. Finally, they pledged to abide by GATT Article VI, which states that CVDs are to be used only when the imported goods are causing or threaten to cause material injury to a domestic industry. A GATT committee was established under the code to deal with the settlement of disputes arising from the use of subsidies and CVDs as well as to monitor the application of the code by the signatories.

Proposed reforms

The subsidies code negotiated in the Tokyo Round proved little better than the original articles. The number of disputes continues to rise. Indeed, the record shows a strong upward trend in countervailing actions against developing countries. Recently, most of the CVD and antidumping actions have been initiated by the United States and the European Community against developing country exporters (see Box tables 9.5A and 9.5B).

Two approaches to the reform of countervailing duty and subsidy practices have emerged. The first views developing countries which subsidize exports as simply damaging their long-run development. Subsidies then become the target for reform, not the countervail-

Box table 9.5A The frequency of U.S. countervailing actions, 1970–85

Year	*Exporter*	*Number of initiations*	*Final outcome of action*			*Average CVD rate*
			Affirmative	*Negative*	*Pending*	
1970–74	Industrial countries	9	8	1	—	. .
	Developing countries	2	2	—	—	. .
1975–79	Industrial countries	59	20	39	—	. .
	Developing countries	45	18	27	—	. .
1980–85	Industrial countries	63	30 (19)	25	8	10.5
	Developing countries	108	69 (26)	30	9	11.5

Note: Numbers in parentheses represent cases considered affirmative although they were withdrawn from CVD actions and settled through alternative arrangements between the exporting and importing countries.
Source: Nam 1986a.

issue of safeguards. An importing country imposes countervailing duties if the exporting country's government is subsidizing its exports. It takes antidumping measures when an exporter sells a product abroad at less than its domestic price or cost of production. Whereas safeguard actions taken under Article XIX can be imposed by the importing country regardless of the exporting countries' policies, countervailing duties and antidumping actions can be taken only if the exporter is engaging in one of these two forms of "unfair" trade (see Box 9.5).

As indicated in Chapter 8, countervailing duties and antidumping policies may be abused so as to become just another form of protection. They can inflict additional costs on exporters through the ing duty. From this viewpoint, CVDs are a means to induce developing countries to abandon subsidies and to adopt other means, such as exchange rate devaluations, to promote exports.

A related solution is for the GATT to approach the problem not through an international code, but through direct negotiations among participants on dismantling subsidies. This is likely to be the approach for dealing with agricultural subsidies.

The second approach is based on the belief that CVD actions are simply a way to protect declining industries in the industrial countries against developing country exporters. CVD procedures deter exports because of the direct costs to exporters of the investigations. If that is their purpose, the requirements for starting CVD actions could be tightened so as to reduce their use as substitutes for safeguard actions. The signatories could also be required to have a greater regard for the situation of developing countries when applying CVD measures. Another suggestion is that there should be a program of technical assistance to help developing countries defend their interests in CVD cases.

Box table 9.5B Frequency of antidumping cases, 1980–85

Initiated by	*Number of cases*	*Against*	*Number of cases*
Australia	393	EC	276
United States	280	United States	105
EC	254	Japan	96
Canada	219	Korea, Republic of	71
Sweden	4	China	58
Finland	3	Spain	43
Austria	1	Brazil	39
Spain	1	Czechoslovakia	34
		Canada	32
		Sweden	16
		Austria	11
		Finland	9
		Others (44)	398

Source: Finger and Nogues 1986.

use of investigations, legal proceedings, and complicated tariff formulas. These procedures can slow down exports or convince an exporter that a negotiated VER is better than "unfair" trade proceedings.

"UNFAIR" TRADE AND THE DEVELOPING COUNTRIES. Countervailing and antidumping policies impose a disproportionate cost on developing country exporters. This is due, in part, to the administrative procedures involved. Firms and governments in the developing countries often lack the trained staff to deal with these procedures. They often have to hire foreign specialists, and the expense can be great. UNCTAD estimates that the cost of a fairly routine antidumping proceeding in the United States can easily exceed $100,000. This may have to be borne by a single exporting firm.

Many new producers are willing to forgo some export profit (by selling the export at a lower price than they would domestically) to gain market share. This standard business practice makes them liable to be charged with dumping. Moreover, the methods used to justify subsidies and dumping tend to ignore the differences between developing and industrial country markets. Often the high trade barriers which prevail in developing countries will raise the domestic price of exportable goods. But the protection will also cause the exchange rate to be overvalued. The overvalued exchange rate reduces the price in local currency of goods exported, which lowers the incentive to export (Chapter 6). A developing country may feel it is quite legitimate to offset this by an export subsidy of some type. But the price will now be lower than the protection-induced price in the home market and may be treated as subsidized or dumped in the industrial country, even though it is a result of distortions in the exporter's domestic economy.

"UNFAIR" TRADE AND THE CENTRALLY PLANNED ECONOMIES. Distinctions between fair and unfair trade are often difficult to establish even in market economies. In centrally planned economies, where the government plays the central role in production, the distinction is even more obscure. How can a country determine if exports from a CPE are subsidized if all prices are set without regard to supply and demand? Dumping can be hard to identify for the same reason. If the CPE is producing only for export, it is impossible even to try to compare the export price and the domestic selling price; the importing country must try to determine the cost of production in the CPE. This is done (at least for legal purposes) by examining the cost of production of a similar product in a market economy—a cumbersome and dubious procedure (see Box 9.6).

The Uruguay Round should examine whether countervailing and antidumping procedures can

Box 9.6 Antidumping actions: the golf cart case

Imports from centrally planned economies which are sold at less than the full market price are often targets of antidumping actions in industrial countries. Yet it is extremely difficult to determine if a CPE supplier has dumped, because official exchange rates, domestic prices, and production costs often bear little resemblance to market-determined ones. A case involving golf carts imported from Poland is a vivid example of the extraordinarily complex techniques the United States and the EC have had to adopt in investigating antidumping actions against CPEs.

Since 1972, Poland has been exporting several thousand golf carts to the United States each year. In 1975, antidumping charges were brought against Pezetel, the Polish foreign trade organization, for selling golf carts at less than "fair value." Because Poland made golf carts for export only and sold them only to the United States, fair value could not be determined by the domestic market price or the price of the export to a third country. The United States used the "constructed value" approach to approximate the fair value of Polish golf carts. Using a value based on the costs to a Canadian golf cart manufacturer, the United States charged Pezetel with dumping. Duties were assessed until 1976, when the sole Canadian producer went out of business. Because no third country produced similar golf carts at that time, fair value could not be obtained by looking at another producer's prices. The United States therefore determined the constructed value by choosing a market economy, Spain, with a level of development similar to Poland's and estimating what it would have cost a Spanish producer to make golf carts. When the cost was converted into dollars, it was determined that the Polish golf carts were not being sold at less than fair value, and in 1980 the earlier dumping finding was revoked.

This method can hardly be considered foolproof. Even if a "surrogate" country had identical factor proportions and prices, there is still no reason to assume its products would be equally competitive. Moreover, studies have shown that there is little correlation between the level of development as measured by GDP and relative prices. Although this investigation ended happily for the Polish golf cart industry, it could easily have turned out otherwise.

be further refined and whether the industrial countries are using these procedures legitimately or as yet another means of safeguarding domestic industry from import competition.

Escalation of trade barriers

Tariff escalation has long been a grievance of the developing countries. Recent research, as reported in Chapter 8, has shown a similar trend in the use of nontariff barriers. A much higher level of effective protection for copper wire than for crude copper or for instant coffee than for coffee beans handicaps processing in developing countries. Possession of a raw material, such as bauxite, does not necessarily give a comparative advantage in producing an intermediate good, such as aluminum, where cheap energy and capital are more

Box 9.7 Barriers to trade in services

The GATT does not cover services, which in many countries are highly protected. For example, Colombian imports can be insured only by Colombian companies, no foreign insurance firms are allowed to operate in India, and those applying for licenses in Turkey are told to wait until a new insurance law is passed. Belgium, Italy, and the Netherlands effectively bar foreign communications firms from providing enhanced communications services by prohibiting their use of government-owned lines. Foreign construction firms are restricted in their ability to provide technical services in Brazil and are excluded from designing and constructing oil-drilling platforms in the United Kingdom. Movie and television exporters, especially those from the United States, are hampered by a variety of barriers. In Indonesia they must use local dubbing facilities; in Venezuela they must process 60 percent of all 35-millimeter prints in local laboratories. Pakistani theaters are required to devote 15 percent of playing time to local films. Britain limits foreign productions to 14 percent of air time on independent television stations. In short, few countries seem prepared to allow foreigners to compete on an equal footing with locals in the provision of services.

important costs—but it can be crucial for some products. The Tokyo Round of the MTN was supposed to deal with this problem, but in fact tariff escalation slightly increased (Chapter 8). This source of trade distortion will have to be taken up again in the current MTN.

Trade in services

The United States and the EC, on the one side, and a group of developing countries led by Brazil and India, on the other, disagreed over whether to include services in the Uruguay Round. Important issues are at stake in this. Trade in services might be considered the same as trade in goods. After all, to buy a good is simply to buy something which yields services. From that point of view it makes obvious sense to include rules on trade in services within the GATT, perhaps merely by adding "and services" wherever goods are mentioned in the agreement. The problem is not so simple.

THE NEED FOR PHYSICAL PRESENCE. Some services can be provided without physical proximity between provider and user. These "long-distance" services include, for instance, wireless transmission of concerts. But more services are "embodied"; they need a physical presence for their delivery. For example, a construction engineer needs to be on site to provide engineering services; a doctor or a dentist has to visit or be visited. A bank or a legal firm may not need to be on the spot to provide many of its services, but efficiency is likely to be much higher if clients have easy access. What this implies for trade in many types of services is that staff and possibly full branches of the business need to be established in the importing country. (Such services are somewhat inelegantly known as "temporary-factor-relocation-requiring" services, as distinct from long-distance services.)

The right of establishment is crucial for multinational service companies such as American Express and Morgan Grenfell; construction companies need permits to bring in engineers, managers, and essential workers. So service transactions are qualitatively different from trade in goods. This suggests that careful analysis is needed before deciding how to amend the GATT rules.

PROTECTION IN SERVICES. Countries have several devices for protecting domestic suppliers of services from foreign competition. These include visa requirements, investment regulations, restrictions on the ability to repatriate earnings, and so on. Italy requires the hiring of local actors and film crews for commercials. Argentina, Mexico, Peru, and Venezuela insist that local accountants supervise foreign auditors (see Box 9.7).

Developing countries fear that many of their own service industries are insufficiently developed to withstand foreign competition. They have also felt that the reforms hinted at so far, in return for opening their markets to service transactions, are unsatisfactory. The services in which developing countries have a comparative advantage seem to be excluded by being labeled "immigration." Developing countries think it unfair that access to their service markets should be made a condition for reductions in illegal, or at least gray area, protection. So the developing countries have insisted upon separate negotiations on services.

DEVELOPING COUNTRY INTERESTS. Now that services have been brought within the Uruguay Round, albeit on "a parallel track," developing countries have to consider where the balance of advantage lies for them in the negotiations. Some developing countries already have considerable exports of services such as tourism, shipping, and construction services. There may be a case for infant industry assistance to some sectors of services. But if developing countries protect more expensive or lower quality services produced by local firms, they run the risk of handicapping their exports of goods: many services are upstream or downstream services to producers. In the industrial countries large companies often internalize many services—research, marketing, financial analysis, and so forth. Small to medium companies usually have easy access to specialist firms which supply such services. In developing countries this is seldom the case.

Access at reasonable cost to quality services can make the difference between success or failure in exporting. In many developing countries, the need for such services argues for at least selective liberalization. If this encouraged the multinational corporations of the industrial countries to provide these services to developing countries, it would help developing countries' exports of manufactures in three ways. First, it would lower their costs and help them to develop markets. Second, it would encourage the multinational corporations to move away from goods in favor of producing more services. Third, if industrial nations can sell more services, they may be more willing to lower protective barriers elsewhere.

Developing countries are likely to have comparative advantage in labor-intensive services such as tourism and construction. Countries in the Caribbean, Latin America, and the Mediterranean have successfully developed tourist industries; India and the Republic of Korea have successfully exported construction services. Activities like keypunching for the computer software industry are also moving to some developing countries.

Those developing countries which have invested heavily in education may earn returns in such areas as computer software and research and development services. Other developing countries have the capacity to export legal and accounting services. For the most part, however, the industrial countries will have a comparative advantage in skill- and capital-intensive services, such as banking, insurance, and passenger and freight transport, for some time to come.

India, Korea, and probably several other developing countries are likely to have a keen interest in how the issue of "the right to establish" is settled. The industrial countries have suggested rules which provide not merely for a branch office but also for the right to employ foreign personnel in it. The construction industry may need to go further. It may wish to bring in not only managers and technicians but also supervisors, skilled workers, and even laborers. For countries where comparative advantage in constructing a road or a bridge may rest mainly on disciplined, and relatively low-paid, teams of construction workers—Korea, for example—it would be important to be able to bring in whole work crews on temporary permits. Once the right to bring in foreign employees is established, it is difficult to see how the right of the construction firm to bring in its whole team can be excluded.

A final reason for developing countries to pursue negotiations on a multilateral basis is that the alternative is likely to be bilateral or regional negotiations. That would result in inefficient and discriminatory freeing of some service transactions, in ways that would not necessarily be in the interests of the developing countries.

The stake of the developing countries in the Uruguay Round

The argument of the preceding chapters is that the gains from trade for developing countries are substantial. Both economic theory and the empirical evidence show that fuller participation in world trade should increase their efficiency and growth. This suggests that developing countries ought to gain if they reduce their trade barriers and liberalize their own economies. But they would find such policies much easier in an environment of more liberal and expanding world trade. This gives developing countries a keen interest in a successful outcome from the MTN.

What, more precisely, do they hope to get out of it? Developing countries want greater access to the markets of the industrial nations. Most want an end to VERs and selective quotas, and they want a safeguard code which ensures that restrictions imposed under Article XIX are limited, temporary, degressive, and nondiscriminatory. But they also want to retain their special and differential status. Several of them are opposed to negotiations in the GATT on services and trade-related investment and would prefer that any discussions on these matters be handled in UNCTAD.

In fact the agenda for the Uruguay Round broadly meet their wishes. The subjects for negotiation include tariffs, nontariff measures, safeguards, tropical products, and products based on natural resources. Negotiations on textiles and clothing (the MFA) are included, but in language which is so hedged as to provide few grounds for hope of significant improvement. The developing countries' desire to retain special and differential treatment seems to be fully met in sections B(IV) and (V) of the General Principles Governing Negotiations. These preserve "differential and more favorable treatment" and state that industrial countries will not expect "reciprocity" for concessions to developing countries. Section B(VI) repeats the GATT's usual formula for recognizing the graduation principle: the "less developed contracting parties expect that their capacity to make contributions or negotiated concessions . . . would improve with the progressive development of their economies . . . and they would accordingly expect to participate more fully in the framework of rights and obligations under the General Agreement."

Developing countries clearly have to consider whether their interests lie in preserving or in negotiating away some of their special and differential status. The industrial countries have long argued that the more successful economies should graduate from the Generalized System of Preferences and take on most of the responsibilities of full GATT membership. Unable to incorporate "graduation" officially into the GSP itself, the industrial countries have unilaterally incorporated aspects of it into their own trade laws.

As a result of the limitations adopted by most industrial countries, the developing countries have gained little from the GSP. In 1981, for example, the United States imported $120.3 billion of goods from the developing countries. From GSP beneficiaries the total was $68.5 billion, and of this only a meager $8.4 billion, or 12.3 percent, actually entered duty free. Studies of the GSP in the European Community show that imports from nonbeneficiaries were growing at a faster rate than those from countries covered by the GSP. Yet the developing countries continue their strong support for special and differential treatment and reject graduation. They may have underestimated both the potential benefits of negotiating for reciprocal reduction of trade barriers in the multilateral trade negotiations and the costs associated with continued dependence on the GSP.

In most countries the GSP excludes such crucial items as textiles, clothing, steel, and footwear. Normally the highest protection is on the products most likely to be exported by the developing countries. GSP treatment carries no long-term guarantee. Because preferences are unilaterally granted to the developing countries by the industrial country "benefactors," tariff and quota levels are not bound: they can be withdrawn or altered. The uncertainty this creates leads the larger exporters to restrain exports for fear of triggering import restrictions in the industrial countries. The uncertainty can also adversely affect firms' plans to invest in export industries. Bound MFN tariffs in the GATT are much more secure than unbound GSP preferences.

Part IV of the GATT allows developing countries access to MFN or GSP tariffs without the need to make reciprocal cuts in their own trade barriers. As a result, few developing countries have lowered their trade barriers significantly. High barriers in the developing countries, whose exports are of growing importance in world trade, are an increasing source of irritation in many industrial countries. Some of the more advanced developing countries run the risk of having reciprocal restrictions placed on their exports—or of being forced by such a threat into making concessions bilaterally.

It has been suggested that by accepting special and differential treatment the developing countries have struck a Faustian bargain. In exchange for preferences, which brought them limited and risky gains, they have given up a voice in reciprocal trade negotiations and left themselves open to attack by protectionists in the industrial countries, who accuse them of unfair trade. The most mature developing countries, at least, should ask themselves whether this bargain still makes sense.