Bela Balassa and Constantine Michalopoulos

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THE WORLD TRADING system is at the crossroads. Despite repeated declarations made by developed country governments of their intention to resist protectionist pressures and to roll back protection, new measures have been introduced to limit imports to the detriment of their own and their trading partners’ economies. Also, some large developing countries have responded to external shocks and the subsequent debt crisis by increasing import protection.

There is a danger that, unless the developed and the developing countries agree on multilateral trade liberalization, further protectionist measures will be taken, leading to the eventual breakdown of the world trading system. The need for multilateral trade liberalization in order to resist protectionist pressures was noted by one of the authors nearly two decades ago:

It would also appear that if no efforts are made to liberalize trade, the alternative is likely to be increased protectionism rather than the maintenance of the status quo. For lack of a better expression, we may speak of an “instability effect,” according to which economic and political relationships are hardly ever in a position of stable equilibrium but have the tendency to move in one direction or the other. Thus, in the absence of pressures for the liberalization of trade, protectionist counterpressures may gain force in the United States as well as abroad (Balassa, 1967, p. 152).

During the postwar period, the cause of trade liberalization was furthered by periodical multilateral trade negotiations. The purpose of this paper is to provide support for undertaking a new round of negotiations. At the same time, while the principal participants of the earlier negotia-

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tions were developed countries, trade between developed and developing countries will need to be an important focus of the next round of negotiations. This is both because of the growing importance of this trade and because of the cost the protection measures recently taken or threatened to be taken, impose on the national economies of the two groups of countries.

The article considers the scope, content and modalities of such negotiations as they would affect developed and developing countries. It further addresses concerns that developing countries have raised about a new round of multilateral trade negotiations and makes recommendations as to how to address these concerns and how to promote institutional changes in support of a global liberalization effort.

Section I of the article briefly summarizes evidence on the prevalence of tariff and nontariff protection imposed by developed and developing countries, and the resulting costs to their national economies. Section II considers the application of the principle of reciprocity in multilateral negotiations, with particular attention to developing country attitudes towards the application of this principle. This section also analyzes the prospective role of the developing countries in multilateral trade negotiations, indicating the common interests of developed and developing countries in the negotiations.

The scope and the modalities of multilateral trade liberalization is the subject of Section III. This section of the article gives separate consideration to reducing trade barriers in manufacturing, in agriculture, and in services. Section IV considers the institutional framework of trade liberalization, with particular attention to safeguards, dispute settlement, and the application of anti-dumping and countervailing measures. Finally, Section V summarizes the conclusions and reviews the policy implications of the analysis.

I. THE EXTENT AND COST OF PROTECTION

Increased concern about the implications of protectionism for economic activity has resulted in a number of recent studies which review the extent, scope and cost of protection in developed and developing countries. These reviews of protection have shown that, on the average, trade barriers in developed countries tend to be higher on agricultural products than on manufactures, and tend to be concentrated in a few sectors such as textiles and clothing, shoes, steel, and automobiles within manufacturing. By contrast, developing countries protect manufacturing more than agriculture and their barriers are both more widespread and more variable.

As a consequence of successive rounds of tariff reductions in the

1 This section draws on Balassa and Michalopoulos (1986) that provides the appropriate references.
framework of the GATT and the subsequent imposition of nontariff barriers, these barriers are at present more important than tariffs in limiting developed country imports; nevertheless, because of their escalation, tariffs continue to restrain access to developed country markets in certain processed goods (Balassa and Michalopoulos, 1986). At the same time, with some exceptions, the developed countries' nontariff barriers tend to be more prevalent and their tariffs tend to be higher on products of interest to developing countries than on their trade with each other.

Despite increasing protection in the last few years, the extent of market penetration by developing countries in developed country markets has risen as has overall trade interdependence between the two groups of countries. This increased interdependence raises the opportunity for mutually advantageous trade liberalization, which can promote structural adjustment and stimulate long term growth.

Recent reviews of the costs of protection in the developed countries showed that these countries pay a large cost to maintain employment in a few manufacturing sectors. Moreover, such analyses tend to underestimate the long term costs of protection that leads to the misallocation of additions to the capital shock and tends to slow down technological progress.

Analyses of the costs of protection in developing countries have focused primarily on evidence that countries with liberal trade regimes tended to grow faster and withstand better adverse developments in the international economy. The reason for their superior performance lays primarily in the lower degree of economic distortions and the greater flexibility associated with trade regimes which provide similar incentives to produce for the domestic and the foreign markets as well as to industry and agriculture.

II. APPROACHES TO TRADE LIBERALIZATION

The quest for reciprocity

The implications of the findings on the cost of protection discussed in Section I is that lowering protection unilaterally would contribute substantially to economic growth in the countries concerned. But the benefits from trade liberalization would be even greater if the country’s trading partners also reduced their trade barriers on a reciprocal basis.

In the post World War II period, reductions in trade barriers have been implemented through the application of the principle of reciprocity in trade negotiations. Article XXVIII of GATT refers to the need for undertaking trade negotiations on “a reciprocal and mutually advantageous basis.” This statement has been interpreted to mean offering balanced concessions in the course of trade negotiations in the sense that the resulting
increases in exports and imports for the participating countries would be approximately equal.

The quest for reciprocal concessions was originally justified largely on balance-of-payments grounds. In practice, however, the principle of reciprocity was used as a means of mobilizing political support for trade liberalization in the context of multilateral negotiations. Reciprocity encourages the formation of coalitions between exporters and the consumers of imported goods who gain from reductions in trade barriers and whose support is necessary for overcoming the political weight of producers with vested interests in protection. Although the principle tends to cater to the mercantilist perception that benefits from trade derive from export expansion while increases in imports involve costs, its practical implementation in the negotiations led to trade liberalization and to large tariff reductions, stimulating world economic expansion through the 1950s and 1960s.

While the dismantling of quantitative import restrictions on trade among European countries after the war occurred in the framework of the Organization for European Economic Co-operation (OEEC), rather than the GATT, reciprocity was similarly introduced as the individual countries accepted the obligation to liberalize their trade restrictions in a parallel fashion. This was done by setting numerical targets for simultaneously reducing the share of intra-European imports subject to quantitative restrictions on food and feeding stuffs, raw materials, and manufactured products in each country (Frank, 1961).

The principle of reciprocity also found expression in the item-by-item negotiations on tariff reductions undertaken in the framework of the GATT during the early postwar years. In the course of the negotiations, each country aimed at obtaining reductions in foreign tariffs on its actual and potential exports, leading to concessions of approximately equal value in terms of increments in exports and imports. These bilateral deals were subsequently combined, with account taken of their impact on the trade of the other negotiating partners under the most-favored-nation clause. As the scope for further item-by-item tariff diminished, this gave place to across-the-board tariff reductions negotiated multilaterally in the framework of the Dillon, Kennedy, and Tokyo Rounds, with exceptions made for so-called sensitive items that were also negotiated with a view to ensure reciprocity.

The early balance of payments rationale has lost importance with the institution of flexible exchange rates, but the role of reciprocity as a vehicle of mobilizing political support for trade liberalization continues to be of importance in the light of recent protectionist trends in industrial countries. This principle can be applied most effectively in the context of a new round of multilateral negotiations within the GATT. Multilateral liberalization is superior to bilateral arrangements because it reduces
compartmenralization and preferential treatment, which tend to introduce trade distortions and allocative inefficiencies.

**Developing country attitudes toward reciprocity**

Although most of the developing countries did not participate in the exchange of reciprocal tariff reductions in the framework of the GATT multilateral trade negotiations, tariff reductions were extended to them under the MFN clause. Their limited participation in the negotiations meant that there was little incentive for the developed countries to reduce tariffs on items of interest to the developing countries.

Latin American countries, which did offer tariff concessions of their own, fared better in the Kennedy Round negotiations than countries which did not offer such concessions (Finger, 1979). In turn, in the Tokyo Round negotiations, few offers of tariff reductions were made by developing countries who focused mainly at obtaining unilateral concessions. The result has been that exceptions from tariff reductions bore heavily on the exports of these countries.

The lack of tariff concessions by the developing countries under the Tokyo Round reflected their demand for "special and differential treatment." This has been codified in the Framework Agreement following the Tokyo Round, which states that "contracting parties may accord differential and more favorable treatment to other contracting parties." The Agreement extended an earlier provision, introduced in 1965, according to which "the developed countries do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of developing countries; i.e. the developed countries do not expect the developing countries, in the course of trade negotiations, to make contributions which are inconsistent with their individual development, financial and trade needs."

Their demands for differential treatment also led developing countries to apply pressure for unilateral trade concessions from developed countries. The Generalized System of Preferences (GSP), introduced following an UNCTAD initiative in 1968 under a GATT waiver, represents a response on the part of the developed countries to this pressure. Under GSP, free entry is provided to developing country non-agricultural products. GSP, however, excludes product groups of principal interest to the developing countries, such as steel, textiles, clothing and shoes. Also, quantitative limits are imposed on duty-free imports and successful exporters have been progressively excluded from the application of GSP. And, while tariff reductions negotiated under GATT rules are "bound", i.e., cannot be raised again, GSP treatment can be revoked at any moment. Moreover, it has been shown that the developing countries derive considerably larger benefits from multilateral trade liberalization than from GSP (Birnberg, 1979).
Irrespective of past attitudes, an important question is the role the developing countries may play in future trade negotiations. This is the key to the direction in which the trade system moves now, and to how overall liberalization of trade can be accomplished in the future. A central issue is whether trade liberalization in areas of importance to developing countries can proceed on the basis of unilateral liberalization and preferential arrangements by developed countries or on the basis of reciprocal negotiations in which developing countries, especially the newly industrializing countries, participate actively and offer to liberalize and rationalize their own trade regimes.

Developing countries, especially countries which are experiencing balance-of-payments difficulties today because of their large indebtedness, argue that they cannot be reasonably expected to liberalize and import more from developed countries. They import as much as their foreign exchange availability permits them to do.

However, developing countries' earnings of foreign exchange are affected by the restrictiveness of their own trade regimes through the impact of differential incentives on the allocation of resources between exports and import-competing activities. Thus, developing countries could import more if they and the industrial countries liberalized trade because this would induce an expansion of their exports. Moreover, if liberalization was to occur under a new multilateral trade round, it is bound to be a prolonged process with the impact on imports likely to be felt no sooner than in the 1990s. Thus, the current balance-of-payments difficulties experienced by a number of developing countries would appear to impose more of a psychological and political constraint to participation in a new trade round than a financial one.

At the same time, reciprocity on the part of the newly-industrializing countries (NICs) and, to a lesser extent, other developing countries will be necessary for trade liberalization to be undertaken by the developed countries. Specific import controls which the NICs maintain create problems for particular export interests in the developed countries. The support of these export interests may well be critical to the developed countries' ability to reduce import barriers on products of interest to the NICs.

Furthermore, with rapidly rising imports from the NICs, it has been increasingly difficult politically to make a case for unilateral concessions to them. In fact, in recent years changes in the opposite direction occurred as

\[ \text{Although there are various definitions of NICs the newly-industrializing countries have been defined in this paper as having per capita incomes between } \$1,100 \text{ and } \$3,000 \text{ in 1978 and a manufacturing share of } 20 \text{ per cent or higher in 1977. They include Argentina, Brazil, Chile, Mexico, and Uruguay in Latin America, Israel and Yugoslavia in the Europe-Middle East area, and Hong Kong, Korea, and Singapore in the Far East.} \]
increased restrictions have been imposed on imports from the newly-industrializing countries. The situation has been well-described by Sidney Weintraub:

There is sort of a Faustian bargain into which the NICs have entered with the industrial countries. The NICs have pressed for special and differential treatment, which they have received, although not in the legal sense of being bound in the GATT for specific products. The preferences can be removed at the discretion of the preference giver. At the same time, many of the most competitive export products of the NICs are precisely those being subjected to selective restriction. Proposals to formally alter the GATT safeguard provisions to permit discrimination are directed primarily at the NICs and Japan. Is there an implicit connection between the selective liberalization (tariff preferences) granted to the NICs for their marginally competitive exports and the selective restriction (usually in nontariff form) on their most competitive exports? The question is not answerable, but it does suggest that the bargain entered into the NICs may be special and differential in ways they never contemplated (Weintraub, 1984).

If the NICs are unwilling to provide reciprocal reductions in trade barriers as part of negotiations, they face another danger: developed countries interested in pursuing de liberalization through multilateral negotiations—especially the United States, will engage in negotiations that exclude the developing countries. Such an outcome would be detrimental both to the interest of developing countries and to the international trading system: trade barriers would again tend to be reduced primarily on items of interest to developed countries; at the same time, the multilateral nature of the trade system would be undermined by a spread of bilateral arrangements.

These considerations suggest that lowering barriers to trade, and reducing uncertainty as to the future imposition of such barriers, on a reciprocal basis is in the mutual interest of developed and developing countries. The degree of reciprocity in negotiations would need to take into account the varying stages of economic development: the GATT enabling clause “states the expectation of the developing countries that they will be able to participate more fully in the framework of rights and obligations under the GATT with the progressive development of their economies and improvement in their trade situation.”

In keeping with this principle it could be expected that the NICs which have already made significant strides in economic development and which hold promise for more future growth should take increasing obligations in a new round of multilateral negotiations. Per capita incomes in 1982 in several of these countries were higher than in developed countries. Singapore’s per capita income was higher than Spain’s, Hong Kong’s
higher than Ireland’s, Israel’s higher than Greece, and Venezuela’s, Yugoslavia’s and Uruguay’s higher than Portugal’s (World Bank, 1984). A number of the developed countries of today, which according to present-day parlance would have been considered developing countries in the early postwar period, came to offer tariff concessions of their own as they progressed on the road towards industrial development. Eventually, these countries, including Japan, Finland, and Ireland, and subsequently, Greece, Portugal and Spain, became full participants in the negotiations.

Between 1960 and 1980, the NICs attained an average annual GNP growth rate of 6.7 per cent compared with 4.3 per cent in the developed countries. This was achieved, although the newly-industrializing countries were buffeted by the oil price increases of 1973–74 and 1979–80 and the subsequent world recessions. While the extent of economic progress in the NICs is obscured by the debt burden under which several of them labor today, in a longer-term perspective they can be expected to reach high levels of economic development. By 1990 the Latin American newly-industrializing countries, Korea, and Yugoslavia may attain Japan’s 1960 per capita income while Singapore may surpass Japan’s 1975 income per head.3

Thus, just as the present-day developed countries have become full participants in the process of trade liberalization during the postwar period, this process should encompass the newly-industrializing countries in the future. This does not mean, however, that the NICs in a new multilateral trade round would necessarily undertake the same obligations and apply the same time schedule as the present-day developed countries. But they would need to offer significant reductions in their trade barriers as part of the negotiations. In turn, such a liberalization effort by the NICs would result in greater trade opportunities for lower income developing countries whose exports to the NICs are constrained by the latter’s trade controls.

But, it would be a mistake to create an arbitrary dichotomy between the NICs and other developing countries. Rather, they form part of a continuum with the more advanced and better integrated in the world economy likely to be able to contribute more and participate more effectively in a negotiating process. The cost of not participating is that trade barriers on items of importance to them are less likely to be reduced.

Finally, the discussion on reciprocity should not imply that developing countries should delay the liberalization of their own trade regimes that contributes to the adjustment process by reducing the bias against exports.

3 Data for the year 1982 and projections for the period 1985–95 in World Development Report 1984 were supplemented by information received from the Economic Projections Department of the World Bank for the period 1982–85. The comparisons have been made for 1990, so as to allow for the time needed to begin the negotiations on multilateral trade liberalization and to put into effect the resulting agreements. After a preparatory period of one or possibly two years, the negotiations may take several years, with their implementation extending further over time.
But should a negotiating process of trade liberalization begin, approaches need to be explored whereby developing countries would get "credit" at the negotiating table for liberalization measures they have already undertaken.

_The mutual importance of trade for developed and developing countries_

The scope for reciprocity increases with the importance of the markets of the developing countries for the developed countries and _vice versa_. The importance of the developed countries as markets for the developing countries in general, and the NICs in particular, is indicated by data on trade flows. In 1983, the developed countries provided outlets for 63 per cent of the exports of the developing countries, while the ratio was 59 per cent for manufactured goods alone.5

Manufactured exports to the developed countries deserve particular attention as they have grown rapidly over time and have come to account for a rising share of domestic output in the developing countries. Thus, according to the rough estimates reported in Table 1, the share of exports to developed countries in the production of manufactured goods in the developing countries increased from 7.3 per cent in 1973 to 10.4 per cent in 1978 and to 12.5 per cent in 1981, with incremental shares being substantially greater. Given the NICs greater export orientation, these ratios are considerably higher for them than for the developing countries as a whole, and the NICs account for over three-fourths of the manufactured exports of the developing countries.

Not surprisingly, exports to the developed countries are of particular importance for developing country producers of clothing, with a nearly three-fifths share of these exports in the value of output in 1981. In the same year, the developed countries accounted for one-fifth of developing country output in the miscellaneous group of other consumer goods. The corresponding ratio was one-seventh for engineering products, where developing countries were successful in increasing their exports of radios and television sets as well as of parts, components, and accessories of various kinds of equipment.

The developing countries have also assumed increasing importance as markets for the developed nations. Thus, the share of exports to developing countries in the manufactured production of the developed countries rose from 2.9 per cent in 1973 to 5.1 per cent in 1978 and 6.3 per cent in 1981, with incremental shares increasing to an even greater extent.

According to available estimates, between 1978 and 1981, ten cents of each dollar increase in the manufacturing output of the developed

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4 The data for the developed countries include Yugoslavia but exclude Australia, New Zealand, and South Africa. In turn, the data for the developing countries include Taiwan (China).
5 GATT, _International Trade 1983/84_.—Unless otherwise noted, the trade data cited below derive from GATT statistics.
## Table 1

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Explanation of Symbols: $X = $exports, $P = $production, $DC = $developed countries, $LDC = $developing countries.

Note: a The estimates exclude the countries of the European Free Trade Association.

b The production estimates for the developing countries are subject to considerable error possibilities. Also, the estimates for 1973 have been obtained through interpolation of the reported figures for 1970 and 1978 while the 1981 estimates have been derived through extrapolation by the use of production indices.


countries was destined to developing country markets. With oil revenues declining and several large, heavily-indebted, non-oil countries applying deflationary policies to cope with the debt crisis, the share of exports to the developing countries in the developed countries' output of manufactures declined in 1983, but this decline was temporary and imports by the developing countries rebounded in 1984.

Among individual sectors, developing country markets are of greatest importance to developed country producers in engineering products, with a market share of 8.5 per cent in 1981. And, between 1978 and 1981, one-
sixth of the increment of engineering output was sold in the developing countries. The markets of these countries are also of importance for developed country exporters of iron and steel, chemicals, and (high-quality) textiles.

The data include exports to the OPEC countries, which provided markets for 36 per cent of developed countries' exports of manufactured goods to the developing countries in 1983 according to GATT statistics. In turn, among the non-oil developing countries, the importance of the newly-industrializing countries as markets has increased over time.

III. REDUCING TRADE BARRIERS IN MAJOR SECTORS

Prior to discussing actual liberalization in the major sectors, it is necessary to address briefly the question of a standstill under which all countries agree to impose no new measures of protection. Past efforts at agreeing to an effective standstill on new protection have proved futile. Despite solemn declarations to the contrary, countries have found it impossible to fend off particular protectionist demands in individual sectors. Perhaps the only way to *de facto* implement a standstill is to launch a negotiated process of multilateral trade liberalization. The initiation of such a process, and not necessarily the actual implementation of liberalization measures, may provide the most effective mechanism, especially in the United States, for strengthening the capacity of government to fend off demands for new protection in individual sectors and thus *de facto* implementing a standstill.

*Manufactures*

Trade liberalization in manufactured goods needs to focus on reducing and, over a predetermined period, eliminating nontariff barriers in both developed countries and the newly-industrializing countries. Barriers in the developed countries represent an increasing threat to the exports of the NICs, while the nontariff measures applied by the newly-industrializing countries limit market access for developed and other developing country exporters and create uncertainty for them.

A successful effort at trade liberalization would need to cover all sectors in which trade is impeded by tariff or nontariff barriers, irrespective of their status under present GATT provisions. The existence of GATT waivers or other distinctions as to the legality of the measures applied should not deter a new approach. If such an approach is not taken, important areas of interest to the developing countries such as agriculture and textiles would be left outside the negotiating process. The same is true for developing country trade barriers consistent with GATT articles XII and XVIII.

The discussion that follows focuses primarily on items of importance for trade between developed and developing countries. These include
textiles, steel and agricultural commodities, which are considered highly sensitive in the developed countries. But, unless they are willing to negotiate over them, participation in the negotiating process would offer little interest to the developing countries. A new round should create opportunities for "concessions" to be traded both within and across sectors and include both tariff as well as non-tariff barriers to trade.

The focus of the trade liberalization effort would nevertheless need to differ between the developed countries and the NICs as the scope of non-tariff measures differs between them. Among the manufactured products imported by the developed countries from the NICs, nontariff measures have been concentrated in textiles and clothing, shoes and, most recently, in steel. In turn, while Hong Kong and Singapore do not utilize nontariff measures and important steps towards trade liberalization have been taken in Korea, the other NICs generally apply nontariff measures to most manufacturing industries.

Correspondingly, while in the developed countries emphasis should be given to sector-level measures, the newly-industrializing countries would need to liberalize their trade across-the-board. But, in order to make the elimination of nontariff measures on textiles and clothing and on steel acceptable to sectoral interests in the developed countries, as well as to expand trade opportunities for low income countries, particular interest attaches to the NICs taking action in these industries parallel with the developed countries.

The textiles and clothing industries in the developed countries have made common cause for restrictions, even though technological changes have rendered textile producers in these countries increasingly competitive. Thus, the developed countries have a rising surplus in trade in textiles with the developing countries and by 1983 the value of their exports to the developing countries exceeded imports from them by nearly two-thirds. Pelzmann, for example, cites the President of the American Textile Manufacturer's Institute, according to whom "today we are the most modern and efficient textile industry in the world," and concludes that protection in the United States textile industry is "more or less redundant" (1983, p. 536).

In fact, there are considerable possibilities for the further expansion of mutual trade in textiles between developed and developing countries through the exchange of higher-valued for lower-valued products, with man-made fibers dominating in the former and cotton fabrics in the latter. The less developed countries have particular possibilities for expanding the exports of lower-valued cotton fabrics while the NICs may specialize in the middle range of products. In this connection, it may be added that the Multi-Fiber Arrangement (MFA) as it is now structured is especially detrimental to developing countries at lower levels of industrialization, which have the potential to expand significantly their exports at the lower end of
the scale but are unable to do so by the small quotas they are presently allocated under the MFA.

It is possible that, if the newly-industrializing countries were to phase-out their existing barriers on textile products, textile industries in the developed countries would also accept such a phase-out. This would, then, reduce the political power of the supporters of the MFA.

In the clothing industry, the cost advantage of the developing countries remains substantial and in 1983 their exports to the developed countries were seven times greater than their imports from them. Nevertheless, the developed countries possess advantages in high-fashion clothing, where proximity to markets is of particular importance. Thus, as it has been argued, "quickness of reaction, the ability to incorporate new trends and designs into production schedules, flexibility of operation, relatively good access to quality fabric suppliers, proximity to major centers of demand and intimate and service-intensive relationships with distribution channels are among the factors that determine success in these product markets" (de la Torre, 1984, p. 239). There are thus possibilities for increased trade in clothing between developed and developing countries, although in the large bulk of clothing products the developing countries have a strong cost advantage.

The MFA comes up for renewal in June 1986. It is unlikely, however, that a major revamping of the agreement can occur in isolation of other trade negotiations. The European Community has already taken such a position in a public pronouncement on the MFA in early 1985. Thus, the elimination of the MFA as currently structured may only be envisaged in the framework of the next round of multilateral negotiations, provided that tariffs on textiles and clothing are maintained at least for some time. Tariffs on clothing continue to be high in the developed countries. Thus, post-Tokyo Round import-weighted averages are 22.5 per cent in the United States, 13.5 per cent in the European Common Market, and 14 per cent in Japan. Effective rates of tariff protection are even higher as tariffs on fabrics average 11.5 per cent in the United States, 10.5 per cent in the EC, and 9.5 per cent in Japan. In fact, according to GATT statistics, in the period preceding the Tokyo Round, effective rates of tariff protection exceeded nominal tariff protection on clothing by 35 per cent in the Common Market, 44 per cent in the United States, and 70 per cent in Japan.

Tariff protection at the levels indicated should suffice to protect the more efficient segments of the clothing industry in the developed countries while phasing-out the Multi-Fiber Arrangement would give inducements for adjustment. This has not been the case so far; rather, the reinforcement of protection under MFA has provided incentives not only to maintain, but to increase capacity. Similar considerations apply to footwear, where restrictions have been imposed by individual developed countries.
Thus, one may agree with the report of a study group that the statement made by the Commission of the European Community, according to which the extension of the MFA for another five years "should enable the Community's industry to make new progress in its restructuring efforts," is no more than "a pious hope." This is because, as the report notes, "there are no incentives for efficient adjustment. Instead, the greatest protection continues to be offered to the least efficient activities" (Curzon et al., 1981, p. 37).

Phasing-out the MFA may take the form of increasing quotas annually for large exporters and eliminating quotas for small ones. At the same time, to ease the adjustment, assistance would need to be provided to finance the retraining and the relocation of workers and to help firms restructuring their activities or leaving the industry altogether. The amounts needed for such adjustment assistance may nevertheless be small compared to the cost of saving jobs under the MFA (see, Balassa and Michalopoulos, 1986).

Adjustment would also be necessary in the steel industries of the developed countries. Thus far, adjustment has been hampered by the subsidization of steel production in the European Community and by quantitative restraints imposed on steel imports in both the Community and the United States.

An agreement to liberalize trade in steel would need to involve the elimination of production subsidies. Import liberalization itself may well begin with the developed countries eliminating restraints on steel imported from the developing countries. With the simultaneous elimination of barriers to steel imports in the NICs, there may be possibilities for an exchange of speciality steel products for crude steel between the developed countries and the NICs. In this connection, it should be noted that in 1983 the steel exports of the developed countries to the developing countries exceeded their imports from these countries nearly five times.

The exports of automotive products, including parts, components, and accessories, from the developing to the developed countries did not reach 5 per cent of the reverse flow of this trade in 1983. But, there are possibilities for further expansion and one would need to ensure that developing country exporters do not encounter barriers in developed country markets in the future. At the same time, the newly-industrializing countries would have to open their markets to competition from abroad, in order to ensure low-cost production in an industry characterized by economies of scale. To the extent that automobiles are viewed by them as luxuries whose consumption should be discouraged, high domestic taxes on automobile purchases could be substituted for the present trade barriers.

In the developed countries, then, the elimination of nontariff measures would be concentrated in textiles and clothing, footwear, and
steel, with further assurances given that such measures will not be applied in other industries. In turn, the elimination of nontariff measures would necessitate across-the-board changes in the newly-industrializing countries. As the adjustment will take time, there is need for a phase-out of the nontariff measures presently applied by the NICs.

The question is, then, how this phase-out may be effected. Among the newly-industrializing countries, the OEEC method of eliminating restrictions on a certain percentage of imports year-by-year has been used recently in Korea. This procedure may also find application in the other NICs in phasing-out their nontariff barriers in the future. While the existence of import prohibitions will bias the results, there exists no simple and straightforward alternative to the OEEC method.

The next question concerns the tariff measures to be taken in conjunction with the elimination of nontariff barriers. Two diametrically-opposed proposals have been made in this regard. Some have suggested that tariffs be reduced *pari passu* with the freeing of trade restrictions, so as to ensure overall trade liberalization; others have recommended converting nontariff measures into equivalent tariffs and thus raising tariffs, so as to minimize the cost of adjustment in the course of the elimination of nontariff measures. Both of these methods have important shortcomings.

While proceeding on two fronts simultaneously would indeed permit making rapid progress in the liberalization of trade, the resistance of vested interests would also increase. Moreover, the task of negotiations would become much greater, thereby burdening the administrative apparatus. Finally, the difficulties of adjustment would increase and greater uncertainty would be created for producing interests.

In turn, although raising tariffs would reduce the burden of adjustment, there would be pressures to increase tariffs more than necessary to offset the effects of the elimination of nontariff measures. Furthermore, there is the danger that, once raised, tariffs would not be lowered later.

A compromise solution would be to postpone tariff reductions on products subject to nontariff measures, without however raising tariffs in the process of eliminating such measures. At the same time, the developed countries should undertake to reduce tariffs on products to which nontariff measures do not apply. This would ensure reciprocity between the developed countries and the NICs, which would reduce nontariff measures across-the-board, and provide benefits to the less developed countries.

Processed foods and raw materials are subject to tariff escalation that discriminates against processing activities in countries producing these foods and raw materials, many of which are less developed countries. In order to contribute to export expansion from these countries, it would be

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b The Korea liberalization is over a long period (ten years) and involves modest changes in protection.
desirable that the developed countries eliminate tariffs on processed foods and raw materials, including tropical products, where the less developed countries are major exporters.

Temperate zone agriculture

The next question concerns trade in temperate zone agricultural products. In recent years, agricultural protection in the European Common Market has engendered large surpluses that have been increasingly exported with the support of high subsidies. And while complaints about these subsidies have largely originated in the United States, developing country exporters of temperate zone products have also suffered their adverse consequences (Zietz and Valdez, 1985).

As a first step towards a more rational system of trade in temperate zone agricultural products, it would be desirable to declare a standstill on new export subsidies. Such a standstill would apply to all exporting countries and not only to the European Community. At the same time, with the Common Agricultural Policy being increasingly costly for the Community, there is a mutual interest in moderating agricultural protection.

One may envisage, first of all, some shift from price support to income subsidies under the Common Agricultural Policy. In encouraging consumption, this alternative would lead to lower exports and/or increased imports. Furthermore, support levels would need to be reduced over time, with the aim to eliminate surpluses in some commodities and to permit increasing imports in others. While the modalities of reducing farm support would obviously be an internal matter to the European Community, a pledge to undertake such reductions may be appropriately made in the course of the negotiations.

In Japan, trade liberalization on agricultural products should entail reduction of quantitative restraints as well as a shift from price support to income support as price levels are high and consumption levels are low. In turn, in the United States, the elimination of the recently introduced export bonus scheme would be the first priority.

Inward-oriented developing countries discriminate against agriculture through the protection of industrial activities. In their case, reducing industrial protection would make an important contribution to improving incentives to agriculture (Balassa and Michalopoulos, 1985).

Services

The United States has long proposed the establishment within the GATT of rules and procedures governing trade in services to parallel those governing trade in goods. The United States has argued that, in the

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7 For alternative proposals to reform the Common Agricultural Policy, see Josling et al., 1981.
absence of rules governing trade in services, national regulatory policies could be used to restrict such trade and discriminate against foreign providers of services.

Most developing countries have generally opposed these proposals on several grounds; (a) there is a fear that industrial countries have a comparative advantage in services and the establishment of international rules would result in limiting the capacity of developing countries to protect service activities on infant industry grounds; (b) there is limited information on services trade, making the conduct of negotiations for establishing rules and procedures difficult; (c) there are conceptual ambiguities in defining various kinds of services traded internationally; (d) in order to be effective international rules affecting trade in services may sometimes need to affect investment—an area of great sensitivity for many developing countries; and (e) the U.S. proposals are sometimes viewed as an effort to deflect attention from barriers to trade in goods imposed by the developed countries.

There is little doubt that the absence of international rules governing trade in services represents an important gap in international economic cooperation. In the absence of such rules, a number of practices inhibiting trade have indeed developed (U.S. National Study on Trade in Services, 1984). Such practices affect an important and growing segment of international trade. According to estimates made by the Office of the U.S. Trade Representative, trade in services amounted to 17 per cent of the world exports of goods and services.

It is also quite true that this trade is dominated by the developed countries, and the United States has a large, although not disproportionate, share. Thus, it is natural for the United States to seek to develop rules aimed at reducing obstacles its service industries face in foreign markets.

At the same time, it is clear that meaningful progress in setting multilateral rules in this area is by necessity likely to be slow. This for a variety of reasons, some purely technical ones, others relating to the reluctance of developing countries to undertake liberalization in the area. These issues will need to be dealt with for liberalization in services to follow.

First, there are conceptual issues on coverage. Bhagwati (1984) suggests a simple rule aimed at distinguishing between services which are embodied in suppliers and require their physical presence and others which are disembodied and hence do not; he would focus on eliminating restrictions in the latter but not in the former. While this distinction is helpful in considering the question of immigration which is obviously unrealistic to tackle in this context, it does not fully deal with other aspects

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8 The principal exceptions have been Singapore and Hong Kong who may expect to benefit from expanded trade in financial services.
9 For some of the developing countries concerns see UNCTAD (1985).
of the issue. For example, the United States is interested in establishing rules pertaining to the right of exporters to provide services through distributors. This might involve investment-related regulations in some countries, although in principle the issue of ownership of distributorships can be separated and dealt with under investment rules. Also, the United States is interested in ensuring that public monopolies do not abuse their position in competitive markets (e.g. airlines) (U.S. National Study on Trade in Services, 1984).

Second, there is general agreement that data on services are inadequate and there is a great need for improvement. For example, data on services do not even remotely approximate the availability of data on trade in goods by product classification and by country of origin and destination.

Third, there is limited information and analysis on the impact of national practices on the flow of service trade. The availability of such information would clarify the issues under discussion.

At the same time, developing countries would benefit from the freer importation of services, which are a crucial component of a modern economy today. The arguments favoring freedom of trade in goods apply also to services. In practice, the newly-industrializing countries may develop new services exports, based on the use of relatively low cost skilled and semi-skilled labor. Examples are data processing and engineering services, where new facilities for data transmission would permit the developing countries to exploit their comparative advantage.

These considerations point to the possibilities for mutually beneficial trade in services between the developed countries and the NICs. Nevertheless, dismantling barriers to services in the newly-industrializing countries may take time, largely because they consider certain services, such as banking and insurance, to be infant industries. This should not lead, however, to the exclusion of developing countries from multilateral negotiations on trade in services. Excluding from negotiations on services countries that do not offer concessions for the full range of services would make it difficult to ensure their later participation, since they might consider that the rules have been slanted to their disadvantage.

All in all, while negotiations on trade in services are important, progress in setting rules and in dismantling barriers affecting such trade will be slow. It is questionable as to whether such negotiations can proceed at the same pace as negotiations on trade in goods, and that the latter should be tied to the pace in the former.

IV. THE INSTITUTIONAL FRAMEWORK OF TRADE LIBERALIZATION

Safeguards

Section III considered the possibilities for trade liberalization in regard to manufactured goods, agricultural products, and services. It should be
recognized that reaching agreement on trade liberalization presupposes the availability of effective safeguards in the event that an unexpected surge in imports causes actual or potential injury to domestic industry. An important objective of safeguards would be to allow for temporary relief while inducing countries to use the safeguard mechanism rather than measures that provide protection outside the GATT framework.

Article XIX of GATT permits a country to impose trade restrictions if imports are causing or threatening serious injury to domestic producers of a competing product. The application of Article XIX is, however, subject to several conditions and it has in practice been by-passed in order to avoid abiding by these conditions. Rather, threats of restrictions by legislative or administrative actions have been used to compel exporting countries to adopt “voluntary export restraints” (VERs) or to enter into “orderly marketing arrangements” (OMAs).

Despite protracted negotiations, no agreement has been reached on a new safeguard code in the Tokyo Round and thereafter. The establishment of an effective safeguard mechanism is, however, necessary to avoid the continuation of a situation when countries take measures that do not conform to GATT rules. A new GATT safeguard code is needed to complement any trade liberalization undertaken within the GATT framework. Such a safeguard code would have to contain the following features:

First, the standard of “serious injury to domestic producers” should be given greater precision than it now has under Article XIX. It would be necessary to specify the factors to be taken into account in determining injury, such as employment, production, and prices. Furthermore, it should be established that imports rather than other factors, such as changes in consumer tastes and in technology, are the principal cause of the injury. Finally, a pre-condition for the application of safeguard measures should be that injury has been suffered by producers accounting for a major share of the total domestic output of the product.

Second, the procedures applied by countries that have recourse to safeguard measures should ensure the transparency of the safeguard process. Also, all interested domestic and foreign parties, not just domestic producers, should be given the right to present their views through public hearings before an independent body. Finally, official determinations and their reasons should be made public.

Third, safeguard measures should preferably take the form of increases in tariffs, with quantitative limitations applied only in exceptional cases. And, if quantitative measures are applied, imports should not be reduced below the level attained in the period prior to the imposition of restrictions.

Fourth, countries should not practice selectivity in the application of

10 For an early statement, see Robertson, 1977.
safeguard measures, unless they obtain the agreement of the affected party or parties.

Fifth, all safeguard measures should be temporary and set on a degressive scale. To ensure that they remain temporary, such measures should be brought under the surveillance and scrutiny of GATT. While the first imposition of safeguard measures may be left to the discretion of the country concerned, their extension beyond an initial period of, say, three years would be conditional on agreement by the GATT. Also, the re-imposition of safeguards within a predetermined period of, say, five years should be excluded.

A pre-condition of the extension of safeguard measures beyond an initial period would be the taking of adjustment actions by the importing country. As noted in Section III in regard to the Multi-Fiber Arrangement, these actions should aim at facilitating the transfer of capital and labor to other activities rather than prolonging the life of inefficient firms.

Sixth, countries applying safeguard measures in conformity with the criteria and conditions of the new code would be subject neither to retaliation nor to any obligation to provide compensation. If, however, a country’s safeguard actions were not in compliance with the code, retaliation would be warranted.

Finally, existing nontariff restrictions, whether in the form of VERs, OMAs, or any other, should be brought under the new safeguard code. A timetable for their subsequent elimination could also be negotiated as part of the modalities for adjustment over time.

Countervailing, anti-dumping and related measures
Actions to improve safeguards have to be taken parallel with commitments by the developed countries to refrain from using for protective purposes trade measures which have other legitimate objectives. In recent years, countervailing and anti-dumping actions and price investigations by developed countries have greatly increased especially in manufacturing, while safeguard proceedings have declined in importance.

In the United States, there are inferences that the industries seeking action under the countervailing and anti-dumping duty provisions are doing this as an alternative to seeking safeguard relief. Although relatively few of the petitions are actually approved, the effect of the investigations themselves is protective—irrespective of the final findings—which may or may not be protective in intent or nature. In other developed countries, surveillance is often administered with a view to ensure that quantities and/or prices of imports are consistent with unofficial targets or understandings with importers. All of these practices result in increased protection, although their original purpose may well be legitimate. Table 2 shows that in some developed countries such measures may be as
TABLE 2
RELATIVE SHARES OF NONTARIFF MEASURES AND OTHER BORDER MEASURES, MAY 1985
All products less fuels; all countries (world trade weighted)

<table>
<thead>
<tr>
<th></th>
<th>Nontariff Measures&lt;sup&gt;a&lt;/sup&gt;</th>
<th>Other Border Measures&lt;sup&gt;b&lt;/sup&gt;</th>
<th>Sum of Columns&lt;sup&gt;c&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td>European Community</td>
<td>13.9</td>
<td>11.6</td>
<td>21.0</td>
</tr>
<tr>
<td>United States</td>
<td>6.4</td>
<td>3.4</td>
<td>9.5</td>
</tr>
<tr>
<td>Japan</td>
<td>9.6</td>
<td>0.0</td>
<td>9.6</td>
</tr>
</tbody>
</table>

Notes:  
<sup>a</sup> The data collected by Nogues, Olechowski, and Winters for 1983 have been adjusted for the termination of the U.S.–Japanese automotive agreement. Other changes in protection occurring between 1983 and 1985 have been relatively minor.  
<sup>b</sup> Countervailing and anti-dumping duties, price surveillance, price investigation, quantity surveillance and automatic licensing.  
<sup>c</sup> The figures in this column are less than the sum of those in the columns reported because some trade flows face several barriers.


important as the more obvious nontariff measures on which this paper has focused.\textsuperscript{11}

Internally, one would need to explore changing procedures for countervailing, anti-dumping, and price investigations to avoid trade disruptions. In the United States, this may be achieved by strengthening the preliminary review process by the Commerce Department for judging whether the case should be referred to the International Trade Commission. In other developed countries, clear and transparent processes would need to be established for handling cases.

Externally, it would be necessary to increase the active monitoring and surveillance of such actions by the GATT and to strengthen dispute settlement procedures in the GATT, so as to reduce the likelihood that countervailing and anti-dumping provisions are abused and other legitimate surveillance measures are used for protective purposes. At the same time, the establishment of an effective safeguard code for legitimate cases of injury to domestic industry may serve to weaken the tendency to seek countervailing actions or other similar measures.

Finally, actions would need to be taken by exporting countries to limit the provision of subsidies \textit{pari passu} with the liberalization of trade. Developing countries may find that lowering their own trade barriers may make it possible to reduce export subsidies which were provided to some

\textsuperscript{11} The table does not include data for Japan, which does not rely on countervailing and anti-dumping action and for which information on other types of border control measures is not available.
industries as a means of offsetting the bias against exporting that their own import restrictions had created. Similarly, action by the European Community to reduce subsidies especially in agriculture would significantly improve the prospects that the scope for countervailing and antidumping action be limited to legitimate cases of injury.

The role of the GATT
The GATT will be only as effective as the members want it to be. Improving the rules under which trade is conducted without a parallel commitment by the major trading partners to adhere by the rules will not be an improvement over the current situation. Provided such an overall commitment is present, the following areas of institutional strengthening deserve consideration.

1. Dispute settlement
The effective application of the safeguard mechanism would necessitate improving existing procedures for the settlement of disputes. A new safeguard code should provide for the establishment of a Committee on Safeguards, with responsibility for the administration of the code and the surveillance of safeguard actions.\textsuperscript{12} Disputes between signatories would be referred to the Committee that would ensure coherence in the application of safeguard measures and build up a case law over time.

Improvements in the dispute settlement mechanism are also necessary to deal with conflicts that may arise in other areas, such as export subsidies, countervailing action to such subsidies, and the application of anti-dumping duties. The first requirement would be to strengthen the panel system. This objective would be served by establishing standing panels, consisting of internationally respected experts, who would perform functions similar to those of administrative judges in the United States. The Committee on Safeguards would be one such standing panel.

The work of the standing panels should be complemented by the establishment of \textit{ad hoc} panels drawn from a list of experts. In order to ensure their independence, a majority of the members of the standing and the \textit{ad hoc} panels should be chosen independently, on their merits, rather than be appointed by governments.

It is important to ensure the arbitration of the disputes. The panels may fulfill the functions of both fact finding and arbitration or, alternatively, arbitration may be done separately from the work of the panels.

The governments of the participating countries should use the dispute settlement mechanism in GATT as a forum for presenting their grievances and should abide by the recommendations of the panels or the arbitrators.

\textsuperscript{12} For such a proposal, see Atlantic Council, 1981, pp. 18–19.
In turn, in cases when these are overruled by the national legislation, financial compensation would need to be made.

2. Surveillance

As recommended by the report of the Group of Eminent Persons, established by invitation of the Director-General of GATT, it would be desirable to carry out annual examinations of trade policies in the framework of GATT (Leutwiler, et al., 1985). The IMF has the authority under Article IV consultations and other provisions for surveillance of the international monetary system, to review the macro-economic and foreign exchange policies of member governments on a regular basis. The World Bank undertakes frequent reviews of the borrowing countries' development policies and its findings are discussed at its Executive Board, an intergovernmental body, in the context of its provision of loans.

The GATT Secretariat has no parallel authority for surveillance of the trading system; nor does it actively discuss the trade policy measures applied by its members. Biannual consultations with members could be instituted with a view to determine the state of their trade policies, including the review of safeguard and countervailing actions and price investigations. A report of the findings could then be discussed by a standing intergovernmental body consisting of GATT member representatives.

This would also permit establishing facts as to the application of non-tariff measures the governments have not reported to the GATT. In general, the GATT should improve its efforts to obtain information on the application of non-tariff measures and should give them considerable publicity.

V. CONCLUSIONS AND POLICY IMPLICATIONS

The fact that reduction in protection is to a country's own advantage has only too infrequently been sufficient to induce countries to take steps to liberalize their trade. Liberalization has been achieved primarily through multilateral trade negotiations in the GATT framework. A multilateral approach based on reciprocity is useful for several reasons. First, only through such an approach can most governments mobilize enough countervailing political pressure to confront the traditional forces of protection; second, the economic benefits from a multilateral approach exceed those of unilateral liberalization; and third, in the absence of multilateral efforts, there is potential for increases in bilateralism which is fraught with inefficiencies.

Multilateral trade negotiations in the framework of the GATT offer the greater—indeed the only—opportunity for significant trade liberalization at present. Such negotiations would need to encompass all items of
importance to trade between developed and developing countries in manufactures, agriculture and services and include both tariff and nontariff barriers. All developing countries and especially the NICs need to be active participants in such negotiations and be prepared to offer a certain degree of reciprocity consistent with their level of development. In the absence of reciprocity, especially by the NICs, even if it is not complete, there is a clear danger that trade in items of interest to developing countries would continue to be more restricted than trade among developed countries.

The negotiations will be complex and need to be carefully prepared. They may differ by sector and would have to respond to the various kinds of protection applied in different sectors and by different countries. Liberalization of nontariff measures should involve both reducing trade barriers and bringing the remaining barriers under the aegis and scrutiny of the GATT. Particular attention needs to be given to the development of suitable modalities for the reciprocal elimination of nontariff barriers, since there has been limited international experience with multilateral liberalization in this area. In the case of tariffs, the focus needs to be on items where there is significant tariff escalation. In this connection, it is important to note that the U.S. Administration does not at present have the authority to reduce tariffs; it would need to obtain such authority in the near future in order to participate in negotiations on tariffs—a task fraught with some uncertainty, given current protectionist sentiments in Congress.

For the negotiations to be meaningful, developed country protection in such sensitive areas as the textiles and clothing, steel, and agriculture needs to be addressed. At the same time, developing countries need to seize this opportunity to rationalize and reduce their own protection of manufacturing activities. Negotiations in services pose difficulties both because of conceptual and factual problems and because a large number of developing countries for these and other reasons are opposed to them. While it is clear that there are significant problems that need to be addressed in this area and negotiations on services may take a long time, it is important that they should go forward.

Indeed, consideration may be given to modifying somewhat the negotiating process in the GATT. Thus, one may envisage a continuous process of discussions, with negotiations occurring over issues and sectors in which there is an opportunity to reach agreement and liberalize trade. At the same time, it should be recognized that there are trade-offs within as well as between sectors, which are important for the success of the negotiating process.

Parallel with the negotiations to liberalize trade, steps should be taken to strengthen the trading system and the GATT. First and foremost this requires the establishment of a new safeguard code which would provide
temporary, uniform, and degressive import relief through measures consistent with the GATT. Second, it requires steps aimed at reducing country abuses of countervailing, anti-dumping and related surveillance measures. Third, it requires strengthening the role of the GATT in dispute settlement and in surveillance over the trading system.

Finally, efforts for trade liberalization through multilateral trade negotiations should not inhibit unilateral liberalization by developing or by developed countries in pursuit of much needed structural reform. In this connection, the World Bank and the IMF would need to continue and expand their lending in support of trade policy reforms in the developing countries. Appropriate “credit” for such reforms should be given to developing countries in the framework of the multilateral negotiations.

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