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TRADE POLICY ISSUES FOR THE DEVELOPING COUNTRIES IN THE 1980s

A Background Study for World Development Report 1981

Whether the developing countries will be able to sustain reasonably satisfactory growth performance under the adverse conditions of the 1980s will greatly depend on external markets' remaining open to their exports. This prospect will in turn depend on what is done to consolidate and strengthen those international institutions and policies intended to promote a liberal world trading system.

The codes on non-tariff measures adopted in the recently concluded multilateral trade negotiations (MTN) constitute an essential framework for resisting the protectionist pressures that are bound to intensify in the 1980s. Only through their practical application with the full participation of the developing countries, however, will the codes evolve into a system of precedent and common law that will constitute an effective discipline for an open world trading system. Resumption of negotiations on the principal unfinished business of the MTN -- namely the adoption of a new and more effective safeguard code that will make emergency restrictive actions, whether formal or informal, subject to internationally agreed criteria and rules and multilateral surveillance -- is also important.

The paper explores the relation between trade policy and "industrial policy" and calls attention to points of conflict and compatibility. Suggestions are offered for a revised approach to trade adjustment assistance. Other topics discussed are: efforts to achieve "fair labor standards" in the third world and the implications of such standards for protectionism and for World Bank policy; trade among developing countries, including an assessment of the options for encouraging it through regional, preferential, and unilateral approaches; and trade in services, including the interest of the developing countries in current efforts to liberalize this sector, which has thus far been neglected in international trade negotiations.

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<td>American Selling Price System</td>
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<td>EEC</td>
<td>European Economic Community</td>
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<td>General Agreement on Tariffs and Trade</td>
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<td>GSP</td>
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<td>OECD</td>
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I. Introduction

Aside from international commodity policy, the salient trade issues for the developing countries in the 1980s concern, in one way or another, access to markets. The ability of developing countries to sustain satisfactory growth levels while adjusting to higher debt service and oil import costs is critically dependent on their export capabilities. More fundamentally, it is hardly an exaggeration to say that those oil-importing developing countries that have realized the greatest economic progress over the last two decades have achieved their success through structural changes in their economies based largely on their ability to achieve a rapid expansion of exports of manufactures.

The potential exists in many relatively labor-intensive industrial sectors for continuing rapid shifts in comparative advantage from one group of countries to others lower on the development scale. Whether this potential, and the consequent vast opportunities for a new international division of production, will be realized depends primarily on domestic economic policies within individual countries, both developed and developing. But internal policies can be profoundly affected by the way in which the international economic system evolves. Although resource transfers may be critical for improving the prospects of low-income developing countries, improved access to world markets may be at least as important for middle-income developing countries. A crucial question for the 1980s, therefore, is how to maintain a reasonably open world trading system in the face of slow growth and mounting protectionist pressures in the industrial countries.

Implicit in this approach is a rejection of the hypothesis that trade can no longer stimulate growth in the developing countries because of the major discontinuity in the world economy caused by oil price increases,
inflation, and economic stagnation. According to the latter view, developing countries should face the reality of shrinking opportunities to expand exports to the industrial countries. They should, therefore, tilt toward the earlier, inward-looking growth strategy for import substitution and also seek more vigorously to expand trade among themselves. 1/

Import substitution may have played a useful role at one stage in the evolution of some of the larger developing countries, and the potential for expanded trade within the developing world may not yet be fully realized. Nevertheless, this paper is predicated on the notion that rapidly expanding opportunities will continue for developing countries to export both to each other and to their main markets in the industrial countries and that expanding developing country exports will not adversely affect overall growth in the developed world (since the developed countries will in turn enjoy greater export possibilities as the developing countries' capacity to import improves). The major proviso is that steps be taken to underpin and strengthen those international institutions and policies that are designed to foster an open world trading system. In short, whether outward-looking growth strategies for developing countries will continue to be valid in the 1980s greatly depends on what is consciously done to shape the international policy framework within which trade takes place rather than on an inexorable unfolding of adverse circumstances.

The subject of appropriate trade policy will be addressed in four parts. The next section briefly reviews the recently completed multilateral trade negotiations (MTN) and assesses the policy significance

for the developing countries in the 1980s. The third section considers the major trade policy issue of safeguards (and the related question of informal trade barriers) on which agreement could not be reached in the MTN. The fourth section considers more briefly four other subjects that are expected to assume increasing importance in the coming decade and that warrant a fresh look: industrial policy and structural adjustment, fair labor standards, trade among the developing countries, and trade in services. Concluding remarks are made in the final section.

II. The Multilateral Trade Negotiations (MTN)

The most comprehensive set of trade negotiations ever conducted was concluded in 1979 under the aegis of the General Agreement on Tariffs and Trade (GATT). Three major sets of results were achieved: a substantial reduction in tariffs; a refinement and improvement of the international rules on non-tariff measures; and the adoption of a framework of procedural arrangements to encourage and facilitate adherence to the agreements on the part of signatory countries.

Tariffs

Despite the diminishing importance of tariffs compared with non-tariff barriers to trade, a great deal of attention was given to tariffs in the MTN. Average tariffs on industrial products were reduced by approximately one-third (38 percent calculated as a simple average, or 33 percent on an import-weighted basis). In addition, the negotiations succeeded in liberalizing tariffs by harmonizing the rates. Because the restrictiveness of a country's tariff structure is partly a function of the degree of dispersion of the rates around their average, liberalization was accomplished by application of a formula for harmonization under which the percentage reduction increased with the height of the tariff.
Under the most-favored-nation (MFN) rule, the duty reductions will be extended to all GATT members on a non-discriminatory basis. Nonetheless, the developing countries have expressed keen disappointment with the results on two grounds: first, that the reductions on products of special interest to developing countries fell short of the average cuts; second, that the MFN reductions implied an erosion of the margins of preferences enjoyed by the developing countries under the general system of preferences (GSP).

The evidence appears to bear out the claim that the tariff reductions on products of interest to developing countries are smaller than the average cuts -- 25 percent versus 33 percent on a weighted basis. If products of potential interest to developing countries are included, however, the picture that emerges is one of roughly comparable reductions. This more dynamic view may be the more relevant given the rapidly growing diversification of developing countries' exports. Moreover, the harmonization of tariffs achieved in the MTN would appear to mitigate the developing countries' long-standing concern about tariff escalation; i.e., that the gap between the tariffs on manufactured products and the lower tariffs on semi-processed and raw materials tends to solidify the traditional role of developing countries as suppliers of basic materials. 1/

As for the erosion of the margins of preference, the problem is to compare the loss to developing countries of the benefits of trade diversion in the preference-granting countries with the gains from trade creation in those countries that are a result of MFN tariff reductions on non-GSP

1/ An additional benefit of narrowing the escalation of nominal tariffs is that it reduces the extent to which the effective protection exceeds the nominal tariff on the higher stages of processing and fabrication.
products. The net result of this calculation, according to the United Nations Conference on Trade and Development (UNCTAD), is a substantial net loss for the developing countries. 1/ The methodology underlying the UNCTAD estimate, however, appears to be open to serious question. As Balassa 2/ has shown, the gains to developing countries from the MFN tariff reductions should, under reasonable assumptions, far exceed any trade losses from reductions in preference margins.

Additional gains by the developing countries will be made because the MFN reductions apply to products that have lost their GSP status in the United States and to products subject to GSP import limitations by tariff quotas applied in the European Economic Community (EEC) and Japan. Moreover, preferences can be -- and in fact have been -- unilaterally withdrawn, whereas the MFN reductions negotiated in the Tokyo Round are legally "bound." Although bindings can be suspended through safeguard action, they are nevertheless a more reliable basis for the long-term planning of investment and export strategies.

**Codes on Non-Tariff Measures**

What distinguishes the Tokyo Round from previous rounds of MTN is its accomplishments in the field of non-tariff mesurees. As the

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level of tariffs has receded over the years, non-tariff distortions have become more significant. 1/ Moreover, they have often been applied in a manner that circumvents the basic GATT rules. The codes adopted in the Tokyo Round update the rules and provide more effective international discipline in their application.

**Subsidies and countervailing duties**

This code prohibits outright the subsidization of exports of industrial products and minerals. With respect to agricultural products, it reaffirms the GATT principle that export subsidies should not be used to gain more than an equitable share of world markets. In contrast to export subsidies, domestic subsidies are not barred. Indeed, their role in achieving legitimate domestic goals is acknowledged, but signatories are committed to avoid the use of domestic subsidies if these have harmful effects on the industry and trade of other countries.

A substantive change of great potential significance for developing countries is the acceptance by the United States of the material injury test for applying countervailing duties. Under a "grandfather" clause, the United States has not previously applied the GATT-mandated injury test and was in fact legally bound under its domestic law automatically to apply countervailing duties once foreign subsidization was established. The U.S. commitment to apply the injury test extends, however, only to signatories of the code.

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1/ Actually, resort to non-tariff barriers is substantially less today than in the 1950s, when they were widely used by the industrial countries to defend the balance of payments. Such use of non-tariff barriers by the industrial countries has been rare in recent years, but these measures have become more important relative to tariffs as purely protective devices.
Specific recognition of developing country interests is reflected in the differential treatment accorded them. Acknowledging that subsidies are an integral element in economic development programs, the code exempts developing countries from the general prohibition of export subsidies in non-agricultural products. In addition, the use of countervailing duties against a developing country is subject to more stringent standards: the illustrative list of export subsidies cannot be invoked as a basis for a presumption of harmful effects, nor will the examples in the code of internal subsidies be regarded per se as subsidies. In return for this differential treatment, developing countries signatory to the code agree to "endeavor" to enter into a commitment to eliminate export subsidies when their use is inconsistent with the countries' competitive and development needs.

Finally, signatory developing countries may utilize the improved procedures of the code for protecting their own interests against developed country export subsidies, domestic subsidies prejudicial to developing country interests, or unilateral retaliatory measures.

**Government procurement**

This code breaks new ground in addressing an increasingly important sector of trade in which GATT has expressly permitted discrimination in favor of domestic suppliers. As the proportion of government expenditures in GNP has been steadily rising, this exception for government procurement has become a seriously limiting element in international trade.

The intent of the code is to provide national and MFN treatment for foreign suppliers of products purchased by government entities subject to the code in amounts above approximately US$200,000 on individual transactions. To this end, the code provides for greater transparency of laws,
regulations, and practices and contains detailed rules on how tenders for contracts should be invited and awarded. As in the case of the code on subsidies and countervailing duties, explicit provisions are included for the multilateral adjudication of disputes.

Special measures for developing countries are provided in the code. Developed countries are called upon to include in their list of government entities those which purchase products of special interest to developing countries and to provide developing countries with technical assistance. Developing countries may negotiate mutually acceptable exclusions from the code, and suppliers in the poorest developing countries may benefit from the provisions of the code even if they are not parties to it.

The significance for developing countries of opening up this new sector to non-discriminatory trade was well stated in an UNCTAD report prepared for the 1979 Manila Conference: "In view of the substantial size of public procurement by developed countries and the capability of the developing countries to meet a good deal of these procurement needs, the developing countries attach great importance to efforts at the national and international levels to liberalize restrictive national and local-government procurement policies that now seal off potentially large markets from international competition." 1/

Technical barriers to trade

Governments have increasingly been adopting technical regulations to ensure that products conform to standards relating to such matters as health and safety, environmental protection, and energy efficiency. Although such product standards generally serve legitimate social objectives, they can be used in various ways for protectionist purposes.

The intent of the code is to ensure that product standards "do not create unnecessary obstacles to international trade." In addition to providing for equality of treatment for domestic and imported products, the code calls upon signatories to cooperate in establishing international standards and to use them where they exist. In the absence of international standards and regulations, signatories should set national standards for performance rather than for design or descriptive characteristics that lend themselves more easily to protective use.

Developing countries receive various forms of special treatment under the code. In addition to providing for technical assistance, the code relieves them of the obligation to apply international regulations and standards when the latter are incompatible with the developing countries' desire to preserve "indigenous technology and production methods and processes compatible with their development needs." In addition, developing countries may receive specific exemptions from other provisions of the code for limited periods.

Customs valuation

The purpose of this code is to clarify the GATT provisions on valuation and to ensure that imports are assessed for duty purposes on commercially realistic terms, not on an arbitrary basis that is a disguised form of protection. The transaction value (i.e., the price actually paid or payable)
is established as the primary basis of customs valuation, with four subordinate methods specified in a stipulated order of precedence.

Under the new rules, the United States has agreed to eliminate the much-criticized American Selling Price system (ASP) under which certain goods have been valued not at the actual transaction price but at the higher price at which the products were sold in the U.S. market.

Special provisions for the developing countries include technical assistance in applying the code, a five-year postponement of its application, and a further delay of up to three years in applying the provisions of the code to trade between related parties (primarily transactions between transnational enterprises and their developing country subsidiaries). However, developing countries pressed in the negotiations for a longer postponement and greater latitude for their customs authorities in transactions between affiliated companies.

**Import licensing**

The purpose of this agreement is to ensure greater equity, transparency, and simplicity in the administration of import licensing systems and thereby to discourage their use for purposes other than those for which they are publicly intended. In allocating import licenses, special consideration is to be given to importers purchasing products from developing, and especially the least developed, countries.

**The Framework Agreement**

This agreement is a composite of decisions on three sets of issues of importance to developing countries.
Balance-of-payments and safeguard measures

The two declarations on these subjects grant greater flexibility for developing countries to adopt protective measures than provided under present GATT rules. In the case of balance-of-payments difficulties, developing countries may resort not only to quantitative restrictions but also to other forms of protection. With respect to safeguard actions for development, the agreement broadens the purposes for which such restrictive trade measures may be taken. They are no longer limited to the protection of particular infant industries but are also sanctioned for broader development purposes.

Administration of GATT and the codes

Refined principles and new rules can have a significant impact on the world trading system only if fair and effective procedures exist for applying them.

The framework agreement regularizes and strengthens the procedures for notification of trade measures, consultation among interested parties, and the conciliation and resolution of disputes. Detailed provisions apply to the establishment, composition, and functions of panels to examine complaints and to the follow-up and surveillance of actions of signatories in the light of panel findings and recommendations.

This strengthened framework of procedures is particularly important for developing countries, since it institutionalizes a mechanism for affording better protection for the interest of countries with weak bargaining power.

Enabling clause and graduation

For many years developing countries had pressed for the legal right to exceptions from the two basic GATT principles of non-discrimination and reciprocity. Until the Tokyo Round, exceptions from the non-discrimination
rules, whether in the form of preferences for developing countries under GSP or preferences among developing countries, could only be adopted by ad hoc waivers of the non-discrimination rule. The new agreement establishes for the first time a legal basis for both types of preferences.

An exception for developing countries from the principle of reciprocity in trade negotiations has already been included in Part IV, the "Trade and Development" section of GATT, adopted in 1965. The new "enabling clause" reaffirms and strengthens the commitment of developed countries not to seek concessions inconsistent with the needs of developing countries in trade negotiations.

Taken together, the provisions on preferences and non-reciprocity are regarded by developing countries as reflecting a more equitable trading relation between rich and poor countries because they remove the anomaly of "equal rights and obligations among unequals."

As a counterbalance to this legitimization of "special and differential treatment" for developing countries, the industrial countries insisted on inclusion of the principle of graduation. In response, therefore, to the changing "development, financial, and trade needs of developing countries," the special dispensations granted to them in both the codes and the framework agreement would be gradually withdrawn. In addition, the developing countries would be expected ultimately to graduate by participating "more fully in the framework of rights and obligations of GATT" as warranted by their economic progress. No specific provisions were spelled out, however, for implementing the graduation principle.
Overall Implication for Developing Countries

The MTN results were greeted with keen disappointment by the developing countries. Although a number of developing countries have signed individual codes (e.g., Argentina, Brazil, India), none has formally subscribed to the full results of the MTN (as of December 12, 1980).

Fundamentally, the objections of the developing countries have been of two kinds. First, it was felt that issues of vital interest to the developing countries were not resolved in the MTN. No liberalization of existing quantitative restrictions (QRs) was achieved nor were any limitations placed on such increasingly common measures as voluntary export restraints (VERs) and orderly marketing agreements that have effects similar to those of QRs. Closely related to these deficiencies was the failure of efforts to negotiate a "safeguard code" that would define with greater precision the conditions and procedures for restrictive "escape clause" action in the case of market disruption.

Although it is true that progress was not achieved in these two areas, this failure reflects a limitation in the scope of the MTN agreements rather than a deficiency in the results on subjects on which agreement was in fact achieved. At the same time that the positive results of the MTN are consolidated, an international effort must be mounted to liberalize QRs in their various forms and to develop an acceptable safeguard code.

The second objection of the developing countries is that the special and differential treatment, which is an essential feature of the "new international economic order" in trade policy, has been compromised in all three aspects of the MTN. With respect to tariffs, it is claimed that the gains from lower MFN duties on non-GSP products are more than offset by the loss of margins of preference under GSP. With respect to the codes, it is argued that
the special provisions pertaining to developing countries do not go far enough and are only permissive rather than binding in nature. And with respect to the framework agreement, the introduction of the graduation principle is seen as the leading edge in a process of arbitrarily discriminating among developing countries and depriving them of rights that they now legitimately enjoy.

Without going into the technical details of this second group of complaints, a few comments are in order. As explained earlier, the trade creation benefits to developing countries from lower MFN tariffs should exceed the trade diversion losses from the reduction in the margins of preference on manufactures subject to GSP. Moreover, developing countries will enjoy the present and potential benefits of the MFN tariff reductions without, for the most part, having reciprocated themselves. As for the criticism that the codes do not go far enough in according differential treatment, they all include in one way or another recognition of the special problems of the developing countries, and in the important case of subsidies developing countries are relieved of the outright prohibition of export subsidies on non-agricultural products.

Insofar as graduation is concerned, we believe the introduction of this principle to be a wholesome development. If special and differential treatment were applied indiscriminately and indefinitely to all developing countries regardless of their state of development and international competitiveness, it would in the long run have adverse effects on both developed and developing countries. As explained in greater detail elsewhere, "By creating a permanent two-tier trading system, it would undermine ... efforts to strengthen international discipline over national trade policies and to foster
the kind of open markets in which all countries, and especially those in the
developing world, have a major stake." 1/

To the extent that developing countries disassociate themselves from
the results of the Tokyo Round because of their preoccupation with preserving
and enlarging preferential treatment, we believe they are not serving their
own interests. Preferences are of secondary importance for developing countries.
As comparative advantage in many industries shifts in their favor, their
overriding need is for a system that encourages and preserves open markets and
imposes an international discipline weighted against the mounting protectionist
pressures of the present world economic environment.

In this respect the newly negotiated codes fell short in failing to
deal with the problems of informal restrictions and safeguards. They are but
the beginning of a bare framework of improved constraints against non-tariff
obstacles to trade. Only through their further development and application in
practice will a system of precedent and common law evolve that can be truly
effective in discouraging and preventing restrictive trade measures. It is in
the interest of developing countries to sign the codes so that they can play
their full part in influencing and shaping the evolution of the new inter-
national discipline.

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1/ Isaiah Frank, The "Graduation" Issue in Trade Policy toward LDCs,
III. Unfinished Business of the MTN: Safeguards, Quantitative Restrictions (QRs), and Voluntary Export Restraints (VERs)

The major piece of scheduled business that could not be concluded in the Tokyo Round was the negotiation of a safeguard code defining protective measures to deal with serious injury to domestic producers from import competition. Because such measures have increasingly taken the form of QRs rather than tariffs, and because the QRs have increasingly been in the form of VERs rather than formal import quotas, it is appropriate to consider together the subjects of safeguards, QRs, and VERs.

It is fair to say that no other subject in the field of trade policy is of greater importance to developing countries than the establishment of a more effective international discipline over safeguard measures. With an increasing number of developing countries demonstrating their ability to attract capital, master modern industrial techniques, and aggressively sell manufactures in world markets, competitive pressure is being felt in many economic sectors of the industrial countries. Adjustment to these heightened pressures through the shift of resources to more productive sectors is rarely painless, but it is particularly difficult in the slow overall growth environment of the 1980s. Domestic political pressure for protectionist measures is therefore stronger than ever. An effective, internationally agreed safeguard code would make it easier for politicians to resist these pressures and to limit the extent and duration of the protective measures when they must be applied.

The failure to negotiate a safeguard code in the MTN was due primarily to differences over the "selectivity" issue -- i.e., whether and under what circumstances the code should allow discriminatory restrictions against particular countries whose exports were regarded as the source of the
injury to producers in the importing country. Since VERs are by their nature restraints applying to particular exporting countries, the resolution of the selectivity issue has important implications for this rapidly growing form of QR.

**The Present Safeguard System**

The existing international rule on safeguards is contained in Article XIX of GATT, the so-called "escape clause." It permits GATT countries to impose import restrictions in the case of serious injury (or the threat thereof) to domestic producers despite any GATT obligations to the contrary. Countries imposing restrictions under Article XIX are generally required to give prior notification to and consult with affected parties, must apply the restrictions on a non-discriminatory basis, and are subject to retaliatory action by any adversely affected exporter in the form of the withdrawal of equivalent concessions.

**Quotas vs. tariffs**

To the extent that countries have formally invoked Article XIX, they have done so increasingly through QRs. As shown in the following tabulation, 1/ not only has the number of quantitative restrictions increased in successive decades since 1949, but their proportion of total safeguard actions rose from 19 to 65 percent:

<table>
<thead>
<tr>
<th>Year</th>
<th>Tariff Measures</th>
<th>QRs</th>
<th>Total</th>
<th>Percentage of QRs to Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1949-58</td>
<td>13</td>
<td>3</td>
<td>16</td>
<td>19</td>
</tr>
<tr>
<td>1959-68</td>
<td>20</td>
<td>16</td>
<td>36</td>
<td>44</td>
</tr>
<tr>
<td>1969-78</td>
<td>15</td>
<td>28</td>
<td>43</td>
<td>65</td>
</tr>
<tr>
<td>Totals</td>
<td>48</td>
<td>47</td>
<td>95</td>
<td></td>
</tr>
</tbody>
</table>

The main reason for the preference for QRs over tariffs is the greater certainty in the former's protective effects. Quotas can be relied on to limit imports to predetermined amounts. Under given conditions it is always theoretically possible to specify a rate of duty that will reduce imports to exactly the same extent as any given quota. Because conditions in the real world change, however, the precise effects of the tariff on the volume of imports cannot in practice be anticipated. The increased costs of imported goods that is a result of the tariff may be offset by decreased foreign costs that are a result of improved productivity abroad, the willingness of exporters to reduce their profit margins, or depreciation of the exporter's currency. Especially under a system of flexible exchange rates, 1/ the greater predictability of imports restricted by quotas makes them a preferred device for producers seeking to protect their home market. 2/ Quotas are also preferred by producers because under conditions of increasing demand their protective effect will grow over time.

**Informal restrictive measures**

Actually, the extent of resort to one or another form of QR has been far more extensive than shown in the tabulations above, which reflects only formal actions taken under Article XIX of GATT. Because of the stringent requirement of non-discrimination and the exposure to retaliatory measures, countries have circumvented Article XIX by applying informal QRs either

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2/ The obverse of this point is that governments granting protection in the form of quotas rather than tariffs can never be certain as to the degree of implicit subsidy accorded to domestic producers.
through administrative action by the importing country or by inducing the exporting country to enter into an orderly marketing agreement (OMA) or to undertake VERs.

What these two types of measures have in common is that they almost always occur as a response to a perceived threat (explicit or tacit) of unilateral restrictions by the importing country. The essential difference between them is that in VERs the control is exclusively on the export side; in OMAs, even though the controls are typically administered by the exporting country, they are backed up by the formal authority of the importing country to impose controls if the export restraints are regarded as insufficiently effective. Another difference is the public nature of the two: OMAs require written agreement, VERs do not.

In the OMA category, for example, are included export restraints negotiated by the United States within the framework of the international textile agreements. The entire arrangement comes under Section 204 of the Agricultural Adjustment Act (as amended in 1956), which authorizes U.S. import quotas once a multilateral arrangement exists under which a substantial volume of world trade is covered by VERs. Similar provisions have been included in U.S. general trade legislation enacted subsequently. Despite the technical distinction based on whether formal backup authority to impose quotas exists, OMAs may be treated interchangeably with VERs because the latter are typically the instrument through which OMAs are carried out.

Advantages for importing countries. From the standpoint of those seeking protection, these informal measures have important advantages. They are often applied without necessity of going through legislatively mandated procedures in which interested parties, including importers and consumers as well as producers, are given an opportunity to express their views. Without
such mandatory procedures, countervailing pressures are difficult to exert, and producer interest tends to be decisive.

Informal measures can also avoid the GATT requirement that restrictions be imposed on a non-discriminatory basis. By applying the restriction only to particular exporting countries deemed to be the main sources of market disruption, the importing country can reduce the likelihood of retaliation, especially when the exporting country is a developing countries with a small internal market and, hence, weak bargaining power in trade matters.

Advantages for exporting countries. For a variety of reasons, exporting countries have tended to acquiesce in discriminatory VERs rather than to insist that importing countries formally invoke Article XIX and apply restrictions on a non-discriminatory basis. One advantage to the exporting country subject to restraint is that VERs are generally the product of negotiation with the importing country and therefore tend to be more flexible than the alternative of QRs on imports. Under VERs the exporter is likely to be able to exert a greater influence over such technical but often highly significant aspects of the restrictions as the width of the product categories (the narrower, the more restrictive), the right to shift among categories, and carryovers into succeeding years.

Another mitigating feature from the standpoint of exporting countries is that VERs seldom apply to all supplying countries. Individual exporters in countries subject to restraint may therefore be able to transship through non-restraining countries. Transshipment, which may be technically difficult to prevent, could not arise if the restrictions took the form of global import quotas. The other side of the coin, however, is that the selectivity of
export restraints by country affords scope for smaller supplying countries, not subject to restraint, to expand their exports independently and preempt markets of the country under restraint. And if such countries expect that their exports will also be forced under restraint, they may be moved to stimulate additional output and exports in order to establish a high historical base for future restraints.

Finally, suppliers in a country adopting VERs may see a hidden benefit in this method of restraint as compared with the alternatives of tariffs or import quotas contemplated in Article XIX. When imports are restricted, by whatever method, a wedge is driven between the foreign price of the product and the price in the importing country. In the case of a tariff, the extra consumer expenditure on any given volume of imports accrues to the government of the importing country in the form of tariff revenues. Who will capture this premium in the case of a quota depends on the method of administering the quota and the market structure in the importing and exporting country.

If import quotas are established, the government could, as in the case of tariffs, capture the windfall by auctioning the quotas to domestic importers. In both cases the proceeds would presumably be spent by the government in a manner that returns some of the benefits to consumers. If, however, the government allocates the quotas to importers, and the importer is free to choose his source of supply among many competing exporters, he should be able to appropriate much of the windfall -- how much depends on the degree of concentration on the import side. But if the quotas are allocated to exporting countries or if they take the form of VERs, the exporting countries (either their governments or producers) will be in a good position to capture the scarcity premiums. Where many potential suppliers exist in an exporting
country, their ability to capture the windfall has in practice been enhanced through suballocation of the export quota among the individual suppliers either by the government or by a trade association designated by the government to perform this function. 1/

In short, as an alternative to formal import quotas, VERs have attractions for both the importing and exporting country that have resulted in widespread use of this restrictive technique. How widespread is difficult to say, since such informal measures are generally neither reported nor published in any systematic way. Moreover, they are sometimes the result not of government-to-government negotiation but of arrangements privately worked out between industry groups in the two countries. It is essential, therefore, to make all such restrictions subject to full disclosure, international scrutiny, and control in the framework of a new safeguard code.

A New Safeguard Code

The objective of a new safeguard code is to win national adherence to and serious observance of a strengthened set of international rules and procedures to limit the use of trade restrictions in cases of "market disruption." The safeguard issue is not addressed to the problem of countering disruption due to "unfair" trade practices such as dumping or export subsidization; separate and carefully crafted codes already exist for these purposes. Rather, it is in principle addressed to the disruptive consequences of the kinds of shifts in comparative advantage that are inherent in an expanding world economy.

1/ A by-product of the use of trade associations to divide up export quotas has been the encouragement of the formation of foreign cartels.
There is reason to believe that changes in comparative advantage may be occurring more abruptly than in the past and hence may be more disruptive. Among the causes are the high degree of international mobility of capital and technology today and the increased effectiveness of transnational corporations and consulting firms in facilitating the worldwide deployment of these resources and management and marketing capabilities. The rapid growth in the exports of manufactures from the newly industrialized countries is testimony to the ability of many developing countries that have advanced beyond a certain threshold to absorb modern technology quickly and to combine it with their comparatively abundant labor resources in order to become effective competitors on world markets for relatively labor-intensive goods.

Main elements

Although the participants in the Tokyo Round could not agree on a safeguard code, there was a broad consensus of what some of the main elements of such a code should be. It should ensure:

- That restrictive measures are limited in scope and duration to what is necessary to prevent serious injury
- That such measures are not used as a substitute for structural adjustment to changes in comparative advantage
- That resort to such measures should be subject to an improved international discipline that should include a more precise specification for the determination of "serious injury" and more explicit procedures for taking safeguard action.

As a means of restraining restrictive action, the detailed and technical procedures suggested by the GATT Secretariat are at least as important as the substantive provisions. Their purpose is to alert in
advance foreign and domestic interests that may be adversely affected by the restriction and that might be in a position to exert countervailing pressures on the authorities in the importing country. Interested parties would be afforded the opportunity to present their views and to submit relevant evidence in public hearings or otherwise. In addition, prior notification of the proposed action to the collectivity of GATT would normally be required, and this would include the opportunity for affected exporting countries to consult.

**The selectivity issue**

As indicated above, the central issue in recent efforts to negotiate a safeguard code has been the discrimination question. A number of governments, and particularly the EEC, have insisted that the code permit restrictions against selected countries considered to be the principal source of disruptive imports rather than against all countries non-discriminatively. The developing countries have strongly opposed selectivity. They fear that it would reduce a major constraint on "escape clause" measures, making it easier for the stronger countries to impose unjustified restrictions against the weaker without risk of the sort of significant retaliation that might occur if the restriction had to be extended to other industrial countries.

The developing countries face a dilemma. Without a new safeguard code, many countries would continue to impose restrictions selectively, but they would do so outside the framework of present GATT requirements through VERs and other informal measures. With a new safeguard code acceptable to the EEC, however, the principle of discrimination, with its dangers for countries with weak bargaining power, would be legitimized. How to escape this dilemma?
Efforts to resolve the problem have consisted of the specification of more stringent substantive and procedural requirements for cases where an importing country proposes to apply restrictions selectively. The substantive provisions would relate to the size and abruptness of the increase in imports and its share of domestic consumption and of total imports. The procedural provisions would require either the prior agreement of the exporting country or, failing that, the authorization of a committee of signatories to the safeguard code.

Unfortunately, little progress has been made in resolving this issue. The countries seeking to include the right to impose trade restrictions selectively are not willing to make that right subject to any kind of prior approval. Because it is of critical importance to conclude a code that brings safeguard measures under more effective international scrutiny and control, we suggest a new approach to break the deadlock.

A way out

A new approach would permit selective safeguard measures to be taken without prior approval but subject to ex post review. The review, which would be conducted by a GATT committee of signatories to the safeguard code, would assess the conformity of the action with the regular procedural requirements and substantive conditions specified in the code, and a public report would be made by the committee. Although ex post review may be a second-best solution, it can serve internationally as a potent restraint on unjustified measures by bringing them to the light of day and mobilizing against them the moral force of collective opinion.

We repeat that, as part of an agreement of a safeguard code, all existing quantitative safeguard measures (including VERs and OMAs) adopted
outside the GATT framework should be reported to that body. A transition period should be established during which such measures would have to be brought into conformity with the provisions of the new code.

IV. Other Issues

Among the many other trade policy issues affecting developing countries in the 1980s, four in particular require a fresh look: industrial policy and national adjustment measures, fair labor standards, trade among developing countries, and trade in services. The purpose of briefly discussing each of these issues is primarily to expose the nature of the problems rather than to prescribe solutions.

Industrial Policy and Adjustment

Concern with industrial policy has been stimulated by two major developments in advanced industrial countries: the declining rate of productivity growth in their economies as a whole and the loss of international competitiveness in particular major sectors of domestic industry. Although the term "industrial policy" is often used but rarely defined, we mean by that term government measures, whether of a general or sectoral nature, intended specifically to improve the long-term performance of the domestic economy in relation to national goals.

Nature of industrial policy

Industrial policies thus defined can be distinguished from macro policies primarily addressing the problems of inflation and unemployment. These problems are generally conceived in shorter-run or cyclical terms, and policies to counter them have traditionally emphasized demand management through monetary and fiscal instruments. Although there clearly are important
interrelations between the problems of productivity and competitiveness on the one hand and inflation and unemployment on the other, it is useful to think of industrial policy as measures mainly concerned, directly or indirectly, with the former set of problems and with the longer-term perspective.

Another way of putting this distinction is that macro policy is primarily concerned with the level of utilization of a country's resources, while industrial policy is mainly concerned with the efficiency with which resources are used.

When we refer to the efficiency or productivity of a nation's economy, it is important to distinguish two aspects. One concerns the question of how output per unit of labor or per unit of total inputs is changing over time within particular industries or sectors. The other aspect of efficiency is the extent to which the deployment of a country's resources among industries is shifting from lower to higher-productivity sectors. A change in a country's productivity trend is a function of both sets of conditions. It is possible, for example, for a nation's productivity to improve in every individual sector, but for the trend in productivity for the economy as a whole to decline as a consequence of shifts in the sectoral composition of output.

Trade and industrial policy

Industrial policy is addressed to improving the performance of the economy in both senses. It is concerned with increasing the efficiency of individual sectors of the economy through sectoral or general measures (e.g., tax incentives) to stimulate investment in new plant and equipment and to promote innovation through research and development. In addition, industrial policy is concerned with measures (e.g., anti-trust, trade
liberalization) to promote the competitiveness of the domestic economy and to encourage the shift of labor and other resources from lower- to higher-productivity sectors.

It is this latter aspect of industrial policy to which trade policy is more directly related. The essential purpose of trade is to enable a country to optimize the deployment of its resources by specializing in those sectors in which it enjoys a comparative advantage in relation to its foreign trading partners. Like technological innovation, therefore, trade liberalization brings about an increase in a country's output from given resources. It accomplishes this result not only through greater specialization but also through the increase in competition and economies of scale made possible by the enlarged opportunity to trade.

Trade liberalization and industrial policy can be mutually supportive approaches to improving a nation's economic performance so long as the instruments of industrial policy are of a general or comprehensive nature. When industrial policies are industry specific, however, they can give rise to two related types of trade policy problems.

Problems

The first problem arises in the case of a "pick-the-winners" strategy of industrial development. A common example is the policy of a number of industrial countries to promote particular high-technology sectors through various forms of government support and subsidy—including such measures as priority in government procurement, concessionary credit, or even outright grants. Clearly, policies of this sort can distort international trade, artificially restricting imports and promoting exports, just as surely as more overt and conventional trade measures.
An effort was made in the Tokyo Round to come to grips with this type of problem. The new code on subsidies recognizes, on the one hand, that domestic government intervention in support of particular industries often reflects fundamental social and political as well as economic factors and therefore should not be proscribed. On the other hand, the code also recognizes that such domestic subsidies can also cause injury to a country’s trading partners nullify their benefits under the agreement, or prejudice their trade interests. To deal with such cases, a procedure of consultation and conciliation is established, and as a last resort countervailing duties may be applied. Whether these provisions are at the same time sufficiently flexible and restraining to be effective in reducing distortions and resolving tensions arising from a "pick-the-winners" industrial strategy remains to be seen.

The second type of issue arising from sectoral industrial policies concerns the other end of the spectrum; i.e., older industries whose future may be in doubt as a consequence of shifts in international competitiveness. In these cases government assistance may take the form of import restrictions (already discussed in section III) or so-called "trade adjustment assistance." Adjustment assistance may consist of temporary compensation to workers who lose their jobs as a result of import competition; various forms of financial and other assistance to improve the efficiency of existing firms and render them more capable of competing with imports; and assistance, such as retraining and relocation allowances, to facilitate the shift of resources to other industries with brighter economic prospects.
Adjustment assistance

The idea of temporary adjustment assistance as an alternative to protection is an attractive one. However, recent experience, particularly in the case of the massive resort to trade adjustment assistance in the U.S. auto industry, has underlined several serious problems.

For one thing, it is often not feasible to differentiate workers whose jobs are lost because of import competition from those laid off for other reasons. In the case of the U.S. auto industry, for example, the coincidence of the decline in the sales of domestic vehicles with a deep recession in the U.S. economy as a whole casts doubt on whether imports have constituted a substantial cause of the job loss. Because of the understandable tendency to give unemployed workers the benefit of the doubt, however, the number of beneficiaries and the costs of U.S. trade adjustment assistance have far exceeded what was contemplated at the time the program was initiated. Moreover, workers outside industries directly affected by imports, but who supply inputs of good and services to the directly affected industries, are claiming discrimination in the absence of provision for the extension of trade adjustment assistance to them.

A second problem is that adjustment assistance sufficiently generous to reduce protectionist pressures tends to be so large as to weaken drastically the incentives for seeking alternative employment. A 1978 study by the U.S. General Accounting Office showed, for example, that only 4 percent of people receiving trade adjustment assistance applied for government retraining programs. 1/ To the extent that these programs in practice consist overwhelmingly of compensation and only to a minor extent of retraining and

relocation, any reduction of protectionist pressures is likely to prove short-lived. As temporary financial compensation runs out, the demand for import restrictions is bound to intensify.

A more fundamental issue underlies the present approach to adjustment assistance. Virtually all efforts to quantify temporary employment losses due to import competition and to compare them with losses due to other causes, such as cyclical economic contraction or technological change, come to the conclusion that the employment effects of trade are small compared to those arising from other causes. A nation's economic growth at any given time is inherently an uneven process in which some firms and industries grow rapidly, others grow slowly, some remain stagnant, and still others decline. This dynamic process implies a constant shift of workers and other resources from declining industries to those higher up on the growth curve. It is surely appropriate for governments to ease this shift of resources on the grounds of both equity and efficiency. But it is not clear why such programs should be provided mainly or exclusively for trade-related employment problems.

One argument for special trade adjustment assistance rests on the allegedly greater disruptiveness of job displacement caused by imports than that of unemployment due to other causes. But it is precisely in the case of market disruption due to a sudden surge of imports that the possibility of temporary safeguard measures in the form of import restrictions already exists. No analogous government measures are generally available for temporarily slowing the pace of other forces causing job displacement, such as the introduction of robots on an assembly line.

Another argument sometimes advanced for special trade adjustment assistance is that it is a means of countering protectionist forces and inducing
support for liberal trade policies. Experience in the United States and other countries, however, does not lend credence to this thesis. Trade unions and traditionally protectionist industries have not noticeably moderated their positions because of the existence of special adjustment assistance for trade-affected industries.

**A new approach**

There is much to be said for a basic review of the premises underlying existing trade adjustment programs and of the manner of their operation. In such a review serious consideration should be given, on the one hand, to the possible desirability of broadening the availability of adjustment assistance to facilitate structural change regardless of cause, and, on the other, to concentrating the emphasis in adjustment programs on retraining and location of labor 1/ and on conversion of plant facilities to new lines of production. One consequence of such a shift would be to encourage a public perception of trade-induced alterations of industrial structure as part of the normal ongoing process of growth and change in a dynamic economy.

**Fair Labor Standards**

In some developed countries, notably the United States and the Scandinavian nations, there is considerable sentiment for using or threatening restrictions against imports from countries allegedly guilty of "unfair" labor practices. To this end, sporadic efforts have been made to introduce a "social clause" into the GATT. Such restrictions are often defended as a means of pressuring employers and governments in the developing countries to

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1/ Important considerations in encouraging retraining and relocation are the portability of health and pension benefits and the treatment of seniority rights.
adopt more humane and equitable labor laws and practices. It is argued, therefore, that the restrictions are in the interest of the workers in the developing countries. Few would argue in favor of "exploiting" labor, and few would deny that there are instances in which laborers are working under indecent conditions and being paid less than the marginal value of their inputs.

**Protectionism in disguise**

The policies of the developed countries in this area are of great significance to the developing countries because "fair labor standards" are a made-to-order vehicle for sheer protectionism. The tendency for both capital and labor in the industrialized countries to regard anything inferior to local conditions as "unfair" is great. But there is a huge gap between what are socially and economically defensible "fair" labor standards (hours, wages, physical conditions of work, etc.) in a rich industrialized country with its resource of technology, skills, capital, and infrastructure, and those that can be supported in a developing country that may be making the most efficient use of its resources and paying labor the marginal value of its product.

Indeed, the pursuit of "fair" labor standards around the world could all too easily strike at the very heart of the reason for trade: comparative cost differences. To insist as a condition for trade that labor in all countries must receive anything like the same compensation for the same effort and must enjoy comparable conditions of work would effectively stop most if not all exports from countries producing at lower levels of technology and having less human and physical capital per worker than other countries. This would constitute a clear disaster for most developing countries.
The drive in the developed countries for using trade policy measures to impose or enforce fair labor standards on low-income countries gains momentum in periods of slow growth. It would therefore be prudent to anticipate efforts in this direction in the decade ahead and to turn those efforts to constructive purposes.

Policy implications

The International Labour Organisation (ILO) has long been concerned with encouraging countries to adopt fair labor standards by adhering to internationally-negotiated conventions on different aspects of this subject. Such conventions cover a wide range of labor conditions including such diverse matters as equal pay for men and women, safety conditions, and protection of the right to organize. In designing fair labor standards the ILO has become sensitive to the need to make them sufficiently flexible to accommodate the conditions of countries with widely divergent social structures and degrees of economic development. The ultimate purpose of this international program to improve the conditions of work worldwide is to ensure "that everyone shares in the fruits of economic progress." 1/ In line with the World Bank's new emphasis on basic human needs, social equity, and improved income distribution, the Bank may be able to make an important contribution to improving the conditions of work in developing countries while at the same time helping to deflect protectionist pressures based on "fair labor standard" arguments. In conjunction with its advisory functions and its lending operations, the Bank should in principle be in a position to

exert direct influence on labor standards in developing countries and also to encourage adherence to those ILO conventions that are appropriate to the state of development of particular developing countries.

Trade among Developing Countries

Special interest in the expansion of trade among developing countries has been stimulated in recent years by the revival of the "export pessimism" that marked the period of the 1950s and early 1960s. 1/

Background of export pessimism

The pessimism of the earlier period derived from several factors. Exports from developing countries were overwhelmingly concentrated in primary materials for which the long-run outlook was regarded as discouraging because of the low income elasticities of demand in the industrial countries. Moreover, processed primary products encountered major barriers in developed country markets because of the high degree of effective protection of the processing activity implied by even moderate rates of duty on the processed products. As for manufactured products, it was believed that newly developing countries were simply not in a position to compete on their own with established manufacturers in the industrial countries. And in those cases where developing country manufacturing was carried on in affiliates of or through licensing by transnational firms, the right to export was often restricted.

1/ Helen Hughes, "Inter-Developing Country Trade and Employment," IEA Sixth World Congress, Mexico City, 4-9 August, 1980, forthcoming.
Reaction in the developing countries to the export pessimism of the 1950s and 1960s took various forms. Inward-looking development strategies based on national import substitution were widely adopted, and this often involved complex forms and extreme degrees of protection. When the limitations of this approach became apparent, especially in small national markets that quickly became saturated, efforts were made to organize economic groupings within which more rational import substitution could be pursued on a broader regional scale. In addition, steps were taken to organize inter-regional preferential arrangements among limited numbers of developing countries. The various efforts were sometimes regarded as part of a broader policy of "collective self-reliance" through the "delinking" of developing countries from excessive dependence on what were perceived as the limited and unreliable markets and resources of the industrial countries.

The export pessimism of the 1950s and early 1960s was undermined by the reality of rapid expansion of developing countries: exports of manufactured products to the industrial countries in the late 1960s and early 1970s. By the mid-1970s substantial liberalization was occurring in the foreign trade regimes of a number of middle-income developing countries. In recent years, however, the spectre of stagnating export markets has again been raised in response to slow growth, high unemployment, and the fear of protectionist reactions in the industrial countries. The sluggishness of the developed world economies has been sustained by tight fiscal and monetary policies applied in efforts to deal with strong inflationary pressures intensified by successive oil shocks.

**Prospects**

It is difficult to predict how developing country exports to the industrial countries will fare under the less favorable conditions generally
projected for the 1980s. A hopeful sign is the limited extent to which new protectionist measures have in fact been adopted against the products of developing countries, an effect partly reflecting an increasing appreciation of the role of open markets in combatting inflation. Moreover, the extent of market penetration by developing countries is still very low in a wide range of potential exports, and this affords scope for rapid export expansion even under conditions of slow growth in total demand in the industrial countries.

Regardless of trends in North-South trade, however, it would be desirable and prudent to expand trade among developing countries, not as a substitute for but as a compliment to trade with the industrial countries. From this perspective it becomes unnecessary to resolve the controversy as to the relative superiority of the one over the other. One view is that North-South trade is preferable because it can be shown to be less capital intensive and therefore more employment creating than South-South trade. The opposing view stresses the special dynamic, learning, and competitive benefits that are believed to characterize trade among developing countries. Although the latter view may be taken to imply a greater readiness to accept trade-diverting as opposed to trade-creating approaches to the expansion of South-South trade, this issue is likely to be decided on the basis of more practical considerations.

Since the early 1960s trade among developing countries in manufactures (exclusive of trade with capital-surplus oil exporters) has lagged well behind the growth of South-North trade, although the share of trade among developing countries stabilized after 1973. 1/ A number of factors

have contributed to the lag including the orientation of established transport and communication networks toward trade with former colonial powers. But the lack of adequate South-South infrastructure has not prevented very dynamic growth in trade among developing countries in non-fuel primary products. Rather, the principal reason for the lag in trade among developing countries in manufactures since the early 1960s would appear to have been the high levels of protection in most developing countries in the face of generally declining protection in the developed countries over the same period.

Encouraging trade among developing countries

Any program to foster the expansion of trade among developing countries must therefore concentrate in the first instance on liberalizing the import regimes of developing countries, including their high tariffs, QRs, and complex licensing procedures. If such a program is to be adopted, decisions will have to be made whether -- or more correctly, to what extent -- the liberalization should be pursued along tradional MFN lines and preferential approaches adopted.

Straightforward MFN reductions in protection provide long-term benefits through trade creation while avoiding the economic costs and distortions of trade diversion. However, this approach may pose formidable political obstacles because it would seem to imply that some of the reductions would be "paying off past debts" of the developing countries to the developed countries. This follows from the fact that most of the developed countries have greatly reduced their barriers since World War II on a MFN basis and are often said to have relatively little more to give by way of concessions. As a result a developing country government may open itself to the charge that it is not even obtaining reciprocity for its liberalized trading practices when the conventional sentiment in the 1980s is that it is the developing countries themselves who should not be asked to reciprocate.
This political obstacle must not be overstated. The developed countries still maintain some high tariffs and some significant non-tariff barriers to imports from the developing countries. Scope therefore does exist for the former to reciprocate. Moreover, in all recent MTN the developed countries have not only been willing but have often been eager to ease entry into their markets in return for liberalizing action by developing countries.

The other route to fostering trade among developing countries is through trade liberalization on a preferential rather than an MFN basis. Here two broad options are open -- preferential arrangements among a limited group of countries, usually within a defined region, or arrangements open, at least in principle, to all or many developing countries regardless of their geographical location.

**Regional approaches**

Experience with regional arrangements does not provide the basis for high expectations. Often the protected regional grouping is too small in economic terms for efficient specialization on the basis of the regional market along. Within the captive market, products are typically manufactured and processes adopted that are excessively capital and technology intensive in relation to indigenous resource endowments. Although growth in regional trade and output may be rapid during the initial period when regional production and trade are being substituted for imports from outside the region, the economic dynamism comes to an end when the trade diversion is complete, and the pace of regional production is therefore geared solely to the growth of internal GNP. At that point, extra-regional exports of manufactures cannot provide an escape because of the high costs built into the structure of protected regional production.
These problems are the classical difficulties encountered when a national development strategy of import substitution is pursued to excess in the degree and duration of protection. But the tendency to excess may be greater in a regional than in a national setting. The bargaining involved in the negotiation of regional arrangements among individual nations is bound to result in greater rigidities and distortions, since the path of least resistance is to trade off intra-regional trade liberalization for higher protection from outside the region for products of special interest to each member.

Beyond the tendency toward trade diversion and inefficient production structures, regional arrangements tend to be difficult to negotiate and highly unstable once they come into effect. As regional groupings typically involve "wider economic integration" than pure trade liberalization, and often include some regional investment planning, the pace of negotiation and implementation has generally been extremely slow. And when countries at different stages of development are involved, there is the tendency of resources to gravitate toward established poles of growth, and thus to accentuate existing income disparities among member countries. More than any other problem, efforts to ensure an equitable distribution of benefits have often led to great strain in the integration process and in some cases to a breakdown in the arrangements.

Regardless of the precise form of content of regional trade groupings among developing countries, they are inherently divisive in discriminating against outsiders and in setting off one group of developing countries against another. Moreover, they inevitably create vested interests in the margins of protection against outsiders, thereby impeding progress toward further liberalization on a broader basis.
Broader preferential approaches

The alternative method of encouraging trade among developing countries is negotiations aimed strictly at reducing trade barriers among developing countries regardless of location. The earliest is the tripartite agreement among Egypt, Yugoslavia, and India signed in 1968, an arrangement which has had insignificant results. 1/ The only other inter-regional preferential arrangement among developing countries is the GATT preferential trade agreement (GPTA). Because its members account for about 40 percent of total South-South exports of manufactures and because it is open to other developing countries, GPTA can be regarded as the core of a global preferential trade arrangement among all developing countries.

The GPTA dates back to 1971, when sixteen developing countries in Latin America, Asia, and Africa agreed to enter into negotiations on mutual tariff and trade concessions. A recent study of this arrangement 2/ concludes that its effect in expanding trade is mainly confined to trade diversion from the developed market and centrally planned economies. Its trade-creating effects among GPTA members is of the order of about 10 percent of the original trade level.

In analyzing the reasons for the extremely modest results of the GPTA, the author of the study calls attention to the complex and time-consuming


item-by-item negotiating procedure based on the self-selection principle, which affords a wide scope for avoiding concessions that would threaten domestic producers. He concludes that "the reluctance of the members to enforce the liberalization process outweighs the pretension that the GPTA could advance to an effective global preferential trade agreement in semi-manufactures and manufactures between the less developed countries."

**Unilateral liberalization**

Given the enormous obstacles to promoting efficient South-South trade via the preferential route, whether regional or more broadly based, and given the unlikelihood of an early resumption of reciprocal MFN negotiations on a worldwide basis, the remaining option for increasing trade among developing countries is unilateral reduction of protection on the part of the more advanced and more rapidly growing developing countries. With floating exchange rates, the case for reciprocity in trade liberalization to ensure against adverse balance-of-payments effects is no longer compelling. Moreover, unilateral liberalization would respond to the domestic economic realities of the rapidly industrializing countries, enabling them to deploy their resources more efficiently and strengthening and extending their demonstrated capacity to compete in manufactured goods on world markets. Despite the difficulties of overcoming domestic vested interests in protection, several of the newly industrializing countries have begun individually to move in that direction.

Beyond the self-interests of the liberalizing developing countries, this approach holds out two other advantages. First, it is probably the single most important step that can be taken to promote trade among developing countries. Second, it would reduce a source of friction and contribute
to a more stable world trading system by signifying the readiness of the more advanced developing countries progressively to adhere to the rules and obligations applying to more mature trading nations. 1/

Trade in Services

Although trade in services is now a substantial proportion of total trade, it is an area largely neglected in any integrated system of international principles or conventions applying to this trade. References to services were included in the codes on government procurement, product standards, and subsidies negotiated in the Tokyo Round, but the problem was only touched upon, and GATT remains an agreement applying essentially to trade in goods.

Scope and nature of trade in service

As a proportion of merchandise exports in 1977, service exports were 33 percent for the developing countries as compared with 21 percent for the world as a whole. By "service trade" is meant the standard balance-of-payments item denoted as "non-factor services," which excludes workers' remittances and investment income. Among the major categories included are transportation, tourism, insurance, banking, construction and engineering, and consulting services. 2/


Wide variations exist in the importance of individual service categories in the trade of different regions and countries of the developing world. As might be expected, tourism is especially important for Southern Europe, some Latin American countries, and a few in Asia and Africa. Because of the widespread practice of registering ships under "flags of convenience," the commercial fleets of Panama, Liberia, and several others have been growing rapidly. 1/ And for some newly industrializing countries, exports of construction services have become important.

Despite the protectionism and special arrangements found in service trade, the pattern of inter-country specialization appears to accord broadly with the traditional determinants of comparative advantage. A rough classification based on relative factor endowments would be as follows: labor intensive (construction services 2/ and tourism other than passenger transport); capital intensive (freight and passenger transport); and technology and skill intensive (business services such as banking, insurance, consulting, advertising).

Protectionism

The principal issue in trade in services is protectionism. But the protectionism often takes forms different from the familiar tariff and quota restrictions applying to goods because at least part of the service may often have to be performed within the importing country (e.g., engineering or accounting services). The restrictions therefore may be in the form of investment regulations that prevent service companies from establishing local

1/ The shipowners, however, are mostly nationals of the Organisation for Economic Co-operation and Development (OECD) countries.

2/ In some cases, however, payments to foreign construction workers appear in the balance-of-payments data largely as worker remittances rather than as payment for non-factor services.
support facilities, visa and work permit regulations that restrict the entry or employment of essential foreign personnel, or limitations on the repatriation of earnings. It may take a break in established patterns of though to include relevant investment and immigration regulations in a program of trade liberalization, but this would appear to be essential in dealing with protectionism in service trade.

In addition to the foregoing distinction between services produced abroad and those performed locally, a distinction can be drawn between direct restrictions on the importation of services and restrictions on the importation of goods used by service companies — e.g., customs practices restricting the importation of equipment used by construction companies, or discriminatory standards that limit the use of containers of a certain size by shipping companies or airlines.

In general, however, it is fair to say that the range of restrictions that apply to international trade in services defies neat categorization. Some service industries face unique problems. For example, the air transport industry must frequently cope with government monopolies in ground facilities such as catering, ticketing, reservation systems, and cargo and luggage handling. Excess profits earned by ground monopolies may be earmarked to subsidize national air carriers, affording the latter an unfair competitive advantage. The tourist industry is affected by exchange controls as many developing countries and some OECD countries restrict foreign currency allocations for international travel. The motion picture industry is often subject to QRs and discriminatory taxes or subsidies. Maritime and air transport are shot through with anti-competitive practices, many of them
stemming from the activities of the International Air Transport Association (IATA) and government-sanctioned liner conferences about which developing countries have expressed particular dissatisfaction.

**Liberalization efforts**

The United States, with a large surplus in many of the items in the service account, has been taking the lead in espousing a concerted effort to liberalize trade in services in accordance with a legal mandate in the Trade Act of 1974. Other industrial countries have also shown an interest in the subject, though to a much lesser extent. Over the years, the OECD countries have negotiated various instruments among themselves that in one way or another bear on aspects of service trade, including the codes of liberalization of invisible transactions and capital movements. Not all OECD countries have subscribed to these codes, however, and many have done so with specific reservations. At present both the U.S. government and the OECD are embarked on major fact-finding exercises with a view to sorting out the issues in the service trade field before considering options for negotiating.

**The interest of developing countries**

Do the developing countries have an interest in such a broad exercise? With few exceptions, the developing countries are now in substantial deficit on overall service account, although a number of them enjoy a large surplus specifically in the "travel" category (which covers internal expenditures on goods and services by foreign tourist and business travelers). As large net importers of other categories of service, the developing countries have resorted to a wide variety of trade and investment restrictions to reduce their current foreign exchange costs and to encourage the development
of domestic service industries. Under present circumstances, therefore, the
developing countries would have little interest in a worldwide liberalization
exercise that is based on strict reciprocity of market access and probably
entails some obligations in the fields of foreign investment and international
labor migration.

What would appear to be in the long-run interest of the developing
countries, however, would be a negotiation based on the general principle of
reciprocity but with recognition of the right of developing countries to
differential treatment for a limited period. The conditions and duration of
the differential treatment would be subjects for mutual determination. But
participation in such a negotiation would provide the developing countries
with an opportunity to shape the general rules for service trade and to
acquire rights to liberalized treatment for their own service exports which,
with rapidly changing comparative advantage, may turn out to be of greater
importance in the not too distant future.

V. Conclusions

Confronted with steep balance-of-payments deficits, heavy external
debt burdens, and stagnating growth in the industrial countries, most
developing countries face the central question of whether they will be able
to sustain in the 1980s the reasonably satisfactory growth performance they
achieved under the adverse conditions of the 1970s. Although the internal
policies of the developing countries will be fundamental, a major
codeterminant of their prospects will be the extent to which markets in
the industrial countries remain open to their exports. It is of the utmost
importance, therefore, that those international institutions and policies
intended to promote a liberal world trading system be consolidated and strengthened.

The conclusion of the multilateral trade negotiations (MTN) at the end of the decade of the 1970s marked the culmination of several years of effort, not only to liberalize but also to modernize and reform the international trading order in the light of new conditions, especially the enhanced role of national governments in domestic economic affairs. In addition to substantial tariff reductions, the MTN addressed the problems of trade distortions arising from other government measures such as subsidies, technical standards, and public procurement.

For the first time legitimacy was given in the MTN to certain forms of special and differential treatment for developing countries beyond those already included in GATT, such as protection of infant industries and non-reciprocity in trade negotiations. For example, export subsidies were recognized as an integral element in development programs, and trade preferences favoring developing countries were accepted in principle without the need for special GATT waivers of most-favored-nation (MFN) obligations. At the same time, the idea of graduation was incorporated in the agreement to imply that developing countries would be expected, as warranted by their economic progress, gradually to shed their special treatment and participate more fully in the framework of rights and obligations of GATT.

The newly negotiated codes are the only formal international basis for resisting the protectionist pressures bound to intensify under the adverse economic conditions of the 1980s. But they are as yet but a framework. Only through their practical application, with the fullest participation of the developing countries, will a system of precedent and common law evolve that will constitute an effective discipline for an open world trading system.
The principal scheduled business that could not be concluded in the MTN was an improved safeguard code to define acceptable measures for dealing with serious injury to domestic producers caused by import competition. Such measures have increasingly taken the form of quantitative restrictions (QRs) rather than tariffs, and voluntary export restraints (VERs) rather than formal quotas.

The proliferation of informal restrictive measures has been due in large part to the desire of importing countries to avoid domestically mandated procedures and to circumvent the formal international requirements of the GATT "escape clause," especially the non-discrimination condition. But from the standpoint of the exporting countries or of producers within exporting countries, voluntary restraints have certain advantages, including the increased possibility of capturing the windfall representing the difference between the world price of the product and its price in the importing countries.

The greatest obstacle to the negotiation of a new and more effective safeguard has been the discrimination issue. The EEC in particular has insisted on the right to impose restrictions only on imports from selected countries and to do so without prior international approval.

In this issue the developing countries face a dilemma. Without a new safeguard code, restrictions would continue to be imposed selectively, but through informal measures outside the framework of GATT. With a new code acceptable to the EEC, legitimacy would be granted to the principle of discrimination and its dangers for countries with weak bargaining power.

A way out of the dilemma is suggested through a safeguard system that would permit selectivity subject to ex post review by a GATT committee of signatories. As part of such an agreement, all existing QRs and informal safeguard measures would be required, over a transition period, to be brought into conformity with the provisions of the new code.
"Industrial policy," although rarely defined, is widely hailed in advanced countries as an essential element in a new economic strategy. What it seems to comprehend is government measures of a sectoral or general nature intended specifically to improve the long-term productivity and competitiveness of the national economy. In this sense, industrial policy can be distinguished from macro policies, which have a shorter-term perspective and concern primarily the level rather than the efficiency of a nation's resource utilization.

Trade liberalization and industrial policy can be mutually supporting approaches to improving a country's economic performance provided that the instruments of industrial policy are applied across the board. When applied to specific industries, they can give rise to conflict.

One such problem of special concern to developing countries is that of government assistance to older industries whose future may be in question because of changes in international competitiveness. As an alternative to import restrictions, adjustment assistance is an attractive idea. However, recent experience, particularly in the case of the U.S. auto industry, has underlined a number of serious problems. Consideration should therefore be given, on the one hand, to broadening trade adjustment assistance to facilitate structural change regardless of cause and, on the other, to concentrating the emphasis on retraining and relocation rather than on straight compensation of labor.

The idea of "fair labor standards" for developing countries can be an effective cloak for sheer protectionism, particularly in a period of slow growth in the industrial countries. The World Bank may be in a good position to deflect these protectionist pressures while at the same time contributing to improving the conditions of work in developing countries. In
conjunction with its advisory and lending functions, the Bank could exert
direct influence on labor standards in developing countries and encourage
adherence to those ILO conventions that are appropriate to the state of
development of particular countries.

Trade among developing countries is seen by some as an escape
from the poor prospects for North-South trade implied by stagnation and
increased protectionism in the industrial countries. Regardless of prospects
for trade with the North, however, it would be desirable to expand trade
among developing countries, not as a substitute but as a complement to trade
with the industrial countries.

Although many factors have contributed to the lag in trade among
developing countries in manufactures since the early 1960s, the principal
reason has been the high levels of protection in most developing countries in
the face of generally declining barriers in the developed countries. The
major question, therefore, is how best to bring about a liberalization of the
import regimes of developing countries (including their high tariffs, QRs, and
complex licensing procedures).

Alternative liberalization options for trade are considered,
including regional economic integration (such as customs unions and common
markets) as well as less comprehensive preferential trading arrangements not
limited to countries of a particular region. For various reasons the pre-
ferential approaches have not proved in practice to be notably successful.
The conclusion is reached that the best alternative is unilateral reduction of
protection by the more advanced and rapidly growing developing countries. In
addition to being the single most important step to promote trade among
developing countries, such liberalization would contribute to strengthening
the world trading system by signifying the readiness of the most successful of the newly industrializing countries to adhere progressively to the rules and obligations of mature trading nations.

Trade in services is today a substantial proportion of total trade, and for the developing countries the proportion is even higher than for the industrial countries. Yet trade in service is largely excluded from GATT and remains essentially a neglected area in the application of any integrated system of international rules.

Although protectionism is the main issue in service trade, its forms are more wide-ranging than those applying to trade in goods. Defying neat categorization, the restrictions comprehend many types of government regulation of foreign investment and immigration that are not conventionally regarded as trade restrictions.

The United States is now taking the lead to promote a negotiation to liberalize world trade practices in services. Such a negotiation could be based on the principle of reciprocity, but with differential treatment for developing countries for a limited period. Participation by the developing countries would provide them an opportunity to help shape the rules and to acquire rights to liberalized treatment for their own service exports, which may turn out to be of greater importance in the not too distant future.
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