THE EMERGING GLOBAL TRADING ENVIRONMENT
AND DEVELOPING ASIA

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Foreword

The Asian Development Bank Economic Staff Paper Series presents the results of selected preliminary research undertaken by the Economics and Development Resource Center. It is designed to stimulate discussion and critical comment on socioeconomic issues facing the developing countries of Asia and the Pacific. It is hoped that in some small way the discussion generated by the series will increase our understanding of the development process in the region.

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Economics and Development Resource Center
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<td>antidumping</td>
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<td>ADC</td>
<td>Asian developing country</td>
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<td>ADM</td>
<td>antidumping measure</td>
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<td>AFTA</td>
<td>ASEAN Free Trade Area</td>
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<td>AMS</td>
<td>aggregate measure of support</td>
</tr>
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<td>APEC</td>
<td>Asia-Pacific Economic Cooperation</td>
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<tr>
<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
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<tr>
<td>CCCI</td>
<td>cross-country, cross-industry</td>
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<td>CTS</td>
<td>Council for Trade in Services</td>
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<tr>
<td>CU</td>
<td>customs union</td>
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<td>DSB</td>
<td>Dispute Settlement Body</td>
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<td>EAEC</td>
<td>East Asian Economic Caucus</td>
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<tr>
<td>EC</td>
<td>European Community</td>
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<tr>
<td>EU</td>
<td>European Union</td>
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<tr>
<td>FTA</td>
<td>free trade area</td>
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<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
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<td>GDP</td>
<td>gross domestic product</td>
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<td>ILO</td>
<td>International Labour Organisation</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IP</td>
<td>intellectual property</td>
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<tr>
<td>MFA</td>
<td>Multifibre Arrangement</td>
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<td>MFN</td>
<td>most favored nation</td>
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<td>MTN</td>
<td>multilateral trade negotiation</td>
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<td>NAFTA</td>
<td>North American Free Trade Agreement</td>
</tr>
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<td>NIE</td>
<td>newly industrializing economy</td>
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<tr>
<td>PAFTA</td>
<td>Pacific Asia Free Trade Area</td>
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<tr>
<td>PTA</td>
<td>preferential trading arrangement</td>
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<tr>
<td>R&amp;D</td>
<td>research and development</td>
</tr>
<tr>
<td>SAPTA</td>
<td>South Asian Preferential Trading Area</td>
</tr>
<tr>
<td>SGM</td>
<td>safeguard measures</td>
</tr>
<tr>
<td>TAFTA</td>
<td>Trans-American Free Trade Area</td>
</tr>
<tr>
<td>TRIPS</td>
<td>trade-related intellectual property rights</td>
</tr>
<tr>
<td>UPOV</td>
<td>International Convention for the Protection of New Varieties of Plants</td>
</tr>
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<td>UR</td>
<td>Uruguay Round</td>
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<td>VER</td>
<td>voluntary export restraint</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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I. Introduction

The decade of the 1980s saw a dramatic change in attitudes toward trade policies in developing and developed countries. Developing countries came to appreciate the benefits of a liberal trade regime and went on to unilaterally dismantle their trade barriers. At the same time, battered by either a high rate of unemployment or declining wages of unskilled workers or both, developed countries found themselves yielding to protectionist pressures. Voluntary export restraints proliferated and antidumping actions became the order of the day. To top that, abandoning many decades of opposition to regionalism, the United States went on to conclude preferential trading agreements with Canada and Mexico.

Against this background, the successful completion of the Uruguay Round (UR) agreement has a special significance for Asian developing countries (ADCs). Trade is the lifeblood of these economies, and a reaffirmation of the commitment to continued trade liberalization by the membership of the World Trade Organization (WTO), the successor institution to the General Agreement on Tariffs and Trade (GATT), is of utmost importance to them. The agreement will not only help contain protectionist pressures in developed countries through more stringent antidumping and safeguard requirements and an effective dispute settlement undertaking, it will also expand market access for ADCs, particularly in the critical sector of textiles and clothing. Of course, the agreement will also bring new obligations for ADCs. Thus, like other signatories to the UR, they must institute tighter intellectual property rights regimes and phase out trade-distorting subsidies and investment measures. As negotiations for the liberalization of trade in services proceed, they may also have to open their markets in services to foreign suppliers.

While offering new opportunities, the post-UR world also presents major challenges for ADCs. Enthusiasm for regionalism, kindled initially by the European Community’s refusal to start a new GATT round in 1982, has continued to grow. The European Community has concluded a multitude of preferential trading arrangements (PTAs) with its neighbors in Eastern Europe and the former Soviet Union while the United States is contemplating a Western Hemispheric PTA. The formation of these regional blocs can lead to a major diversion of trade from ADCs to bloc members.

Side by side, competitive pressures have strengthened the hands of protectionists in Europe and the United States. This has, in turn, led to demands in those countries for higher environmental and labor standards in developing countries. Proposals have been made for the introduction of trade sanctions against countries which fail to raise their environmental or labor standards. If these proposals are adopted, many ADCs will experience a decline in their access to developed country markets.

Given these challenges and the opportunities offered by the UR, what should be the response strategy of ADCs? To seek an answer to this critical question, the Asian Development Bank has undertaken a multicountry study, funded by its regional technical assistance (RETA) program. The study, entitled "The Emerging Trading Environment: Economic Implications for Developing Member Countries (DMCs)", is being carried out in two phases: the first focusing on a regionwise analysis and the second on an in-depth examination of possible country-specific strategies for ten ADCs.

This paper provides a summary of the results emerging from the first phase of the study (see Appendix). The paper is organized as follows. In Section II, we discuss the critical role international trade has played in stimulating growth in ADCs. In Sections III
and IV, we review the implications of new challenges—expansion of regional arrangements and demands for higher environmental and labor standards—for ADCs. In Section V, we provide a critical assessment of the UR in areas where it is already having an impact. Included in the discussion here are the agreements relating to the Multifibre Arrangement, intellectual property rights, antidumping, safeguards, and dispute settlement understanding. Finally, in Section VI, we focus on areas where the UR agreement will not have a major impact immediately but paves the way for such impact in the future. Thus, we discuss the General Agreement on Trade in Services (GATS) and the agreement on trade in agriculture.

II. Importance of Trade in Asia

There are two aspects of growth in ADCs' trade which deserve special attention. First, since the early 1970s, ADCs have experienced a phenomenal expansion of their exports. Growth rates of their exports have consistently and significantly exceeded those of the world and other developing countries. Beginning with a small share in world trade, today, these countries together have become major players in the world market. Second, as shown in Table 2.1, despite the absence of any significant trade preferences, intraregional trade has grown at a rapid pace. This is, of course, the result of rapid growth in incomes in the region as well as of outward-oriented trade regimes in the countries.

Growth in export volume of the ADCs has on the average been two to three times that of global exports over the last two and a half decades. As a result, the ADCs' share of global exports rose from about 7 percent in the early 1970s to 16 percent in the early 1990s. If Japan is included with the ADCs, the share of Asian exports in global exports over this period increased from about 15 percent to 26 percent. It is also noteworthy that while the global export share of the ADCs has been increasing, the average share of developing countries in world exports has remained more or less constant. If the ADCs are excluded, the other developing countries as a group experienced a sharp decline in their share of global trade. This phenomenon was most pronounced in Latin America, the Middle East, and Africa.1 With global export shares of other developing regions declining, the share of ADC exports in total exports of developing countries more than doubled from about 26 percent in the early 1970s to 56 percent in the early 1990s, and is likely to increase further in the second half of the 1990s assuming current export trends continue.

1 Part of the reason for the declining export shares of Africa, the Middle East, and Latin America is that their average export unit values have dropped continuously since the early 1980s because of the concentration of primary products in their total exports. Since the export composition of Asia is predominantly in manufactured goods, the average export unit value did not drop so sharply. See IMF (1994).
Table 2.1 Key Indicators of Asian Trade and Development

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<tr>
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<tr>
<td>I. GDP Growth (percent)</td>
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</tr>
<tr>
<td>World</td>
<td>3.8</td>
<td>3.1</td>
<td>2.0</td>
</tr>
<tr>
<td>Developing countries</td>
<td>5.2</td>
<td>3.9</td>
<td>5.5</td>
</tr>
<tr>
<td>ADCs</td>
<td>6.8</td>
<td>7.8</td>
<td>7.5</td>
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<tr>
<td>II. Export Growth Volume (percent)</td>
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<tr>
<td>World</td>
<td>5.7</td>
<td>4.3</td>
<td>4.6</td>
</tr>
<tr>
<td>Developing countries</td>
<td>3.5</td>
<td>4.2</td>
<td>8.3</td>
</tr>
<tr>
<td>ADCs</td>
<td>11.1</td>
<td>11.2</td>
<td>13.7</td>
</tr>
<tr>
<td>III. Share of World Exports (percent)</td>
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<tr>
<td>Developing countries</td>
<td>28.5</td>
<td>29.0</td>
<td>28.7</td>
</tr>
<tr>
<td>ADCs</td>
<td>7.3</td>
<td>11.9</td>
<td>16.2</td>
</tr>
<tr>
<td>ADCs &amp; Japan</td>
<td>14.5</td>
<td>21.1</td>
<td>25.6</td>
</tr>
<tr>
<td>Developing Countries (excluding ADCs)</td>
<td>21.2</td>
<td>17.1</td>
<td>12.5</td>
</tr>
<tr>
<td>IV. Share of Developing Country Exports (percent)</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>ADCs</td>
<td>25.7</td>
<td>41.8</td>
<td>56.3</td>
</tr>
</tbody>
</table>


With exports expanding rapidly, the Asian region was able to finance increasingly larger volumes of imports. The ADCs accounted for about 17 percent of global imports over 1990-1994 compared with 7 percent in the early 1970s. If Japan is included, the Asian region as a whole accounted for a little over 23 percent of global imports in 1993. With exports and imports growing more rapidly than gross domestic product (GDP), ADCs have become progressively dependent on foreign trade. In fact, the majority of the ADCs have become increasingly open (i.e., the share of exports and imports as a proportion of GDP has increased in a majority of ADCs). This has been most pronounced in the case of Hong Kong, Singapore, People’s Republic of China (PRC), Malaysia, and Thailand. Among the other ADCs, Republic of Korea (Korea); Taipei, China; and Indonesia have maintained high but stable ratios of exports and imports to GDP. However, despite relatively liberal trade policies, the export orientation of the Philippine economy has not increased perceptibly, with the share of exports in GDP averaging below 20 percent so far in the 1990s. In contrast, the export orientation of the South Asian economies, with the exception of Sri Lanka, has remained low (about 10 percent or less of GDP).

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2 Increased “openness” of the ADCs to foreign trade has been matched by a marked increase of external financial flows (mainly private) to them. ADCs currently account for about 48 percent of total net external inflows to all developing countries. The Asian economies are thus getting progressively integrated into the global economy both in the goods and money markets. See ADB (1995).
The factors underlying the spectacular export performance of the ADCs have been extensively analyzed. In broad terms, ADCs that have achieved high export growth pursued a combination of policies that involved prudent macroeconomic management, low and declining rates of protection to domestic industries, and a competitive exchange rate policy. Furthermore, these economies progressively reduced domestic price distortions and remained open to foreign technology and, in more recent periods, to foreign direct investment. Some of these economies also created an incentive regime that directly favored exports, albeit at some cost in terms of inducing domestic distortions, like subsidized export credit, preferential access to foreign exchange to exporters, and low or zero customs duty on intermediate inputs and capital goods used for export production. Another factor that assisted exports was that these countries created specialized institutions for disseminating information on overseas markets and for facilitating marketing of products abroad.

Impressive growth has also taken place in intraregional trade in Asia. Table 2.2 highlights the main features of Asian trade for selected years over 1980 to 1993. Both intra-Asian exports and imports as a proportion of the region’s total exports and imports, respectively, have risen sharply; however, the larger share of intra-Asian imports compared with intra-Asian exports is merely indicative of the fact that Asia’s exports have risen faster than its imports. The increase in intra-ADC trade (i.e., trade among Asian developing countries) is even more impressive. The proportion of aggregate exports absorbed among the ADCs themselves increased from 22 percent ($35 billion) in 1980 to 35 percent ($225 billion) in 1993. Thus between 1980 and 1993, approximately 39 percent of total incremental ADC exports was absorbed within other developing countries of the region.

<table>
<thead>
<tr>
<th>Table 2.2 Intra-Asian Trade</th>
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<tr>
<td>US$ billion</td>
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<tr>
<td>Intra-Asian exports</td>
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<td>Intra-Asian imports</td>
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<tr>
<td>Total Asia exports</td>
</tr>
<tr>
<td>Total Asia imports</td>
</tr>
<tr>
<td>Percent</td>
</tr>
<tr>
<td>Intra-Asian trade as proportion of total trade</td>
</tr>
</tbody>
</table>

Note: Asia includes ADCs plus Japan.
Source: IMF, Direction of Trade Statistics, various issues.

3 For a recent assessment see World Bank (1993).
4 Some analysts have attempted to decompose the factors underlying Asian export growth by examining i) whether exports of the region increased because they were concentrated in commodities for which world trade grew rapidly; ii) whether Asian exports increased because they were concentrated into countries whose imports have grown relatively rapidly; and iii) whether Asian exports increased because these countries improved their export competitiveness and thereby increased their share of imports in individual commodity markets. Applying the constant market share analysis developed by Leamer and Stern, Lloyd (1994) estimates that for Indonesia, Korea, and PRC, the dominant factor explaining their export growth over 1980-1991 was a rapid increase in market shares abroad caused by an increase in their export competitiveness.
Foreign trade has thus been a central feature of Asia’s economic prosperity over the last three decades. While the newly industrializing economies (NIEs) took the lead in the 1960s in trade liberalization, since the mid-1980s several Southeast Asian economies have also unilaterally liberalized their foreign trade regimes. This trend has spread to South Asian economies in the 1990s. While the Asian economies are therefore poised to play a much greater role in global trade in the foreseeable future, much will, however, depend on the manner in which the global trading environment takes shape over the next decade. The successful conclusion of the UR has removed a considerable amount of uncertainty about transparency and fairness of multilateral trading rules. The ADCs are nevertheless concerned about several unresolved and potentially dangerous developments that could undermine the trade and growth prospects of the ADCs.

III. New Challenges: Regionalism

For four decades following the Second World War, the United States remained firmly committed to multilateralism and was opposed to regionalism. The sole exception to this was the European Economic Community which it supported primarily for geopolitical reasons. Starting with the Geneva Round of GATT in 1947, the United States led the world into a series of multilateral trade negotiations (MTNs) and, by 1979, when the Tokyo Round was concluded, secured agreements to bring down the average level of tariffs in industrial countries from 40 percent to 5 percent.

Three years after the Tokyo Round, at the GATT Ministerial Meeting in November 1982, the United States began efforts to start yet another round of MTNs. But it was unsuccessful in persuading the European Community (EC) and developing countries to undergo such a round. This led Ambassador William Brock to turn to regionalism as an alternative instrument for sustaining the movement for free trade. Brock believed that an ever-expanding set of free trade areas (FTAs) could achieve worldwide free trade.

This switch in tactics, completely justifiable under the circumstances, proved a turning point in the history of regionalism and launched what Jagdish Bhagwati of Columbia University calls the Second Regionalism.\(^3\) Negotiations for the Canada-USA Free Trade Agreement were opened in 1983 and completed in 1988.\(^4\) President Bush, who assumed office in 1988, continued on this path, and the North American Free Trade Agreement (NAFTA) comprising Canada, Mexico, and United States was negotiated during early the 1990s. In June 1991, Bush also announced the Enterprise of Americas Initiative under which he offered to negotiate FTAs with Latin American countries. President Clinton, who succeeded Bush in 1992, first secured the approval of the US Congress for NAFTA in December 1993 and then proceeded to sign FTA agreements with groups of countries in Asia-Pacific and Latin America. On 15 November 1994, at Bogor, Indonesia, he led the 18-member Asia-Pacific Economic Cooperation (APEC) forum into signing an agreement for a FTA by 2020. On 11 December 1994, he brought all countries in the

\(^3\) The First Regionalism was launched with the creation of the European Economic Community.

\(^4\) In the meantime, in 1986, the MTN had been revived with the launching of the UR. Though negotiations were slow and rocky, the UR was completed successfully and ratified by the United States Congress on 1 December 1994.
Western Hemisphere, except Cuba, to Miami to sign an agreement to form a Free Trade Area of the Americas by 2005.

Side by side with these developments, the process of widening and deepening of the EC has been moving ahead. The Community was enlarged from nine members to 12 in 1986 and to 15 in 1994. Simultaneously, plans for the creation of a Single European Market as envisaged in the Maastricht Treaty, signed in December 1991 and approved by all members in 1993, have been progressing steadily. Most recently, Klaus Kinkel of Germany has gone on to propose a Trans-American Free Trade Area.

Pursuit of regionalism in North America and Europe has, in turn, led to a dramatic pursuit of regional pacts around the world. Between 1989 and 1994, the GATT was informed of as many as 33 regional agreements. Within Asia, in 1990, Prime Minister Mahathir of Malaysia announced the formation of the East Asian Economic Grouping which was later recast as the East Asian Economic Caucus (EAEC). In 1992, members of the Association of Southeast Asian Nations (ASEAN) signed an agreement to form the ASEAN Free Trade Area (AFTA) by 2007. In May 1995, South Asian countries announced plans to form a South Asian Preferential Trading Area (SAPTA).  

What are the challenges posed by these developments to Asia? Though the subject of regionalism is vast and complex, we can divide the answer to this question into four areas: (i) static welfare effects, (ii) dynamic time path issues, (iii) impact on Asia, and (iv) Asia's future strategy. Let us consider each of these in detail.

A. Static Welfare Analysis

Trade economists traditionally use the term "regional integration" to refer to discriminatory trade liberalization by a group of countries. But recently, the term has also been used to refer to market-driven integration such as that taking place currently in East Asia. This integration is completely consistent with multilateralism and, as such, noncontroversial. In the following, we will use the terms regional integration and regionalism to refer exclusively to discriminatory liberalization.

A regional arrangement may take the form of a preferential trading arrangement free trade area, customs union (CU), common market, or complete integration. Under a PTA, member countries impose lower tariffs on each other than on outside countries. Under a FTA, which is a special case of a PTA, union members free up trade entirely among themselves but retain their own tariffs on outside countries. A CU is a FTA with a common external tariff across countries but not necessarily across commodities. A common market is a CU with free mobility of factors within the union. Finally, a complete integration scheme allows for harmonization of domestic policies. The best examples of a CU is the EC and the best example of a FTA is NAFTA. However, because agriculture and services are not fully covered, even these arrangements are imperfect examples of the two types of schemes. On

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5 It is important to point out that apart from the European Union, NAFTA, and MERCOSUR (which establishes a customs union among Brazil, Argentina, Paraguay, and Uruguay), few regional arrangements are effective FTAs or customs unions. Even NAFTA is just beginning its implementation. AFTA members have taken a largely unilateral, nondiscriminatory approach to liberalization and as such cannot be characterized as a true preferential trading area.

6 For a relatively up-to-date introduction to the subject, see de Melo and Panagariya (1992). A critical overview of the subject is provided in Bhagwati and Panagariya (1996a).

7 Of course, NAFTA is just beginning to be implemented.
the other hand, EC, now the European Union (EU), goes beyond a CU in that it is also characterized by free mobility of capital, partial mobility of labor, and policy harmonization among members.

To explain the basic welfare economics of preferential trading, Harvard economist Jacob Viner introduces the influential concepts of trade creation and trade diversion. To understand these concepts, suppose that as part of a FTA, Indonesia removes its tariff on video camera recorder (VCR) imports from Singapore but not from the rest of the world. Suppose further that this change leads to an expansion of VCR imports into Indonesia from Singapore. Is this change beneficial or harmful for Indonesia and the customs union? The change is beneficial if the extra imports from Singapore displace previously protected, inefficient Indonesian VCRs and harmful if they displace previously competitive and more efficiently produced VCR imports from the rest of the world. Viner associates the former case with trade creation and the latter with trade diversion. He argues that a PTA or FTA is likely to be beneficial if, on balance, it gives rise to more trade creation than trade diversion.

While recognizing the importance of trade creation and trade diversion for evaluating the impact of a PTA on the customs union as a whole, Arvind Panagariya of the University of Maryland argues that from an individual member country’s viewpoint, it is necessary to take account of the tariff revenue redistribution effect. When a FTA is formed, tariff revenue previously collected on imports from the partner is redistributed at least partially to the latter’s exporters. This redistribution is a loss to the importing member and a gain to the exporting member of the customs union. To explain, consider again the Indonesia-Singapore example. Make the realistic assumption that the customs union is small with respect to the rest of the world. This implies that Singapore’s supply curve is upward sloped while that of the rest of the world is horizontal. Starting with a nondiscriminatory tariff, assume that Indonesia eliminates the tariff on Singapore. As long as this change does not eliminate VCR imports from the rest of the world entirely, the VCR price in Indonesia will remain constant and there is no improvement in Indonesia’s internal efficiency. At the same time, tariff revenue collected previously on imports from Singapore disappears. Indonesia loses from the FTA. By contrast, Singapore benefits because its VCR exporters now require tariff-free access to Indonesia’s protected (from outside countries) market. Tariff revenue collected on imports from Singapore in the pre-FTA equilibrium is transferred to exporters in Singapore in the form of the internal higher price.

Thus, discriminatory liberalization has a mercantilist flavor: It hurts the country undertaking the liberalization and benefits the partner. It follows that, if one or more partners have low tariffs initially—the United States and Canada in NAFTA and Singapore and Malaysia in AFTA—they are likely to benefit from higher tariff preferences received from other members than given to them. This conclusion explains, at least partially, why the promotion of preferential trading within AFTA has been so difficult.

B. Dynamic Time-Path Issue: Regionalism and Multilateralism

While Jacob Viner focuses on static effects of regional arrangements and introduces the concepts of trade creation and trade diversion to analyze them, Bhagwati (1995b) focuses on the so-called dynamic time-path issue and asks whether regional arrangements
are building blocks or stumbling blocks to multilateral free trade.10 From Asia’s viewpoint, this is a crucial issue. For even if the static welfare effect of arrangements such as NAFTA is to divert trade away from it (see below), if they lead to worldwide free trade faster and with greater certainty, the change may be desirable.

Economists are divided, however, on whether regional arrangements will be building or stumbling blocks to multilateral free trade. Jeffrey Frankel of the University of California at Berkeley and Shang-Jin Wei of Harvard University carefully review the arguments on each side (Frankel and Wei 1995). There are four arguments on the “building blocks” side of the debate.

First, if small countries organize themselves into larger groups, multilateral negotiations will have to be among a small number of groups instead of 120 or more individual countries. This will, in turn, make the negotiations more efficient.11 It is important to note here that the argument is valid only if groups are organized into customs unions. Under a FTA, members have their own external tariffs and will have to negotiate individually in multilateral negotiations. Thus, in a future negotiation, NAFTA members will all have to be represented. By contrast, the EC which has a common external tariff, has participated as a single unit in past negotiations.

Second, under certain circumstances, the political leadership in a country may not be able to get support for either unilateral or multilateral liberalization but may be able to do so for liberalization within a regional context. Once regional liberalization has taken place, however, economic incentives may shift so as to produce support for wider liberalization.12

Third, the threat of regional integration may help build momentum for liberalization among groupings. An example offered to support this argument is President Clinton’s “Triple Play” of late 1993. Soon after the approval of NAFTA, Clinton upgraded the APEC meeting of November 1993 into a high-profile Leaders’ Meeting to pressure the EC into negotiating the UR. Because NAFTA approval had already demonstrated the US political will for concluding regional agreements, the upgrading of the APEC meeting signaled to Europeans that if they let the French farmers hold the UR hostage, APEC members would proceed without them. The threat is said to have worked and facilitated the conclusion of the UR.13 The other side of this argument is that the process may not always work out smoothly and the threat may have to be carried out. The outcome may then be regionalization of the world economy.

Finally, progressive expansion of regional groupings may eventually lead to multilateral free trade. For example, suppose we start with a single bloc. Inclusion of new members increases the bloc’s market power and improves its terms of trade. Those that continue to be left out lose out progressively. The bloc continues until it encompasses the whole world, a happy outcome. However, the argument assumes that the bloc places prohibitive tariffs at each stage on outsiders. Similarly, it is also argued that when the bloc reaches a certain size, it may choose not to accept any new members because its own welfare might decline thereafter. The bloc then has an incentive to reject multilateral liberalization. If we start with more than one bloc initially, strategic considerations come into play, and once again, without cooperation, multilateral free trade is unlikely to prevail.

10 A summary of the theoretical literature on this subject can be found in Bhagwati and Panagariya (1996a, 1996b).
12 This argument has been made by Wei and Frankel (1994).
13 Fred Bergsten (1994) and Kahler (1994) make this argument while Bhagwati (1995a) questions it.
On the “stumbling blocks” side of the debate, there are three main arguments. First, a FTA may end up being an instrument of protection rather than liberalization. It can be argued, for instance, that NAFTA extended protection to the US auto industry over the entire North American market. Under a FTA, the rules of origin can also be manipulated to increase protection, as happened in the case of NAFTA (see, for example, Krueger 1993). It is also likely that negotiators will seek to exclude precisely those sectors that will be threatened most by welfare-enhancing trade creation. This has been particularly true of ASEAN negotiations over the years (Wonnacott and Lutz 1989). In the same vein, NAFTA inserted special agreements limiting import surges into the US from Mexico in the important sectors of orange juice and sugar where trade creation was sure to dominate.

Second, at least in a CU setting, blocs have an incentive to raise rather than lower tariffs on outside countries. A larger bloc has more monopoly power than do individual countries in the bloc. Therefore, there need be no presumption that a small number of blocs will facilitate global liberalization (see Krugman 1991, 1993).

Finally, the forces of liberalization may have a better chance of winning out over protectionists if the choice is just between status quo and multilateral free trade. But if the additional choice of regionalism is offered, the political process may take the regional route to the exclusion of multilateral free trade. Businessmen and bureaucrats, after having achieved regional integration, might not find the extra effort for multilateral negotiation worthwhile. The view that “these are our markets” and “we already have free trade in the region” may come to dominate (Bhagwati 1993).

These arguments demonstrate that, in principle, the relationship between regionalism and multilateralism can go either way, and the best one can do is to make an informed judgment. Bhagwati takes the view that there are only two compelling arguments for giving up non-discrimination: (i) a group of countries wants to develop a common market with a common external tariff and free mobility of capital and labor within the union, just as in a federal state; and (ii) the MTN route closes because some countries refuse to negotiate multilaterally and the only feasible path to trade liberalization is open-ended, easy-to-join preferential trading areas among as many nations as can be found.

The first of the arguments formed the basis of the European Common Market. A common external tariff delivers the benefit of reducing the number of negotiating countries at MTNs. Moreover, complete integration can deliver the full benefits of a federal state such as the US.

The second of the above arguments was the key motivation for the US to turn to regionalism in the early 1980s. Unfortunately, under President Bush, the US abandoned Brock’s approach of open-ended FTAs and turned to geographically circumscribed FTAs as illustrated by NAFTA and the Enterprise of Americas Initiative. For this reason, and because the multilateral trading system has experienced a new lease of life with the completion of the UR, many economists favor returning to the WTO, the successor to GATT, and abandoning the pursuit of regionalism.

C. Impact of NAFTA and the EU on Asia

So far, the impact of regionalism on Asia from its own regional arrangements has been minimal. AFTA, and prior to it ASEAN, have not resulted in major trade preferences. APEC is still a forum for consultation, and EAEC and SAPTA are yet to get off the ground. It is feared, however, that the impact on Asia of regional arrangements elsewhere in the
world—particularly NAFTA and the Single Market in Europe—can be large. It is important to remember, however, that while this may be true of some specific sectors, the overall impact is unlikely to be large. External tariffs in the US, Canada, and the EU are low and will be lowered further under the UR. Therefore, the room for trade diversion from these markets is limited except in some specific sectors, such as agriculture, in which external tariffs are high.

Frankel and Wei provide a summary of empirical estimates from the literature. These estimates vary substantially across studies and therefore inspire only limited confidence. According to Hufbauer and Schott (1993), NAFTA will divert from Taipei, China, and Korea about $300 million of manufactured exports annually that went to the US, with machinery and transport equipment being the largest component. Kreinin (1992) and Kreinin and Plummer (1992) predict a larger diversion: 5 percent of exports to North America in the case of Korea and 4 percent in the case of ASEAN.

Hufbauer and Schott (1993) predict annual trade diversion from South Asia and East Asia excluding Korea and Taipei, China at $350 million worth of manufactures and $100 million worth of primary products. The hardest-hit sectors are machinery and transport equipment, clothing, and other consumer goods. Safadi and Yeats (1994) find the effects on South Asia to be relatively small, but in their estimates the effects are concentrated in textiles and clothing.

A major concern in Asia has been NAFTA’s impact on foreign direct investment. Kreinin (1992) predicts that FDI may be diverted from ASEAN to Mexico in food, chemicals, textiles, metals, electronics, and transport sectors. McCleery (1993) predicts very large investment diversion from ASEAN: 4-5 percent for Indonesia, 5-7 percent for Malaysia, and 2-3 percent for Singapore. The Mexican crisis that broke out in December 1994 has changed all this, however, at least in the short run. The massive flows of investment into Mexico that preceded NAFTA have been arrested, at least temporarily and it does not appear that the investment diversion predicted by these studies will actually materialize.

The effects of the EU on developing Asia’s exports are estimated to be larger than those of NAFTA. Davenport (1991) and Page (1992) estimate that the net effects as a percentage of the region’s existing exports to the EU will be -0.3 for ASEAN, -6.1 for the NIEs, and -0.3 for the PRC. Kreinin and Plummer (1992) estimate diversion effects of 8 percent for ASEAN and 5 percent for Korean exports. A key reason for differences between the two sets of results is that the former allow for higher growth in the EU as a result of the single market, which partially offsets the trade diversion effect, while the latter do not.

D. Asia’s Future Strategy

How should Asia respond to growing regionalism around the world? The first point to make, as Frankel and Wei do, is that for countries with high levels of protection the most urgent task is to carry further their unilateral liberalization. This advice is particularly applicable to countries in South Asia, though it also applies to Thailand, Indonesia, and Viet Nam. Regional integration among developing countries with high external trade barriers has been tried since the 1950s and has failed to deliver faster growth. Such integration has served primarily to extend national import substitution policies to the regional level. The option of joining a developed-country regional arrangement such as the EU should also be resisted until external trade barriers have been lowered substantially. As
argued by Panagariya, when a FTA is formed, the tariff revenue collected on imports from partner countries in the pre-FTA equilibrium is transferred to the latter’s exporters. And if tariff rates are high and imports from partner countries substantial, such transfers can be considerable.

Beyond this point, what role should regionalism play in Asia? Both qualitative and quantitative analyses lead to the conclusion that subregional groupings such as AFTA and SAPTA are not particularly desirable.\textsuperscript{14} Gains from these arrangements, if any, will come from their contribution to speeding up nondiscriminatory liberalization in member countries.

What about an Asia-wide trading bloc? Panagariya (1994) addresses this issue systematically and concludes that, the issue of desirability apart, it is an infeasible proposition. Under the current circumstances, there are barriers to such a bloc both within Asia and outside. Internally, countries in Asia—even if we limit the bloc to East Asia—are too diverse to come to an agreement. Under the current political circumstances, economies such as PRC; Taipei, China; Korea; and Japan are unlikely to participate in a regional arrangement. Even within a small group, ASEAN’s success in promoting preferential trading has been limited. Thus, excluding Singapore, which has virtually no trade barriers, intra-ASEAN trade is less than 5 percent of member countries’ trade. And less than 5 percent of this trade is subject to any kind of preferences. Even if Asia could overcome internal barriers, the external barrier—opposition from the US—cannot be overcome. Countries in Asia depend heavily for their exports on the US and are unlikely to risk participating in a bloc opposed by it.\textsuperscript{15}

This naturally brings us to the possibility of an APEC-wide FTA, which, under the current membership of APEC, would include all the major countries in East Asia, Australia, New Zealand, NAFTA members, and Chile. An agreement to turn APEC into a FTA by 2020 was signed by member countries at the November 1994 annual summit in Bogor, Indonesia. Should this idea be pursued vigorously or opposed?

There is no doubt that APEC countries constitute a large economic space and a Pacific Asia FTA (PAFTA) would generate substantial net trade creation.\textsuperscript{16} According to some simulation, all members would benefit while the main outside entity, the EU, would lose. It has also been argued that PAFTA would give its members a strategic advantage in future multilateral negotiations.

While these arguments have some value, there are also dangers in PAFTA. First, there is a strong possibility that PAFTA could be dominated by the US. Because the US is also pursuing a FTA with its Latin American neighbors, it is not clear how it would balance the interests of Asia with those of the latter. Second, because PAFTA would be a FTA and not a CU, it is not clear how much extra leverage it would give member countries in a multilateral bargain. Member countries would still have to be represented individually at

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\textsuperscript{14} Panagariya (1994) and DeRosa (1993) provide qualitative and quantitative analyses of AFTA, respectively. Srinivasan and Canoner (1995) do the same for SAPTA.

\textsuperscript{15} There have also been proposals for Asia-wide nondiscriminatory liberalization. Though such liberalization is unlikely to be opposed by the US, it is sure to be opposed by Asian countries themselves. For one thing, it would worsen the region’s terms of trade vis-à-vis outside countries. Moreover, liberalization by Japan would reduce the margin of preference enjoyed by developing East Asian countries under the Generalized System of Preferences.

\textsuperscript{16} For Computable General Equilibrium (CGE) models supporting this conclusion, see Lewis, Robinson and Wang (1995).
multilateral negotiations and would have to bargain for their individual as opposed to collective interests. Third, creation of PAFTA along with the expansion of NAFTA into a FTA contains all ingredients for dividing the world into three major trading blocs. These blocs have as much potential for triggering trade wars as for facilitating multilateral negotiations. Even if blocs did not turn pernicious, they could become a hindrance to further multilateral liberalization for reasons discussed earlier. Finally, there is the "innocent bystander" problem. Countries likely to be left out of all of these blocs—primarily those in South Asia and Africa—could find their trade opportunities drastically reduced.

Given the existence of NAFTA and the EU and proposals or agreements for PAFTA and TAFTA, there would seem to be enough enthusiasm for further liberalization on the part of all major participants. It is then not clear what extra advantage is to be had from a "spaghetti bowl" of FTAs before going to the full multilateral negotiation. Viewed this way, it is difficult to disagree with Bhagwati, who puts the case for abandoning the FTA approach more forcefully: "Is this infatuation with FTAs, including the pressure being exerted by many in the United States to move APEC in the direction of a FTA, desirable when the multilateral system has already been jump-started...?"

Bhagwati advocates a proactive role by Asian members of APEC in seeking an agreement that APEC will not be converted into a preferential FTA and ensuring that multilateral free trade, not preferential free trade, will constitute the centerpiece of the newly emerging world trading system. For this, Japan will have to play a leadership role in the architecture of the new world trading system. The US and the EU are at present preoccupied with preferential arrangements, and without Asia's proactive role, multilateralism runs the risk of being pushed into the background.

IV. New Challenges: Environmental and Labor Standards

Economists generally view freer trade and investment as mutually beneficial to the countries involved. This view has not been shared by all countries at all times, however. During the decades following the Second World War, developing countries were generally skeptical of foreign trade as an engine of growth. It was even believed that "integration into the world economy will lead to disintegration of the domestic economy." This thinking led to the adoption of import-substitution policies accompanied by strict controls on foreign investment. With the exception of some countries in East Asia, which switched course and began implementing outward-oriented policies in the early 1960s, developing countries remained inward-oriented until the end of the 1970s.

By contrast, developed countries, subscribing to the view that freer trade was beneficial for all, moved progressively toward an open world trading system. Successive multilateral negotiations under the auspices of the GATT, particularly the Kennedy and Tokyo Rounds, brought about substantial reductions in tariffs in virtually all industrial countries.

In what Bhagwati calls an "ironic reversal", today, developing and developed countries have traded places. The fears of integration into the world economy are being heard, not from the developing countries, which, learning from the experience of East
Asian economies, see great good in it, but from the developed countries of the North, which fear that trade with the labor-abundant South places the fortunes of their own unskilled labor at risk. This fear has manifested itself in demands by them for higher environmental and labor standards in developing countries. In the US, Congressman Gephardt has introduced the so-called “blue” and “green” bill which would authorize the administration to impose “ecodumping” duties against lower environmental (i.e., green) standards and “social dumping” duties against lower labor (i.e., blue-collar workers) standards in foreign countries. At the WTO, the US and Europe are pushing for environmental and labor standards that will either force developing countries to raise standards or allow developed countries to counteract the implied subsidy.

Though international environmental agreements and arguments in favor of using trade policy to counter “unfair” competitive advantage arising out of lower labor standards have been around for almost a century, demands for linking market access to environmental and labor standards has never been expressed as forcefully as today. Bhagwati offers several reasons for this development.

First and foremost, persistent unemployment in Europe and a decline in real wages of the unskilled in the US have given way to the fear that free trade with labor-abundant developing countries perils the fortunes of the unskilled in the North. Second, the increased globalization of the world economy and the fierce competition it has brought about have led to increased sensitivity to any policy or institution of a trading partner that seems to give it an edge. Third, some environmental and labor groups in “higher” standard countries fear that free trade with “lower” standard countries will generate pressures for lowering their own standards. Finally, the environmental and, especially, labor groups feel a sense of transborder moral obligation to human beings abroad.

A. Trade and Environment

Today environmental cleanup is a major challenge facing virtually all Asian countries. Pollution of water, air, and soil and depletion of forests are major problems these countries must confront in the forthcoming decades. There can be little disagreement on this. The same is not true, however, when it comes to the choice of instruments for cleaning up the environment. Differences of opinion exist on whether trade policies should be employed to foster a cleaner environment. The differences are particularly pronounced in the international arena, where developed countries advocate trade sanctions against a trading partner who fails to enforce a minimal environmental standard, while developing countries oppose them.

To understand whether or not a link between environmental standards and trade policy is justified, we must distinguish between national and transnational environmental pollution. When pollution affects primarily the population of the country where it originates, it is national in nature. Examples in this category include contamination of drinking water by a country’s own industries or people, indoor pollution from cooking, and air pollution in big cities from auto emission. Pollution that originates in one country but affects the pollution levels of another is transnational. Transnational pollution may be bilateral, regional, or global. Acid rain, which takes pollutants from the US into Canada, is an example of bilateral transnational pollution. Global warming and ozone-layer depletion are examples of global transnational pollution. Of course, transnational pollution may have a national element and vice versa. Auto emission pollutes the “national” atmosphere but
also leads to the accumulation of carbon dioxide in the atmosphere, which contributes to the so-called “greenhouse” effect of global warming. In the following, we present a critical analysis of the link between trade policy and environment in the case of each type of pollution in turn.

1. National Pollution. A majority of pollution problems in developing Asia are national in nature. The first question we may ask is whether a country should restrict its own imports or exports to reduce environmental pollution. For example, to reduce auto emissions, should a country raise tariffs on auto and gasoline imports? Or, to reduce deforestation, should it restrict exports of woods? The answer to these questions is in the negative. A more efficient policy is a general consumption sales tax in the case of importables and a production tax in the case of exportables. Similarly, the most efficient policy to reduce auto emissions is to tax auto emissions directly. Current GATT/WTO rules are in conformity with this prescription in the sense that they do not allow increased trade restriction to promote a cleaner environment.

Indeed, the pressure for modifying the WTO rules today is not coming from countries with low environmental standards wishing to improve the environment by recourse to trade restrictions. Instead, it is coming from countries with higher environmental standards that wish to limit access to their own markets for countries with lower environmental standards. Because the higher-standard countries are developed and the lower-standard countries developing, the issue has an obvious North-South dimension. The demand by Northern countries is backed by two arguments. First, working like subsidies, cross-country, cross-industry (CCCI) differences in environmental standards give lower-standard countries an “unfair” competitive advantage and should be subject to countervailing duties. Second, free trade with lower-standard countries can lead to a race to the bottom and a progressive lowering of standards in higher-standard countries. Let us examine each of these arguments.

There are at least three major difficulties with the first argument and, hence, with the associated countervailing duties. First, there is no reason to believe that lower environmental standards in a country are intended to gain unfair competitive advantage. Cross-country intra-industry differences in environmental standards are likely to arise purely from differences in tradeoffs between aggregate pollution and income at different levels of income. In the words of Bhagwati, “richer Americans prefer to save dolphins from purse seine nets whereas poorer Mexicans prefer ... to raise the productivity of fishing ... by using such nets.” Countries are also likely to have differences in priorities on which kind of pollution to attack. ADCs will want to worry more about clean water, while richer countries will focus on clean air.

Second, there is an internal contradiction between first adopting a higher environmental standard and then objecting to another country’s lower environmental standard on the ground that such a situation gives the latter a competitive advantage. The higher standard is adopted because the country values environment more than other countries and, as such, the loss in competitive advantage is a desirable effect. Consider a two-country world in which a polluting industry faces identical cost conditions and environmental standards in both countries initially. Suppose further that one of these countries, A, values the environment more and raises the environmental standards facing the industry. This will place the firms in A at a competitive disadvantage and have the desirable effect of shrinking the industry. If A were now to force the other country, B, to
adopt the same higher standard, the competitive disadvantage in A will disappear and the industry there will expand. The desirable pollution-reduction effect obtained initially by A will be reversed, at least partially.

Finally, it must be understood that a loss of competitive advantage is not equivalent to a loss in comparative advantage. Here we must recall the central lesson of trade theory taught by David Ricardo 180 years ago: a country can have an absolute disadvantage but not comparative disadvantage in all commodities. To make the point succinctly in the present context, suppose there are two commodities and two countries. Both commodities pollute. Suppose further that the pollution tax on each industry is higher in one country than in the other but the ratio of the two tax rates is the same in the two countries. This set of taxes will have no effect whatsoever on the international competitiveness of either industry in the more highly taxed country.

Next, take the second argument for trade sanctions in the presence of CCCI differences in environmental standards. This argument is based on the possibility that in today's world of highly mobile capital, countries with higher environmental standards will lose "capital and jobs" to countries with lower standards. This may, in turn, trigger a race to the bottom where all countries will lower standards in order to attract capital and jobs. There may then be a case for setting, at the least, minimum floors to the standards.

This argument, though valid in principle, rests on two assumptions that must be scrutinized carefully: (i) capital is responsive to the differences in environmental standards, and (ii) different countries engage in competitive lowering of environmental standards to attract capital. Assumption (i) does not stand up to a careful empirical scrutiny. Douglas Brooks of the Asian Development Bank concludes: "Evidence of firms or industries migrating to overseas locations with lower environmental standards is largely anecdotal. On the other hand, there is solid evidence that the bulk of foreign direct investment has been targeted to countries with higher environmental standards, suggesting that the low relative costs of compliance with environmental regulations and higher benefits of more skilled workers and more developed infrastructure and markets in those countries outweigh the production cost benefits of environmental laxity" (Brooks 1995).

No empirical evidence is available for or against assumption (ii). But the likelihood that countries systematically lower environmental standards to compete for capital is very low. Such competition typically takes place through tax breaks, which may result in a race to the bottom in taxation of foreign capital.

The inevitable conclusion from Brooks' discussion is that the economic case for ecodumping duties on the basis of either "unfair trade" or "race to the bottom" is not persuasive. Moreover, even if such a case could actually be made, the manner in which ecodumping duties will have to be assessed and implemented makes them highly undesirable. The duties are likely to be assessed by a process similar to the current antidumping process, which is known to have played an extremely protectionist role. In due course, like antidumping, "anti-ecodumping" processes could proliferate, extending to even developing countries. For it is not inconceivable that countries with lower environmental standards will find even lower standards in some of their trading partners or that countries with lower average standards will find their standards to be higher in

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17 Purely on theoretical grounds, there is no necessity for such a race and one cannot even rule out the possibility of a "race to the top". See Wilson (1996).

18 Levinson (1996) examines the available evidence systematically and finds, at best, weak support for the assumption.
specific industries than their trading partners. Such proliferation of anti-ecodumping will undoubtedly be destructive of the multilateral trading system.

These arguments lead Bhagwati (1995b) to conclude, “The ‘fixing’ of the WTO for environmental issues therefore should not proceed along the lines of legitimating ecodumping.” To deal with political pressures for action, he offers an alternative proposal: Given that the demand for CCCI harmonization is greatest when plants move to low-standard countries, higher-standard countries should require their multinationals to enforce the same high standards abroad as they face at home. In effect, the proposals ask multinationals to act in Rome as you do in New York, not as Romans do, and builds on the so-called Sullivan Principle under which US firms in South Africa were urged to adopt US practices rather than the South African apartheid ways. If plant location is sensitive to differences in environmental standards, this requirement will arrest plant relocation. If not, as is likely, it will contain the pressure for pernicious actions in higher-standard countries.

2. Transnational Pollution. Transnational pollution requires a cooperative solution at the international level. The natural vehicle to achieve this cooperation is an international agreement or treaty. Though the 1987 Montreal Protocol on Substances that Deplete the Ozone Layer is the best-known example, international environmental agreements cover a wide range of subjects and have existed at least since the beginning of this century. Most recently, in August 1995, countries adopted a global accord to regulate fishing on the high seas. For a partial list of international environmental agreements, see Appendix 3 of the paper by Brooks (1995).

An essential problem international treaties face is that, because of the public-good nature of environmental protection, nations have an incentive for a free ride. Because the benefits of reductions by complying members in fishing or carbon dioxide emissions become automatically available to others, countries have an incentive not to comply with international agreements. This naturally brings into the picture trade sanctions as an instrument to secure compliance.

The trade policy question WTO confronts, then, is whether to legitimize trade sanctions on WTO members who try to “free ride” a treaty concluded by a plurality of the membership. The answer would seem to be in the affirmative, but the issue is more complex. For it is entirely possible that the provisions of the treaty themselves are not legitimate in the eyes of the countries accused of free riding. Bhagwati (1995b) argues,

... these nations have to be satisfied that the agreement being pressed on them is efficient and, especially, that it is equitable in burden-sharing. Otherwise, nothing prevents the politically powerful (i.e., rich nations) from devising a treaty that puts an inequitable burden on the politically weak (i.e., the poor nations) and then using the cloak of a ‘multilateral’ agreement and a new GATT/WTO-legitimacy to impose that burden with the aid of trade sanctions with a clear conscience.

To ensure that the solution to global warming is efficient and equitable, Bhagwati favors pollution permits that are marketable at the world level. Under this scheme, any country wishing to emit greenhouse gases would have to buy a permit from a worldwide quota. This would ensure efficiency. To ensure equity, the proceeds from permits could be used according to some multilaterally agreed upon criteria for such purposes as refugee resettlement and UN peacekeeping operations.
B. Trade and Labor Standards

There are both similarities in and differences between the issues related to environmental and labor standards. Issues of “unfair” trade raised in the context of national pollution apply to labor standards, but labor standards do not have a counterpart to transnational pollution. At the same time, there is a moral aspect to the labor standards issue that is not critical to the environmental standards issue.

Narhari Rao of the Asian Development Bank notes that there is considerable ambiguity in the definitions of labor standards (Rao 1995). The US Department of Labor emphasizes freedom of association, the right of labor to organize and bargain collectively, prohibition of forced labor, minimum age of employment, and acceptable conditions of work. The European Union’s “social charter” lists a broader set of labor rights including the right to vocational training and protection of elderly and disabled persons. The International Labour Organisation (ILO) has 174 conventions, evolved over a period of 75 years, covering a wide range of labor standards. Enforcement of labor standards is up to national governments. Only those standards for which national laws exist can be enforced.

1. Some Simple Economics of Labor Standards. The basic economics of labor standards is not very different from that of environmental standards. Drawing on the rapidly growing literature, Rao identifies five propositions. First, contrary to what some proponents of higher labor standards claim, a rise in labor standards need not raise a country’s welfare. In particular, if the initial labor standards are above what the society considers to be optimum, raising them further will lower welfare. A case for policy intervention may exist if benefits of a standard are not fully internalized by those choosing it. But because the externality is purely national in scope, it does not provide a basis for demands for higher standards by other countries. Second, optimum standards themselves depend on other variables in the economy. For example, in a country with poor facilities for education and low income, the optimum minimum age of employment will be lower than in a rich country with ample opportunities for education. Therefore, in general, a case for harmonization of labor standards, particularly between rich and poor countries, cannot be made on welfare grounds. Third, a rise in one labor standard can well lead to a decline in another labor standard. For instance, if a country raises the minimum wage, to remain competitive, firms may lower safety standards. Thus, raising labor standards in an overall sense is a tricky issue. Fourth, within the Heckscher-Ohlin model, the terms of trade and welfare effects of raising labor standards in labor-abundant countries are likely to be negative on labor-scarce countries. A higher labor standard such as an increase in the minimum working age lowers labor supply and hence the supply of labor-abundant exports. This, in turn, worsens the terms of trade and welfare of labor-scarce countries which import labor-intensive goods. Finally, the inclusion of labor standards among the choice variables does not undermine the case for free trade. As long as labor standards are chosen optimally, free trade remains globally welfare-superior to restricted trade.

2. A Critical Evaluation of the Case for Labor Standards. The case for raising labor standards is made on either moral or national welfare grounds. According to the former, if labor standards in a country are morally unacceptable, the resulting competition is itself morally illegitimate and unfair. Other countries then have a right to suspend the trading rights of that country. There are two types of problems with this argument. First, it is
difficult to assess the extent to which the argument is driven by true moral concerns rather than a desire to protect one's own import-competing industries. Drawing on Bhagwati (1996), Rao (1995) gives the following passages from Adam Smith that conveys a sense of how serious the concerns by the people of one country are over what happens in another:

Let us suppose that the great empire of China, with its myriads of inhabitants, was swallowed up by an earthquake and let us consider how a man of humanity in Europe, who had no sort of connection with that part of the world, would be affected upon receiving intelligence of this dreadful calamity. He would, I imagine, first of all express very strongly his sorrow for the misfortune of that unhappy people, he would make many melancholy reflections upon the precariousness of human life. And when all this fine philosophy was over, ... he would pursue his business or pleasure ... with the same ease and tranquility as if no such accident had happened.

The most frivolous disaster which could befall himself would occasion a more real disturbance. If he were to lose his little finger tomorrow, he would not sleep tonight; but provided he never saw them, he would snore with the most profound security over the ruin of a hundred million of his brethren.

The second problem with the moral argument arises from a lack of universally agreeable labor standards. Bhagwati argues that once we got past slavery, universally condemned practices become rare. This may not appear to be the case when one looks at the large number of ILO and other conventions that exist. But the fact is that many countries have signed many ILO conventions because they are not binding, while others such as the US have chosen not to sign a large proportion of them at all. The US has even chosen not to sign the non-ILO Convention on the Rights of the Child adopted by the UN General Assembly in November 1989.

Bhagwati puts the matter forcefully: “The notion that labor standards can be universalized, like human rights such as liberty and habeas corpus, simply by calling them ‘labor rights’ ignores the fact that this easy equation between cultural-specific labor standards and human rights will have a difficult time surviving closer scrutiny.” He goes on to examine closely many labor practices in the US that can be judged as morally objectionable. These include the low degree of labor participation in decision making, poor treatment of migrant labor in agriculture and the textiles industry, low degree of unionization of labor, and effective constraints on strikes. Even on the issue of child labor, he finds little on which there is universal agreement. The Convention on the Rights of the Child does not prohibit child labor and simply requires governments to provide for a minimum age but says nothing about a uniform age across countries. Bhagwati concludes that:

the idea of the Social Clause in the WTO is rooted generally in an ill-considered rejection of the general legitimacy of diversity of labor standards and practices across countries. The alleged claim for the universality of labor standard is (except for a rare few cases such as slavery) generally unpersuasive.

The case for labor standards based on national welfare, reviewed carefully by Rao (1995), turns out to be equally weak. The case is made, as in the case of environmental standards, on the basis of “unfair” trade or race to the bottom. With respect to the former, one can essentially invoke the critique offered above in the context of national environmental standards. With respect to the latter, there is no systematic evidence supporting the view that the decline in wages of the unskilled in the US and high
unemployment in Europe have been caused by freer trade with labor-abundant countries or by migration of capital to developing countries in response to lower labor standards there. Technological change, which may have favored skilled over unskilled labor, is perhaps the more likely explanation for the decline in the unskilled wage. If free trade were the main culprit for the wage decline, at least the relative price of labor-intensive goods should have declined in the US. Available evidence shows that the opposite is true. Similarly, migration of capital in response to wage differences is also unlikely, since several studies have shown that once we adjust for productivity differences, wages in developing countries are not significantly different from those in developed countries.

3. Policy Options. A defensible case for developed-country demands for higher labor standards in developing countries has not been made so far. Yet, political pressures for action exist. Bhagwati, while rejecting unequivocally the idea of a Social Clause in the WTO, offers four solutions: First, those wishing to improve a given set of labor standards can employ instrumentalities such as nongovernment organization-led educational activities in favor of their positions. If the ideas being proposed are good, they are likely to be accepted without coercion. But one can add private boycotts, available under national and international law, to the arsenal. Second, assisted by these methods of suasion, a multilateral consensus must be achieved on a carefully defined labor standard and formally agreed to by the ILO in the light of modern thinking in economics. "The ILO is clearly the institution that is best equipped to create such a consensus, not the GATT/WTO, just as multilateral negotiations are conducted at the GATT, not at the ILO." Third, in extraordinary cases, international processes are available for even coercive corrective multilateral action. For example, under the UN embargo procedures, which take precedence over GATT and other treaties, South Africa was subject to an international embargo despite its membership in GATT. Finally, nations that feel that their moral views must be respected at any cost can also take corrective actions under the existing GATT/WTO procedures. Thus, if the US wishes not to import carpets made with child labor in India and Pakistan, it can do so unilaterally by making a compensatory offer of an alternative trade concession or accepting retaliation by the offended parties in the form of withdrawal of an equivalent trade concession. The compensatory concession or retaliation by the partner can be viewed essentially as the cost of spreading one's virtue to other countries.

Echoing Fields (1994), Rao (1995) suggests distinguishing between "labor rights" and "labor standards"—a distinction rejected by Bhagwati except in the case of slavery—where the former are akin to human rights and therefore enforceable. Labor rights could include (i) banning slavery and indentured labor, (ii) no exposure to unsafe or unhealthy working conditions without full knowledge of the risks involved, (iii) no child labor unless family financial conditions necessitate it, and (iv) freedom of association in the workplace and the right to organize and bargain collectively with employers. Beyond these rights, Rao does not favor either the harmonization of labor standards as a desirable goal or the use of trade sanctions to enforce labor rights. Like Bhagwati, he opts for ILO rather than WTO as the institution that should be entrusted with the responsibility of evolving a consensus on labor rights.

Finally, Rao draws attention to the fact that, in the long run, economic growth in the poor countries will be the most effective and noncontroversial way to raise labor standards there. "Empirical evidence suggests that economic growth increases both employment and
real wages: and rising real wages in turn raise labor standards. This is borne out in the detailed study by Gary Fields (1995). ...”

V. Uruguay Round: Areas of Current Impact

The UR was launched in September 1986 at a meeting of trade ministers in Punta del Este, Uruguay. After prolonged negotiations, an agreement was signed in December 1993, which was then ratified by the US Congress, EU, and Japan in December 1994. Implementation of the agreement began on 1 January 1995.

Though the UR Agreement deals with a wide variety of topics and consists of as many as 18 separate agreements, from the viewpoint of ADCs, six areas are of special significance: textiles and clothing, trade-related intellectual property rights (TRIPs), new instruments of trade policy including antidumping, safeguards and the dispute settlement mechanism, agriculture and services, and trade-related investment measures. In the first three of these areas, the Agreement will have profound effects in the coming years. In the remaining three areas, the immediate effect will be modest, but the Agreement sets the stage for future negotiations for liberalization. We begin by offering a critical analysis of the agreement on textiles and clothing.

A. Textiles and Clothing

Approximately half of the world trade in textiles and clothing is governed today by the MFA, a global voluntary export restraint (VER) consisting of a series of bilateral quotas administered by exporting countries. It restricts imports into developed countries including the US, EU, Australia, and Canada from developing countries and Japan. The MFA applies to fiber made from cotton, wool, and synthetics and hence the term “multifibre.”

The MFA was first brought into existence in 1974 by placing under a single umbrella a number of separate agreements existing at the time. The fourth renewal of the agreement ended on 31 December 1993. Legally speaking, the MFA is outside GATT and violates its principles but is actually negotiated under its auspices and administered partially by it. The MFA itself is highly complex consisting of 69 clauses and 20,000 annexes. In all, there are approximately 3,000 bilateral quotas distinguished by countries and products.

The Textiles and Clothing Agreement of the UR proposes to phasewout the MFA and to return textiles and clothing to full GATT/WTO discipline in ten years. This is of immense significance for ADCs, which account for more than 40 percent of world exports of clothing. For many ADCs, textiles and clothing account for as much as a quarter of their manufactured exports. In contrast to many Latin American and African countries, whose exports of textiles and clothing are either unconstrained or subject to nonbinding quotas, most of the ADCs face binding quotas. Therefore, among exporters, they have the most to gain from the MFA phasewout.

1. How Will the Phasewout Work? The Textiles and Clothing Agreement consists of nine Articles and an Annex and is applicable to all WTO members irrespective of whether they are signatories to the MFA. The Annex sets out textiles and apparel products to be
integrated into GATT/WTO. There are 800 Harmonized System tariff lines listed in the Annex. Box 1, taken from the paper by John Whalley of the University of Warwick, summarizes the main features of the MFA phaseout as envisaged in the Agreement (Whalley 1995). Liberalization will proceed on two tracks: abolition of quotas and faster growth of quotas not abolished.

Box 5.1
The Uruguay Round Agreements on Textiles and Clothing

1. **Basic Commitment**
   To return textiles and clothing to full GATT/WTO discipline in 10 years, i.e. by 2005.

2. **Transitional Arrangements**
   Accelerated growth rate factors for MFA quotas
   - Stage 1. (Jan 95) MFA growth rates all increased by 16%.
   - Stage 2. (Jun 98) MFA growth rates all increased by further 25%.
   - Stage 3. (Jan 02) MFA growth rates all increased by further 27%.

   Product integration
   - Stage 1. (Jan 95) All countries to integrate 16% of products listed in Annex in Agreement into GATT/WTO.
   - Stage 2. (Jun 98) All countries to integrate a further 17% of products into GATT/WTO.
   - Stage 3. (Jun 02) All countries to integrate a further 18% of products into GATT/WTO.

   Special selective safeguards
   - New trade restrictions allowed in transitional period where damage to domestic industry occurs attributable to agreement.
   - Safeguards degressive (3 years).
   - Safeguards also not to reduce trade below previous 12-month level.
   - Certain products exempt from safeguards action.

   Treatment of least developed countries
   - Special treatment in growth factors for small suppliers.
   - Special treatment for least developed under special safeguards.

3. **Developing Country Concerns**
   Transitional arrangements will do little to achieve integration into GATT/WTO; most adjustment in importing countries postponed until 10th year. Doubts over political commitment to implement 10th year measures.

   Regime to follow after transitional period may not be free trade; antidumping is a concern.


Abolition of quotas will be done in four stages. Stage One liberalization took place in the first half of 1995 when products accounting for 16 percent of the restraining country’s imports in 1990 were freed up from the quota restriction. Stage Two will be implemented in the first half of 1998 when quotas on products accounting for another 17 percent of 1990 MFA imports will be abolished. In Stage Three, to be implemented in the first half of 2002, products accounting for yet another 18 percent of 1990 imports will be integrated into the GATT/WTO. Stage Four liberalization takes place on 1 January 2005, when all MFA quotas will be abolished. On that date, trade in textiles will come to be governed by the same rules as trade in other manufactures.
Because quotas on a large number of products will remain in existence during the ten-year transition period, liberalization will proceed along a second track by expanding the quotas at a rate faster than that laid out in the original bilateral agreement. The UR Agreement boosts the original MFA growth rate by 16 percent in Stage One (the first three years of the phaseout period), 25 percent in Stage Two (the next four years), and 27 percent in Stage Three (the last three years). Table 5.1, taken from Whalley (1995) shows the impact of this provision: If the quota for a product would have grown annually at 3 percent under the original bilateral MFA, it will now grow at 3.48 percent during the first three years, 4.35 percent during the following 4 years, and 5.52 percent during the remaining three years. If the quota was slated to grow under the MFA at 6 percent, it will now grow at 6.96, 8.7, and 11.05 percent during the respective periods. The boost to the growth rate is, of course, smaller than the initial growth rate.

Table 5.1 Some Examples of How Phased Increases in Quota Growth Rates Provided for in the Uruguay Round Agreement on Textiles and Apparel Will Work

<table>
<thead>
<tr>
<th>Stage of Integration</th>
<th>Year</th>
<th>Growth Factor to be Applied to MFA Growth Rate Quotas</th>
<th>Established Growth Rate *</th>
<th>Base Quota: 100</th>
<th>Established Growth Rate*</th>
<th>Base Quota: 100</th>
<th>Established Growth Rate*</th>
<th>Base Quota: 100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stage I</td>
<td>1</td>
<td>16%</td>
<td>3.48%</td>
<td>103.4</td>
<td>5.8%</td>
<td>105.8</td>
<td>6.96%</td>
<td>197.0</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>16%</td>
<td>3.48%</td>
<td>107.0</td>
<td>5.8%</td>
<td>112.9</td>
<td>6.96%</td>
<td>114.0</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>16%</td>
<td>3.48%</td>
<td>110.8</td>
<td>5.8%</td>
<td>119.5</td>
<td>6.96%</td>
<td>122.4</td>
</tr>
<tr>
<td>Stage II</td>
<td>4</td>
<td>25%</td>
<td>4.35%</td>
<td>115.5</td>
<td>7.25%</td>
<td>128.2</td>
<td>8.70%</td>
<td>133.0</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>25%</td>
<td>4.35%</td>
<td>120.5</td>
<td>7.25%</td>
<td>137.3</td>
<td>8.70%</td>
<td>144.5</td>
</tr>
<tr>
<td></td>
<td>6</td>
<td>25%</td>
<td>4.35%</td>
<td>125.7</td>
<td>7.25%</td>
<td>147.4</td>
<td>8.70%</td>
<td>157.1</td>
</tr>
<tr>
<td></td>
<td>7</td>
<td>25%</td>
<td>4.35%</td>
<td>131.2</td>
<td>7.25%</td>
<td>158.1</td>
<td>8.70%</td>
<td>170.8</td>
</tr>
<tr>
<td>Stage III</td>
<td>8</td>
<td>27%</td>
<td>5.52%</td>
<td>138.4</td>
<td>9.21%</td>
<td>172.7</td>
<td>11.05%</td>
<td>189.7</td>
</tr>
<tr>
<td></td>
<td>9</td>
<td>27%</td>
<td>5.52%</td>
<td>146.1</td>
<td>9.21%</td>
<td>188.6</td>
<td>11.05%</td>
<td>210.6</td>
</tr>
<tr>
<td></td>
<td>10</td>
<td>27%</td>
<td>5.52%</td>
<td>154.1</td>
<td>9.21%</td>
<td>205.9</td>
<td>11.05%</td>
<td>233.9</td>
</tr>
</tbody>
</table>

* This is the assumed growth rate carried over from the former MFA bilateral restraints.

Though the phaseout is a vast improvement over MFA, as Whalley points out, there are several reasons why liberalization during the ten-year transition will be limited. First, products accounting for 49 percent of MFA imports in 1990 will simply not be liberalized until 1 January 2005. Thus, the phaseout is backloaded. Second, because importing countries choose which products will go first and which ones later, they can avoid effective liberalization through this channel almost until the end. The Annex to the Agreement, which lists products to be integrated includes many tariff lines that are not currently restricted under the MFA. But these can be reintegrated into GATT/WTO in the early phases to satisfy the requirements of the phaseout. According to ITCB estimates, almost one third of the volume of textiles and apparel imports into EC and US are now unrestricted partially reflecting large volumes of interdeveloped country trade. This means that until the beginning of Stage Three on 1 January 2002, importing countries need not liberalize any products subject to binding quotas. The initial lists submitted by the US and EU, indeed, confirm this fear. Third, the impact of accelerated growth in quotas will also be limited because the most binding quotas are likely to have a very low established growth rate, e.g., 1 percent. Even after all three acceleration factors have been applied, the growth rate will be
below 2 percent. Finally, safeguards provisions may lead to a backsliding even when some liberalization takes place. The Agreement permits safeguard actions for three years if liberalization results in damage to domestic industry. Taking these and other factors into account, Whalley sums up the situation as follows:

Given the complexity of, and differences among, the MFA classification systems in the importing countries, it is difficult to make clear judgments about either the speed or coverage of integration under the program, except to say that all products will be integrated into GATT after ten years. But because a significant number of MFA quotas are nonbinding, and the initial quota growth rates for the more sensitive products are restrictively low, the fear is that much of the effective long-run adjustment needed to eliminate the MFA will be delayed until the 10th year of the phaseout.

Finally, it deserves noting that the UR does not imply free trade in textiles and clothing at the end of the ten-year transition period. Tariffs, which are high at present, will remain in place unless further action is taken. The Agreement permits safeguard actions for three years. Therefore, any safeguard actions taken in the last two years of the phaseout could still be in force in 2005. Moreover, like other manufactures, textiles and clothing will be subject to antidumping.

2. Economic Impact. Given all the complications during transition and the strong likelihood that much of the liberalization will take place on 1 January 2005, the payoff on speculating on transitional effects is low. Not surprisingly, most studies have focused on estimating the impact of a complete removal of the MFA. Though the effects of the phaseout will be along several dimensions including foreign direct investment and product quality, the greatest attention has been paid to static welfare effects.

Static welfare can be judged in terms of (i) global efficiency, (ii) gains to importing countries, and (iii) gains to exporting countries. Each of the last two of these effects can be further divided into gains to consumers and producers. The analysis presented below assumes that the demand and supply curves reflect social marginal benefit and costs.

Suppose there is one importing country, the US, and two exporting countries, 1 and 2. Also assume that exporting countries are identical in terms of their cost conditions. In panel c of Figure 5.1, DD represents the demand for imports of a MFA product in the US. In panels a and b, S_1 and S_2 are export supplies of 1 and 2 and are identical by assumption. Adding the supply curves horizontally, we obtain SS in panel c as the total supply curve facing the US. Global efficiency is maximized by free trade, which yields the price and total quantity associated with point E. Under perfect competition, each country supplies half of the total demand. This is the solution that will be obtained with the removal of the MFA and tariffs.

The current equilibrium deviates from this solution for a variety of reasons. These include, but are not limited to, (i) a tariff imposed by the US; (ii) a VER imposed by US; (iii) the nature of allocation of the VER between the exporting countries; (iv) presence of rent-seeking in exporting countries; (v) possibility of quality upgrading; and (vi) foreign investments undertaken to take advantage of nonbinding quotas in certain countries.

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There are two limitations on the use of safeguard actions. First, safeguards are not to reduce imports below the level attained in the preceding 12 months. Second, if a safeguard measure remains in force for more than a year, it must allow at least 5 percent growth annually in the subsequent two years. Of course, it must be phased out at the end of three years.
To get an idea of the most fundamental inefficiencies resulting from the MFA, ignore the tariff, quality upgrading, and foreign investment. Under free trade, the price is \( P' \) and the gains from trade to the US equal \( m + k + g \). The gains to country \( i \) (\( i = 1, 2 \)) are \( a_i + b_i + c_i \), which, when summed over \( i \), equal \( \ell + h + n \).

The MFA by itself restricts imports to the left of point \( E \) through bilateral VERs on both countries. In panel \( c \), suppose imports are restricted to \( \bar{Q} \). This establishes a price \( \bar{P} \) in the US market. Assuming efficient allocation of the quota between exporters (i.e., \( \bar{Q}/2 \) for each country, given identical costs), this restriction generates a loss of areas \( k + g \) at the global level. The quota generates a rent equal to \( k + \ell \) which, under the MFA, is collected by exporting countries. It is then immediate that MFA makes US unambiguously worse off with losses measured by \( k + g \). The effect on exporting countries is ambiguous in general. Their gains from trade under the MFA are \( a_i + b_i + d_i \), which exceed or are exceeded by the gains under free trade as area \( d_i \) is larger or smaller than area \( c_i \). Exporting countries lose from a reduction in exports (reduced market access) but gain from rent transfer in the form of access to the higher internal US price. The net effect depends on which of these effects dominates. It is easy to verify that the more elastic the US demand curve around point \( E \), the lower is \( \bar{P} \), corresponding to a given \( \bar{Q} \), the smaller is area \( d_i \), and the greater is the likelihood that MFA is welfare worsening for exporting countries. But in principle, given the loss because of reduced market access and the gain from rent transfer, the effect can go either way. There is one exception, however. If the quota is nonbinding, the exporting country necessarily gains from the MFA, for the MFA raises the price received by the country relative to that under free trade but does not limit market access \textit{ex post}. 
This basic analysis can be modified by several factors. First, the existence of a tariff modifies the equilibrium in favor of the US and against exporting countries. The tariff essentially transfers back a part of the quota rent to the US. For instance, a per-unit tariff or price shifts the quota rent to the US and away from exporting countries. Second, global losses will be larger if, as is likely, quota allocation is inefficient. Thus, in Figure 1, if country 1 is allocated more than \( Q/2 \) and country 2 less than \( Q/2 \) or vice versa, the production cost of \( Q \) will be higher than that shown by SS. Third, if the administration of the VER by exporting countries generates rent seeking, which uses real resources, losses to them from MFA will be larger (or gains smaller). Fourth, countries may respond by upgrading the quality of their exports. The quota is set out in quantitative terms regardless of quality. This allows producers to expand the value of exports by moving into higher-quality lines within quota categories. This has been true of Hong Kong; Korea; and Taipei, China. Diversification may also happen into product categories not subject to MFA restriction or into countries not participating in MFA. Finally, the equilibrium may be altered by “quota hopping”—investment from heavily restricted to lightly restricted markets.

Simulation models that try to get at quantitative estimates of the effects of MFA removal rarely take all these modifications in account. According to the analysis above, the welfare effects of MFA removal alone are positive on importing countries and ambiguous on exporting countries. But because quotas on Asian exporters are binding while those on Latin American and African exporters are not, studies uniformly show Asia benefiting from the removal of the MFA. But within Asia, there are both winners and losers. A representative study by Trela and Whalley (1990) has US, EC, and Canada as importers and 34 developing economies as exporters. There are 14 textiles and apparel items and a residual other good. The model is calibrated to 1986 data on production, consumption, and trade. Two counterfactual experiments are of interest: (i) both MFA quotas and tariffs are removed, and (ii) only MFA quotas are removed. In case (i), global gains as measured by equivalent variation are $23.4 billion—with $15.3 billion accruing to developed countries, $5.4 billion to Asia, and the rest to other developing economies. PRC is the largest winner in Asia with $1.8 billion. Hong Kong, Macao, and Singapore lose. In case (ii), global gains decline to $21.9 billion of which $19 billion accrues to developed countries. Gains to developing economies and Asia are dramatically lower than in case (i). Asia gains just $1.3 billion. This comparison shows the crucial importance to ADCs of tariff liberalization in textiles and clothing in developed countries. Table 5.2, taken from Whalley’s paper, summarizes the results.

Though the PRC turns out to be a big beneficiary of MFA removal in almost all studies, a point of caution is in order. Not being a member of WTO, PRC is especially vulnerable to selective safeguard actions when MFA removal begins to generate pressures for protection in US and EU. Without WTO membership, PRC can be singled out for such action without the fear of a challenge in WTO.

Though welfare gains from a MFA phaseout without the removal of tariffs appear to be small, changes in export flows are expected to be large. The United Nations Commission for Trade and Development (1986) estimates that removal of the MFA and tariffs by developed countries will expand exports of clothing by 135 percent and textiles by 78
percent. Trela and Whalley (1990), using a global general equilibrium model, estimate that the change will be much larger: the value of imports of textiles and clothing will rise by 305 percent in US, 200 percent in Canada, and 190 percent in EU. Though Trela and Whalley’s estimates are on the high side, the potential for export expansion is rather large.

3. **Policy Response.** What should be the policy response of Asian countries? There are three broad areas that require attention. First, Asia is by far the largest player in the world textiles and clothing market. And though market shares may shift among Asian countries as just noted, overall Asia will remain dominant in the years to come. Therefore, it is critical that the proposed MFA phaseout does not slide back. This means close monitoring of the process of liberalization itself including the products that are liberalized at various stages and quota expansion. More importantly, as imports into developed country markets expand, pressures for the use of transitional safeguard and eventually antidumping actions will rise. Countries in Asia must resist these pressures through an active presence at WTO and recourse to its dispute settlement process (see below under “New Instruments of Protection”) to ensure that these measures are not substitutes for MFA quotas.
Second, ADCs should also exert pressure for further reductions in tariffs on textiles and clothing in developed countries. As Whalley's calculations illustrate, the extra gains from tariff liberalization to Asia are even more than from the removal of the MFA. In future market-access negotiations, developing Asia should continue to push in this area.

The final area where attention is needed is policies of exporting countries themselves. Low-wage countries such as Bangladesh, India, and Pakistan stand to benefit greatly from the MFA phaseout. This means getting the internal trade and investment policies right. The precise nature of these policies depends on specific circumstances of the countries and will require detailed analyses at the country level.

C. Trade-Related Intellectual Property Rights

TRIPs agreement has been the source of maximum contention in Asia and perhaps rightly so. Though the introduction of intellectual property (IP) rights will generate both positive and negative effects on developing countries, the net effect will very likely be negative because of the increased prices of patented products, particularly in the area of pharmaceuticals. Having said this, it must be noted, however, that in public debate in some countries (e.g., India), losses were greatly exaggerated and gains understated.

1. Key Provision and Legislative Changes. Provisions of the TRIPS agreement are wide-ranging and cover virtually all areas of intellectual property including patents, copyright and related rights, trademarks and geographical indications, layout designs of integrated circuits, industrial designs, and protection of undisclosed information (trade secrets). The agreement is built upon existing international conventions negotiated under the auspices of the World Intellectual Property Organization. The relevant conventions are the Berne Convention on copyright, the Paris Convention on patents, and the Washington Treaty on Intellectual Property in respect of Integrated Circuits. In addition to requiring compliance with the substantive provisions of these conventions, the agreement specifies standards to define key issues of protection in each area. The agreement includes commitments on national enforcement procedures as well as effective multilateral procedures for settlement of disputes. According to Arvind Subramanian of the International Monetary Fund (IMF), “The post-TRIPS world can proclaim levels of IP protection in developing countries comparable to, and in some cases exceeding those in, industrial countries prior to the Round” (Subramanian 1995).

Part I of the agreement sets out general obligations of members. There are essentially two main provisions here. First, members must treat nationals of other countries no less favorably than their own on all IP matters including standards, enforcement, and acquisition. Second, members must not treat the nationals of any one country less favorably than those of another country. This is the most favored nation (MFN) principle applied to IP.

The agreement is silent on national regimes with respect to exhaustion or the permissibility of parallel imports. “Exhaustion” implies that once a product has been sold legitimately, the IP rights holder’s exclusive right over its sale is “exhausted” and it can be resold. The presence of an “exhaustion” provision in a country implies that products sold legitimately in other countries can be imported and ensures that the IP rights holder does not sell the product in the country at a higher price than elsewhere.
Part II of the agreement addresses each intellectual property right in succession. Provision on copyright protects the rights of authors of books, music, and films. Members are required to comply with the substantive provision for the Berne Convention on the Protection of Literary and Artistic Works in its latest version (Paris 1971). The Berne Convention has a broad definition of authorship and gives protection extending to 50 years after the death of the author. The agreement provides that computer programs be protected as literary works under the Berne Convention and lays down criteria for the protection of data bases by copyright.

The agreement makes important additions to the existing international rules on copyright and related rights in the form of provisions on rental rights. It requires that authors of computer programs and producers of sound recordings be given the exclusive right to authorize or prohibit the commercial rental of their works to the public. A similar exclusive right applies to films whenever commercial rental leads to widespread copying that materially impairs the right of reproduction. Performers are to be given protection from unauthorized recording and broadcast of live performances (bootlegging). Performers and producers of sound recordings are to be protected for at least 50 years. Broadcasting organizations are to have control, for 29 years, over the use of broadcast signals.

Hong Kong, Indonesia, Korea, and Singapore are not signatories to the Berne Convention and will have to make changes to satisfy its substantive provisions. Because Pakistan, Philippines, Sri Lanka, and Thailand are not signatories to the most recent version of the Berne Convention (Paris in 1971), they too will require changes in their national legislation. The provision on computer programs will affect Thailand and Viet Nam, and those on the introduction of rental rights will affect India, Indonesia, and other South Asian countries. Virtually all countries will need to amend laws to increase protection for sound recordings to 50 years.

In the area of patents, members must comply with the substantive provisions of the 1967 Paris Convention on the Protection of Industrial Property. In addition, the agreement requires that 20-year patent protection be available for all inventions, whether of products or processes, in almost all fields of technology including pharmaceuticals. Plant varieties are to be protected either by patents or a sui generis system such as the breeder's rights provided in the International Convention for the Protection of New Varieties of Plants (UPOV Convention) of 1978 or its stronger revision of 1991. Rights conferred in respect of processes must extend to the products directly obtained from the process. There is a tight nondiscrimination provision which, among other things, requires that countries cannot force a patentee, under the threat of compulsory licensing, to "work" the invention locally, i.e., meet local demand through local production rather than imports. A necessary condition for requiring the patentee to issue a compulsory license is that it be shown that normal channels of obtaining a voluntary license have failed.

India, Pakistan, and Bangladesh currently have virtually no protection for pharmaceutical products and will be affected significantly in this area. Malaysia, Pakistan, Sri Lanka, and Viet Nam will have to increase the term of patent protection. Because no ADC is a member of the UPOV Convention, all of them will have to introduce some kind of protection for plant varieties and seeds. In most countries, legislative changes will be required to eliminate the provision for compulsory licensing in the absence of local "working" of the invention.

Protection of layout designs of integrated circuits (semiconductor chips) is provided under the Washington Treaty on Intellectual Property in Respect of Integrated Circuits,
which was opened for signature in May 1989. The agreement goes beyond this treaty, however, by adding further provisions: protection is to be provided for at least ten years; the right extends to articles containing the chip; an “innocent infringer,” though free from liability, must pay a suitable royalty on the use or sale of stock in hand and ordered before learning of the infringement, and compulsory licensing and use by the government is allowed only under a number of strict conditions.

Protection of rights in integrated circuits is absent from all ADCs except Korea. Nearly all countries will require laws granting protection to chips for ten years.

On trademarks and service marks, the agreement provides the first full set of key standards that include the definition of signs that must be eligible for protection. It requires that protection be granted for a minimal period of seven years and should be renewable indefinitely. If the trademark is not used for three years, protection can be canceled. The agreement prohibits the practice of requiring that a foreign trademark be used only when linked with a local trademark. This provision will require legislative changes in India. Finally, service marks are to be protected as trademarks. This provision will require changes in India, Pakistan, and Malaysia.

In the area of geographical indications, the agreement lays down that members should prevent the use of any indication that misleads the consumer as to the origin of goods. Wines and spirits are provided a higher level of protection. This part of the agreement does not affect developing Asian countries in any significant way.

Industrial designs are protected under the agreement for a period of ten years. Owners of protected designs would be able to prevent the manufacture, sale, or importation of articles bearing or embodying a design that is a copy of the protected design.

Finally, trade secrets and expertise that have a commercial value must be protected against breach of confidence and other acts contrary to honest commercial practices. This provision could necessitate legislative changes in Indonesia, Philippines, Thailand, and Viet Nam.

The final section of Part II of the agreement deals with anticompetitive practices in contractual licenses. This section addresses developing countries’ concerns that IP protection will strengthen the monopolistic control of developed countries over technology. The agreement recognizes the members’ right to specify in their domestic legislation anticompetitive licensing practices or conditions that constitute an abuse of IP rights. It also recognizes the right to take remedial measures against anticompetitive practices provided they are consistent with other provisions of the agreement. Finally, countries are obliged to consult with each other to facilitate the enforcement of national laws against companies engaged in cross-border activities.

Part III of the agreement deals with the important but tricky issue of enforcement of TRIPs. The broad objective of the enforcement provision of the agreement is to ensure effective national enforcement of IP laws without the procedure becoming abusive. The main point to note here is that the primary responsibility for initiating action for enforcement falls on the private right holders, not the country. The country’s responsibility is to put in place procedures and remedies that will enable the right holder to initiate enforcement action in case of infringement. This means that the mere fact of infringement of IP rights does not make a country susceptible to multilateral trade sanctions. The country can be challenged by WTO only if it can be shown that it has failed to fulfill its obligations under the TRIPs agreement.
Countries have two types of obligation: on procedures and outcomes. The former includes judicial, administrative, and criminal procedures. These will not require major changes in existing laws. The more difficult issue concerns outcomes. As Subramanian (1995) notes,

Article 41.1 of the TRIPS agreement specifies that enforcement must be expeditious, while Article 41.5 states that the TRIPS agreement "does not create any obligation to put in place a judicial system for the enforcement of IP rights distinct from that for the enforcement of law in general, nor does it affect the capacity of Members to enforce their laws in general." The key question that arises, in my view, is whether the standards of performance required of national courts and customs are absolute or relative. Frankly, the TRIPS agreement does not provide a clear answer...

Subramanian goes on to explain the point with the help of an example. Suppose it takes ten years for an IP case to move through national courts in India, would that be regarded as ineffective enforcement and therefore subject to the WTO process? Would India’s case be weakened by the fact that the equivalent figure for the US or EU is two years? Or could it invoke the fact that a developing country cannot be held to the standards of developed countries? Answers to these questions are not clear and may have to await future deliberations at the WTO. If dispute settlement panels decide to hold countries to some absolute standards, a disparity will arise in a country’s legal system because IP cases will be processed faster and hence become a privilege.

Part III of the agreement deals with two further issues: dispute settlement procedures and transitional arrangements. The strengthened WTO dispute settlement procedures (see below) will apply to the TRIPS agreement. On the one hand, this means that countries that fail to meet their obligations can be subject to trade sanctions by offended countries. On the other, it will help contain unilateral sanctions such as those imposed by the US under its Special 301 provision of the Trade Act of 1988. Offended countries must seek the redress of TRIPS violations by their trading partners through the dispute settlement procedure.

Regarding transitional arrangements, national treatment and the MFN provision must come into force beginning 1 January 1996. Provision on enforcement, introduction of plant variety protection and protection of biotechnological processes will have to be implemented by 1 January 2000 by developing countries and 1 January 2006 by the least developed countries. Patent protection for biotechnological products will have to be implemented by 2005. In the important area of pharmaceuticals, the transitional provisions are complex. But, in short, business will be as usual (i.e., no impact) until 1 January 2005. Implementation will begin to have an impact starting 1 January 2005. Any drugs that are already on the market before 1 January 2005 will not be subject to patents.

2. Economic Impact. Knowledge is a public good in terms of nonrivalry in consumption and nonexclusion. Once knowledge is created, its consumption by one agent does not reduce the knowledge available to others (nonrivalry), and, in the absence of IP rights, it is freely available to everyone. These properties usually do not hold in the "pure" form, and the degree to which they hold varies with the product. From a social standpoint, it is the nonexclusion property that gives rise to the need for IP protection. In the absence of such protection, unless an innovator can keep knowledge secret as in the case of the Coca-Cola formula, benefits of the innovation will spill over to others. This will undermine the incentive to invent in the first place. IP rights allow the innovator to reap the benefits of
innovation and, thus, help ensure that desirable innovations take place. (This argument applies equally to writers, musicians, and film makers.)

On the one hand, the grant of an IP right helps generate innovations but, on the other, it raises the price for the resulting product to the consumer. The society must weigh these two interests to arrive at the optimal length of IP protection. The optimal length will vary by product, but for administrative convenience, the actual length of patents is uniform.

In the international context, if innovators are located in one part of the world, say the North, and consumers everywhere, the part of the world that does not expect to innovate, the South, does not have much incentive to provide IP protection. A conflict between the two sides is then likely to follow with the North demanding TRIPs and the South objecting to such demands. The conflict is made particularly complicated by the nonrivalry property of knowledge. After all, the use of knowledge by the South does not reduce its availability to the North.

Indeed, if one makes the plausible assumption that IP protection in developing countries does not impact the level of innovations, from a global standpoint, the optimal policy is not to have IP protection in these countries. For in this situation, the marginal social cost of the use of knowledge by them is zero (no innovations are foregone). Any gains to innovators from the introduction of IP protection will be more than offset by losses to consumers resulting from higher prices.

From the viewpoint of ADCs, the effect of the TRIPs agreement can be divided into four categories. First, TRIPs will lead to monopoly pricing of products that could be sold previously at a fraction of the cost by imitators. This effect could give rise to large losses in sectors such as pharmaceuticals and chemicals, where reverse engineering is relatively easy. Second, if TRIPs lead to new innovations, which in turn result in higher consumption of products in Asia, the latter will benefit. For example, IP protection may lead to more research on tropical diseases. This gain will accrue regardless of who innovates. Third, if TRIPs also give rise to innovations by Asian firms, the latter will profit from selling the resulting product globally. These profits constitute a part of Asian gains. An example is computer software from India and Pakistan. Finally, the presence of IP protection may influence the location of research and development (R&D) activity itself. Systematic evidence on this effect is not available. The only sectors where IP rights seem to have some influence on location are pharmaceuticals and chemicals.

Despite this favorable effect of IP protection, the pharmaceuticals and chemicals sectors are precisely the sectors where developing countries are likely to lose most in the post-TRIPs world. This is because of increased prices of drugs and chemicals which will no longer be subject to imitation. Using a simple, partial equilibrium model, Subramanian estimates that, assuming the elasticity of demand to be 0.75, starting in 2015 when the full impact will be felt, annual real income losses in the pharmaceuticals sector could range between $315 million to $1.3 billion for India, $33 million to $133 million for Indonesia, $46 million to $186 million for Pakistan, $59 million to $237 million for Philippines, and $47 million to $189 million for Thailand.

A key factor influencing the size of these losses is the proportion of drugs that will be patented. According to data presented by the pharmaceutical industry, almost 60 percent of current sales of drugs in developing countries would have been patented in the presence of IP protection. This figure is clearly the upper limit. A more careful study for India by Wattal (1995) which looks at the top 500 products, places this figure at only 16
percent. In the figures reported in the proceeding paragraph, the upper limit assumes the proportion of patentable drugs to be 60 percent and the lower limit 15 percent.

TRIPs may bring some gains in the pharmaceutical sector, however, by encouraging research in tropical diseases. Even if this research is done by developed countries, ADCs will benefit on account of cures that may not have been available in the absence of TRIPs.

This point is even more relevant in the area of agriculture. This sector is increasingly witnessing a privatization of R&D efforts. There is also evidence from the US that R&D in agriculture responds positively to IP rights protection. In Asia, currently, R&D is concentrated in hybrids, which are difficult to duplicate. If IP rights protection is introduced, R&D will rise in other varieties as well.

There has been a great deal of confusion regarding the potentially harmful effects of TRIPs on farmers’ rights to retain grain from harvest to be used as seed, across-the-fence sales, and experimental research using protected seeds. As Box 5.2 taken from Subramanian’s paper explains, these concerns are unfounded.

**Box 5.2 Plant Variety Protection—Needless Anxiety?**

The TRIPs provisions on the protection of plant varieties and seeds has raised concerns about their possible detrimental impact on the development of agriculture, which still accounts for a high share of GDP in several Asian developing countries. Farmers, who have led the chorus of opposition against these TRIPs provisions, perceive their very livelihood as being threatened, believing that the agreement would create monopolies of seed creators (usually foreign) and raise significantly the costs of production in agriculture by:

* Bringing under protection existing seed varieties and genetic material
* Preventing farmers from retaining their seeds from the current harvest for re-sowing the following season (the so-called “farmer’s privilege”)
* Preventing farmers from selling small quantities of retained seeds (across-the-fence sales)
* Preventing the experimental or research use of protected seeds without the authorization of the creator of the seed variety.

How valid are these concerns?

It should be noted that the TRIPs provisions on plant varieties offer countries the option of choosing either a system of patent protection (which is likely to be stronger than the alternatives in terms of favoring creators) or a sui generis method, or a combination of the two. The only requirement of the sui generis method of protection is that to be “effective”; this term has been intentionally included in constructive provisions of the International Convention for the Protection of New Varieties of Plants (UPOV convention). However, countries retain the freedom to choose the weaker version of UPOV (the 1978 agreement) over its stronger revision (the 1991 agreement).

In relation to farmers’ concerns, the following should be noted. First, plant variety protection would only apply to the new subject matter, that is, matter created five years after the entry into force of the agreement for developing countries (the year 2000), and eleven years in the case of the least developed countries (2006). Matter in the public domain—existing seeds and other material—would not have to be protected.

Second, as regards “farmers’ privilege”, both UPOV 1978 and UPOV 1991 explicitly recognize the right of countries to allow their farmers to retain seeds from their harvest for further growing on their land. Indeed, this is a widespread practice in several industrial countries.

Third, “across-the-fence” sales of seeds would probably be technically inconsistent with both UPOV versions, unless they were considered to be covered by the exception for private non-commercial purposes. In practice, such sales occur all around the world, and it would in all probability not be feasible or economic for right holders to take action against such commercially insignificant activity.

Fourth, as regards the concerns about technology diffusion, the UPOV convention explicitly states that the right holder should not prevent use of protected matter for experimental purposes—the so-called breeders’ exemption. However, under UPOV 1991, if a seed is “essentially derived” from a protected seed, the commercial sale of the former cannot be effected without the consent of the creator of the latter. UPOV 1978 does not impose even this constraint.

Thus, many of the specific concerns of farmers are probably not well-founded, being based on an inaccurate reading of the text of the agreement. The overall welfare implications of TRIPs on agriculture for Asian countries might even be positive in the medium term, as discussed in the text.

Finally, for some countries such as India, gains may also arise from exports of IP-based products. India is an exporter of computer software, films, and audio-video recordings. There will be gains in these areas from royalties as well as increased R&D.

3. Policy Option. In areas such as pharmaceuticals, where countries expect to lose from TRIPs, Subramanian suggests three policy actions: First, the TRIPs agreement does not prevent the use of price controls. Indeed, price controls exist in many developed countries with strong IP rights regimes. In Europe, which has a nearly harmonized patent regime, the average price of patented drugs can vary by a factor of 3:1, due largely to price controls. Second, the TRIPs agreement has severely limited the use of compulsory licensing (which was, for example, the preferred tool in Canada for regulating drug prices) by imposing two stringent requirements: (i) The country must demonstrate that the patentee has refused to make available a voluntary license on reasonable commercial terms and conditions; and (ii) adequate compensation must be paid to the patentee. These conditions can be waived, however, if it can be shown that the IP rights holder’s actions have resulted in an anticompetitive practice. ADCs can, in their national competition laws, specify standards of abuse, encompassing such outcomes as high prices. In the event that these standards are violated, compulsory licensing could be used to redress the abuse and bring prices down to a reasonable level. Finally, under the TRIPs, governments retain the possibility of allowing parallel imports. If a patent holder acts as a discriminating monopolist, charging a higher price on one market and a lower one in another, the higher-price country can import from the lower-price country. Though, on average, prices charged by a discriminating monopolist will be lower in ADCs than in developed countries, there may be variation within Asia. Countries may be able to take advantage of this price differential by going to the lowest source of supply.

D. Nontraditional Instruments of Trade Policy

With the relative decline of tariffs and quotas, the use of nontraditional instruments of trade policy is on the rise and is likely to continue this trend. Two of the most important instruments are antidumping and safeguards. In addition, the WTO dispute settlement process which is considerably tighter than its predecessor under GATT, promises to be an effective instrument of containing protectionist actions taken in violation of GATT/WTO.

1. Antidumping. There has been an explosion of antidumping (AD) proceedings in recent years. The number of outstanding AD measures in the US rose from 112 in 1985 to 198 in 1989 and 236 in 1992. Until recently, only four or five nations (counting the EU as one) regularly used AD measures. These included EU, US, Canada, and Australia. Japan has used its AD laws only a handful of times. Among developing Asian countries, only Korea has been a consistent practitioner of AD over the past ten years, though India has begun to appear with some regularity. Recently, Taipei, China and Thailand have also taken AD actions. Interestingly, a significant proportion of Asian AD actions have been imposed on other Asian countries.

ADCs have been frequent targets of Western AD actions. The economies most frequently subject to antidumping proceedings are People’s Republic of China; Korea; Taipei, China; and Thailand. But India, Malaysia, Indonesia, Philippines, and others have
also been targeted. AD measures against ADCs have constituted some 30 percent of the total AD cases in developed countries since 1985.

AD measures are permitted by GATT under its Article VI, which defines dumping as having occurred if the product of a country is sold in another country at less than its normal value. Normal value is, in turn, defined as the price at which the product is sold in the domestic market. If the latter is not available, normal value is defined as the highest export price in any third country or the cost of production of the product in the country of origin plus a reasonable addition for selling cost and profit. Article VI allows AD duties provided the effect of dumping is to cause or threaten material injury to the established domestic industry. The duty is not to exceed the difference between the normal price and the price at which the product is sold in the country where dumping occurs.

Beyond these general guidelines, Article VI does not provide any detail on how a particular price is to be calculated (e.g., should it be the average of various transactions prices within a specified period?), the determination of material injury, or the procedure to be followed in imposing AD measures. The Tokyo Round Antidumping Code made some progress in this direction but did not go far enough and, moreover, was signed by only 35 countries until as late as 1990. The UR Antidumping Measures (ADM) Code goes much farther and will be adhered to by all members of WTO.

a. Provisions of the ADM Code. Kenneth Abbott of Northwestern University notes that the UR ADM Code introduces several features restraining protectionist elements of AD but, in many cases, these are weakened by additional provisions (Abbott 1995). There are seven main features that deserve mentioning: First, US and EU have for years compared the prices charged in individual export transactions with the average home market price to determine the existence of dumping. This practice is biased in favor of a finding. The ADM Code now requires that export prices be compared on either an “average-to-average or transaction-to-transaction” basis. As a result, the US has adopted the average-to-average comparisons in the majority of cases. Second, the ADM Code also restraints the methodology for calculating “constructed value”, which has been used in the US as a measure of normal value, which is compared with the export price to establish the existence of dumping. In the past, calculations of constructed value could be inflated by adding 10 percent of overhead cost and 8 percent profit to direct costs of labor and material. This biased the system in favor of a finding. The new Code requires that overhead and profit be based on actual data. Third, Article VI requires an injury test for the “industry” but does not define industry. As a result, in practice, when individual firms or trade associations file AD petitions, it is presumed that they are acting on behalf of an “industry.” Under the ADM Code, a determination must now be made, though, in Abbott’s view, the test is relatively lax. The test requires that the petition must be “supported” by producers (i) accounting for 25 percent of the total production of “like products”, and (ii) representing more than 50 percent of the production of those firms expressing a position, pro or con, on the petition. Fourth, in the US, AD duties stay in force for years. The ADM Code introduces a sunset clause under which such duties are to be generally terminated after five years. Unfortunately, the clause is weakened by the provision that if the authorities determine that the expiration will lead to further dumping and material injury, they can extend the measures beyond five years—apparently indefinitely. Fifth, in the US, a dumping margin in excess of 0.5 percent of the export price was sufficient for a finding. The ADM Code raises this margin to 2 percent. Finally, if the volume of dumped imports from a country is less
than 3 percent of the total imports of like products, AD proceedings must be terminated. This restraint is weakened, however, by the additional provision that if dumped imports from several countries together account for more than 7 percent of total imports, the 3 percent rule does not apply.

b. **Economic Effects.** Economists have long believed that, except in the case when dumping is predatory and leads to the replacement of competitive firms by a monopoly or oligopoly, it is beneficial to the country in which it takes place. The logic is simple: a country benefits from the low price of imports and the high price of exports. Because in today’s world many firms from many countries compete against one another in any given market, the existence of predatory dumping is nearly impossible to find. Therefore, economists almost always regard AD as pure protection.

It may seem that AD duties generate revenues that may be a source of improved welfare. This is unlikely to be true, however, since the effect of ADM is to raise the border price rather than lower it. Therefore, while a tariff can improve a country’s terms of trade, an AD duty is likely to do the opposite. The price to the buyer in the importing country rises by more than the AD duty per unit.

From the seller’s viewpoint, the increase in the border price, constituting an improvement in the terms of trade, may seem to be a good thing. But because the duty is discriminatory and other exporters are present in the market, the seller subject to the ADM can be priced out of the market. Thus, because of what may be called “trade diversion” to a higher-cost source, the welfare effect of AD actions are likely to be harmful for both exporting and importing countries.

How will the new ADM Code affect ADCs? Abbott concludes thus

...The ADM Code restricts some of the more egregious purely protectionist devices in current use and limits the protective effect of ADM in other ways, several of which will be beneficial to Asian developing countries. At the same time, however, the Code leaves rational authorities with considerable discretion, and the major users of ADM have taken advantage of this ambiguity to enact measures designed to maintain at least much of the former strength of their antidumping laws.

c. **Policy Actions.** Noting that AD actions are costly to the countries imposing these measures, Abbott does not favor their introduction in ADCs. He goes on to note, however, that if domestic pressures in ADCs are going to require the adoption of ADM in any case, a strategic approach may be worth considering. In his own words,

Strategically, then, the wisest course for new users of antidumping laws would seem to be—if restrictive elements must be adopted—to mimic the restrictive elements in the laws of the US, the EU and other countries. This would have two potential benefits. First, if those elements are challenged in the WTO DS systems as inconsistent with the ADM Code, the same challenge would lie against the laws of those other countries. Litigation by a single country would effectively liberalize the laws of many countries. Second, even if the restrictive elements are not challenged, or are upheld as permissible under the Code—as might be the case for negotiated liberalization...

In support of his argument, Abbott notes that the use of ADM by Korea had an important effect on the ADM Code negotiated in the UR Agreement. The first case under Korea’s amended AD law— involving polyacetal resin from US and Japan—led to a GATT complaint by the US regarding procedural and substantive deficiencies of Korea’s decision.
Partly in response to the US concerns, the Western nations agreed to more stringent procedural rules in the UR ADM Code.

2. Safeguard Measures. GATT Article XIX provides an explicit "escape clause" remedy for industries that incur serious economic costs because of liberalization of markets. If, as a result of the obligation incurred by a country under GATT, including tariff concessions, there is such a large increase in imports that it threatens serious injury to domestic producers of like products, the country can suspend the obligation in whole or in part. Article XIX is consistent with the use of quantitative restrictions.

Formal safeguard measures have not been employed frequently, however, because of the availability of other instruments (e.g., tariffs and quotas in developing countries and ADM in developed countries). What have been used are "gray area measures" such as the voluntary export restraints (VERs). This is one of the areas the newly created Safeguard Measures (SGM) Code attempts to address.

a. Main Provisions of the SGM Code. There are five important changes the new SGM Code makes: First and most important, the SGM Code abolishes the use of VERs. Existing VERs are to be phased out over four years. For the future, the Code explicitly states that a WTO member state "shall not seek, take or maintain any voluntary export restraints, orderly market arrangement, or any other similar measures on the import side." But the only way to enforce this provision is through a challenge by the "victim" in the WTO, which, given that the "victim" is the initiator, is unlikely. Because of this problem, it is difficult to predict whether the Code will actually be successful in banishing VERs.

Second, with respect to the formal SGM (as opposed to VERs which are informal measures), the SGM Code limits the duration of SGM to four years. If it is determined, however, that protection is necessary and there is evidence that the industry is adjusting rather than simply enjoying its protection status, they can be extended for another four years.

Third, the original Article XIX provided for either compensation to affected exporting countries or, if an agreement on compensation cannot be reached, suspension of offsetting concessions granted to the nations imposing SGM. SGM is also to be applied on MFN basis. These and other requirements introduced by the new SGM Code make the use of the safeguard mechanism unattractive, especially because the AD mechanism is available. Therefore, the SGM Code drafters decided to eliminate the provision of retaliation for the first three years provided the measure is taken in response to an absolute increase in imports and in accordance with other provisions of the Code. With no threat of retaliation, it is then unlikely that any country will offer compensation.

Fourth, exports of a developing country are exempt from SGM as long as they constitute less than 3 percent of the total imports of the products in question. The exemption does not apply, however, if cumulative exports of such countries exceed 9 percent of the total imports.

Finally, ADCs can use SGM for ten years. But because they are not exempt from retaliation in the absence of compensation beyond the three-year period, this provision does not help make safeguard actions more attractive than AD measures. There is a provision in the SGM Code, however, that allows developing countries to reuse SGM more frequently. According to Abbott, this provision "could provide a way to minimize the effect of the compensation requirement."
b. Economic Effect and Policy Action. The economic rationale behind SGM is clearly much more sensible than that behind AD measures. Safeguard measures are intended to minimize the costs of adjustment to a more liberal trading environment. And they are correctly intended to be temporary. They are to be levied on a MFN basis and as such do not discriminate across different sources of supply. Most importantly, they do not have the perverse effect of worsening the importing country’s terms of trade.

Given these benefits, it stands to reason, that when there is a choice between SGM and AD actions, the former should be the preferred instrument. A disadvantage of safeguard measures under the old regime was compensation or, in its absence, retaliation. The new SCM Code has, however, solved that problem by dropping retaliation for the first three years. Moreover, because developing countries are allowed to reuse SGM more frequently, they may be able to extend that period, coming close to the five-year limit (under normal circumstances) for AD actions. Indeed, even if the option to reuse safeguards turns out to be difficult, given other advantages, ADCs should consider this option more seriously than has been the case so far.

3. Dispute Settlement. Under the dispute settlement (DS) provision, created originally by GATT Article XXIII and strengthened in 1979, 1989, and 1994, members agreed to discuss trade problems at meetings of the GATT Council of Representatives, and to submit their disputes to GATT panels. In the earlier years, the DS procedure was used infrequently, and it was feared during the 1970s that it might collapse out of disuse. But partly because of steady strengthening and partly because of intensification of disputes, the mechanism has been used more frequently in recent years. From two or three cases per year during 1983-1986, the number jumped to eight in 1987 and 17 in 1988. Significantly, developing countries including those in Asia have been absent from the DS system, especially as complainants. For example, during the five years from 1985 to 1989, there were only five cases against developing countries, of which three were essentially the same (the Korean beef case) brought by different complainants, and none at all brought by them.

a. Provisions of the Understanding on Dispute Settlement. The UR Understanding on Rules and Procedures Governing the Settlement of Disputes creates a powerful rules-oriented DS system roughly akin to domestic legal systems. The system is in the spirit of civil litigation. A country that feels itself wronged by another country’s violation of one of the UR agreements must initiate a proceeding by a request to the WTO Dispute Settlement Body (DSB), the General Council. Unless formation of a panel is rejected by consensus of the DSB, which includes the complainant, a DS panel is created. Because the panel must be created by the second meeting of the DSB at which the matter appears on the agenda, there is no fear of delay. Time limits also apply to the later stages of the proceedings.

If the panel finds that a violation has taken place, it is to “recommend” that the country concerned bring the offending measure into compliance. The primary objective of the procedure is to secure removal of offending measures. Any sanctions are viewed as a means to this end. The new GATT/WTO DS system also has a standing Appellate Body to which panel decisions can be appealed. The Appellate Body can affirm, reverse, or modify panel decisions. If it determines that a violation has occurred, it, too, must recommend the removal of the offending measure.
Panel and Appellate Body decisions, which are advisory to the DSB, are automatically adopted by the latter unless there exists a consensus for rejection. A "reasonable period of time" for compliance is established. The time period is suggested by the party subject to the decision but approved by the complainant, the DSB, or an arbitrator. If the decision has not been implemented within the "reasonable time," the complainant country may initiate negotiation for trade compensation. If compensation is not agreed upon within 20 days, the complainant country may ask for authorization to suspend an equivalent level of concessions. Approval for such suspensions is automatic unless there is consensus in DSB against it. The understanding limits the suspension of concessions to economic sectors related to the one in which the violation occurred.

b. Special Provision for Developing Countries. The agreement includes several special provisions to assist developing countries, especially as complainants, and to protect least developed countries. First, when a developing country is the complainant, it is guaranteed at least one developing country member on the dispute panel. Second, WTO is required to make available the assistance of a legal expert from the WTO technical cooperation service to a developing country complainant. Third, the DSB is required to consider additional measures to encourage the implementation of decisions when the complainant is a developing country. Finally, all members are to "exercise due restraint" in bringing cases against and seeking compensation from least developed countries.

The new system does not, however, respond to the long-time developing country demand for more public-oriented procedures; and it does not overcome all the practical problems faced by developing countries contemplating WTO litigation. A key problem is that, even when the DS process leads to a ruling that permits retaliation by a developing country, the retaliation may be meaningless when undertaken against an economically powerful country.

c. Provisions Regarding Unilateral Actions, Safeguard, and AD Measures. A special provision in the Understanding entitled "strengthening of the multilateral system" deals with challenges by one member to policies of other member countries. The context to this provision is provided by the Section 301 actions taken unilaterally by the US against several countries over the last two decades. Though the primary target of such actions has been Japan, many Asian developing countries including PRC, India, and Korea have also been subject to them. According to the Understanding, member states are prohibited from determining the existence of a violation except through the DS process.

Regarding safeguards, the main weakness to which there is no apparent solution, is that the Understanding leaves open the possibility of VERs when there is no complainant to challenge them. A purely private-interest DS system in which proceedings can begin only when someone who files a complaint cannot solve this problem. Abbot suggests that this is an area in which further strengthening may be required, either by providing for the initiation of DS proceedings against VERs by the WTO Secretariat or by more aggressive review or political pressure by the SGM Committee.

The DS system is also weak in the area of antidumping. In response to US demands, the Understanding requires a unique "standard of review" to be applied to DS panels reviewing national ADM. A DS panel may review the facts determined by national AD authorities, but the review must be limited to whether they properly established those facts and whether their evaluation of facts was unbiased and objective. If these standards are
met, the panel may not reach a different factual determination. Unlike the ADM Code, which creates objective rules on AD measures, the standard review opens the door for national discretion in the application of those rules.

d. Economic Impact and Policy Options. The impact of the DS Understanding is far-reaching. Good policies cannot yield results unless they are enforced. And, despite the weaknesses pointed out by Abbott (1995) in the areas of Safeguards and AD, the new DS procedures will go a long way toward creating a powerful enforcement mechanism. This is particularly so in comparison with the lax DS procedures implemented in the past.

From a policy perspective, it stands to reason that developing Asia should make more active use of the DS system than it has in the past. As noted above, developing countries have simply not been complainants at the GATT despite the fact that they were subject to unilateral actions and AD measures. To change this, developing Asian countries will surely need to invest in the training of personnel, gathering information, and creating institutions capable of making the country’s case to WTO in case of violations by other countries.

VI. Uruguay Round: Areas of Future Action

A. Trade in Services

1. The Structure of the General Agreement on Trade in Services (GATS). The GATS is composed of three main components: first, a framework agreement that provides a set of general principles and rules that apply to all trade in services as defined in the Agreement; second, the sectoral annexes defining specific commitments with regard to specific sectors each country is willing to subject to nongeneral obligations; and third, national schedules of specific commitments regarding market access and national treatment that apply to a subset of services on a sector-by-sector and country-by-country basis. The key provisions of the Agreement are summarized below.

a. Framework. The framework spells out the rights and obligations applicable to all services. Like GATT, the core principle of GATS is the MFN treatment (Article II). While it provides for temporary deviation from the MFN obligation, such deviations must be listed in the Annex on Article II exemptions and are subject to review every five years. The exemptions, which are subject to future negotiations, must not continue for more than ten years.

While recognizing a country’s right to impose domestic regulations relating to qualification requirements, technical standards, and licensing, the GATS requires that such measures affecting services trade be transparent. The GATS also stipulates that all relevant measures affecting trade in services be made publicly available so that firms can better understand the conditions under which they need to conduct business (Article III).
The other general obligations of the framework include mutual recognition or harmonization of criteria or authorization, licensing, or (certification) of services suppliers, so that it does not discriminate or restrict trade (Article III); discipline to ensure that monopolies are inconsistent with the MFN requirement and the specific commitments of GATS (Article VIII); and prohibitions on restrictions on international transfers and payments except for reasons of balance of payments, to be permitted on a temporary basis, subject to progressive phasing out (Articles XI and XII). Finally, the GATS allows exceptions to MFN obligations and preferences for partners in regional economic integration agreements (Article V).

The scope of obligations regarding national treatment and market access is limited only to services listed in a country's schedule (Articles XVI and XVII). Government procurement services, which are not included, are subject to future negotiations (Article XIII). The GATS does not contain specific obligations on subsidies but suggests that negotiations be held to deal with subsidies and countervailing duties (Article XV).

Disputes on GATS obligations are to be governed by the DS Understanding of the WTO (Article XXIII). Other institutional provisions of GATS concern the establishment of the Council for Trade in Services (CTS) (Article XXIV), technical cooperation (Article XXV), and relationships with other international organizations (Article XXVI). The accord recommends that the CTS establish in its first meeting a working group to examine the nexus between service trade and environmental issues; and another working group to examine the disciplines required to ensure that measures relating to qualifications, technical standards, and licensing in professional services do not pose unnecessary barriers to service trade.

b. Sectoral Annexes. The sectoral annexes interpret and apply the rules of the framework agreement to specific sectors. The annex on movement of persons makes it clear that the agreement applies to the temporary entry of individuals who are service suppliers of a member country and to citizens of a member country who are employed by a domestic service supplier.

The annex on financial services describes how the framework agreement applies to insurance, insurance-related services, banking, and other financial services. Members are not disallowed from taking measures for prudential reasons or for reasons of integrity and stability of the financial systems. With regard to the dispute settlement panels, the annex requires that they have the necessary expertise relevant to the specific financial service under dispute. Negotiations on finalizing the financial services offered in the national schedules of liberalization commitments continued till July 1995. During May-June 1995, countries could include MFN exemptions in their schedules and could improve, modify, or withdraw all or part of the commitments on financial services offered.

The annex on air transport services applies to scheduled and nonscheduled services in such areas as aircraft repair and maintenance, selling and marketing of air transport services, and computer reservation system services. The annex acknowledges the precedence of existing bilateral aviation agreements and excludes measures relating to traffic rights and services.

The annex on telecommunications requires countries to accord MFN and national treatments to all foreign services suppliers seeking access to and use of public telecommunications and transport network and services. However, distribution of radio and television programs is excluded from this provision. Service suppliers are allowed to use their own equipment and operating protocols, provided they comply with certain technical
specifications. However, developing countries are allowed to impose reasonable restrictions to improve their domestic telecommunications infrastructure and to boost participation in their trade in telecommunications services. However, such restrictions should be reflected in the country’s GATS schedule.

The basic telecommunications services are not part of the telecommunications annex nor are automatically accorded the market access and national treatment provisions. The annex provides that the MFN provisions of GATS will not be operative in the telecommunications sector until the ongoing negotiations on reciprocal liberalization among countries with major telecommunications markets are concluded in April 1996. The MFN provision remains operative whenever the signatories make a specific commitment in their national schedules.

The annex on maritime services is similar to the basic telecommunications annex in that it suspends the MFN provisions except where specific commitments have been made. Negotiations will continue on international shipping, auxiliary services, and access to and use of port facilities; the results will be implemented in June 1996.

c. **National Schedules.** In addition to the framework agreement and annexes, there are binding commitments to market access and national treatment in services, arrived at on the basis of bilateral negotiations, which are presented in the national schedules. A large number of countries have scheduled market access commitments in a wide range of services, but the most comprehensive ones are limited to tourism and financial services. Table 6.1, taken from the paper of Patrick Low of the World Trade Organization, provides a list of the number of commitments on service activities of GATS participants (Low 1995).

<table>
<thead>
<tr>
<th>More than 100</th>
<th>Austria, European Union, Japan, Switzerland, United States</th>
</tr>
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<tbody>
<tr>
<td>Between 81 and 100</td>
<td>Australia, Canada, Czech Republic, Hungary, Iceland, Norway, Slovak Republic, Sweden</td>
</tr>
<tr>
<td>Between 71 and 80</td>
<td>Finland, Hong Kong, PRC, Liechtenstein, New Zealand, South Africa, Thailand, Turkey</td>
</tr>
<tr>
<td>Between 61 and 70</td>
<td>Dominican Republic, Malaysia, Mexico</td>
</tr>
<tr>
<td>Between 51 and 60</td>
<td>Argentina, Poland, Singapore, Venezuela</td>
</tr>
<tr>
<td>Between 41 and 50</td>
<td>Brazil, Colombia, Israel, Kuwait, Morocco, Nicaragua, Philippines, Romania</td>
</tr>
<tr>
<td>Between 31 and 40</td>
<td>Chile, Cuba, Pakistan, Ghana, India, Jamaica</td>
</tr>
<tr>
<td>Between 21 and 30</td>
<td>Aruba, Brunei Darussalam, Egypt, El Salvador, Kenya, Macau, Netherlands Antilles, Nigeria, Peru, Senegal, Uruguay</td>
</tr>
<tr>
<td>Between 11 and 20</td>
<td>Antigua &amp; Barbuda, Benin, Costa Rica, Côte d’Ivoire, Gabon, Guatemala, Guyana, Honduras, Mauritius, Mozambique, Trinidad &amp; Tobago, Tunisia, Zambia, Zimbabwe</td>
</tr>
<tr>
<td>Between 1 and 10</td>
<td>Algeria, Bahrain, Bangladesh, Barbados, Belize, Bolivia, Burkina Faso, Cameroon, Congo, Cyprus, Dominica, Fiji, Grenada, Indonesia, Madagascar, Mozambique, Malta, Myanmar, Namibia, New Caledonia, Niger, Saint Lucia, Sri Lanka, St. Vincent and the Grenadines, Suriname, Swaziland, Tanzania, Uganda</td>
</tr>
</tbody>
</table>

*Note: The total number of activities is the number of sectors listed in GATT document MTN.GNS/W/120. Source: Low (1995).*
The list of unfinished agenda of GATS, where negotiations are scheduled to continue, includes emergency safeguards, government procurement, financial services, basic telecommunications, maritime transport services, movement of natural persons, and subsidies.

The important achievement of GATS is that it establishes for the first time a set of rules and disciplines regulating access to service markets. However, the agreement is extremely limited in its scope, as it does not extend national treatment unless it is specified in their national schedules and allows invocation of "temporary" exemptions from the MFN obligation. The sectoral annexes on financial services, telecommunications, civil aviation, and maritime are subject to ongoing negotiations. Nevertheless, it should be recognized that the telecommunications annex establishes important rights regarding the provision and use of information of other value-added services. The achievement of the UR on services is at best described as establishing a "bound standstill agreement for policies pertaining to specific sectors," which paves the way for substantive liberalization depending on future rounds of negotiations (Hoekman 1995). The shortage of output and trade data for services precludes undertaking any rigorous analysis of the significance of GATS for either individual countries or the world as a whole. As Low rightly emphasizes:

More work is required to evaluate the relative importance of specific commitments, the gaps in specific commitments, and the importance of market access and national treatment limitations where specific commitments have been made.

B. Trade in Agriculture

Trade in agriculture has traditionally been excluded from key GATT disciplines as applicable to trade policies in industrial products. In the original GATT Agreement, while Article XI imposed a general prohibition on quantitative restrictions on trade, paragraph 2 (c) allowed import restrictions on agriculture and fisheries products. Similarly, Article XVI on subsidies (paragraph 4) disallowed direct or indirect subsidies on the export of any product except primary products but with a caveat that "such subsidy shall not be applied in a manner which results in that contracting party having more than an equitable share of world export trade in that product." Since what constituted an "equitable share of world export trade" was not defined, large distortions gradually built up in the agriculture sectors of both the US and the EC. Over time, these distortions severely altered the pattern of international trade and affected the global allocation of resources and efficiency. Drawing attention to the global resource allocation distortions prevalent at the time when the UR agriculture agreement was negotiated, Ammar Siamwalla of the Thailand Development Research Institute (TDRI) observes that "... the European Community for example was able to move, through a highly protectionist regime, from importing cereals to exporting them, from importing sugar to exporting it" and "... indeed becoming the largest sugar exporter" (Siamwalla 1995). GATT (1994) also echoes the same sentiment and estimates the annual cost of domestic support measured for the agriculture sector at $173 billion in industrial economies and $24 billion in developing economies over 1986-1988. In addition, export subsidies averaged $18.2 billion and $3.2 billion, respectively, over 1986-1990.

At the time when the UR negotiations began, hopes were high that considerable progress would be made in dismantling the trade barriers in the agriculture sector of the industrialized countries. The initial position of the US was that all trade-distorting subsidies should be eliminated; this position was moderated in 1990 to a 75 percent cut in domestic support programs and a 90 percent cut in export subsidies (Schott 1994). The EC did not
take the US position seriously and assumed that, like in the past, the issue of agriculture subsidies would be removed from the agenda before the end of the UR. Indeed during the first four years of the UR negotiations, agriculture trade reforms were not addressed in a serious manner. However, at the Brussels Ministerial Meeting in December 1990, the issue was discussed in the form of a compromise proposal presented by the Swedish Agriculture Minister Hellsbrum. The solution involved a 30 percent cut in export subsidies, import restrictions, and domestic support measures from the levels prevailing in 1990, phased out proportionately over a five-year period. Even these modest reductions in agriculture sector distortions were not acceptable to the European negotiators, and the Brussels meeting ended without an acceptable solution. This meeting did, however, drive home the point to the Europeans that the UR could not be concluded without reaching an agreement on agriculture, no matter how modest. This realization came in part because the Cairns Group of Countries was not prepared for a multilateral trade agreement that did not address agriculture sector distortions in a comprehensive manner.

In December 1991, the Draft Final Act (Dunkel draft) included a set of mild proposals for the agriculture sector, which were to lay down the foundations for the final UR agreement. The initial reaction to the proposals by the powerful members of the EC, especially the French, was negative. Acrimonious debates followed within the Community on the merits of the Draft Final Act proposals, and no progress was achieved until the Blair House accord of November 1992 between the US and the EC. The Blair House accord further diluted the suggestions for reforming the agriculture sector compared with the Draft Final Act. Even these proposals were not acceptable to the French who wanted even milder reforms. Time was running out because President Clinton had effectively put a deadline to the UR by requesting Congress to renew the US's "fast track" negotiating authority only up to 15 December 1993. In December 1993, US and EU negotiators agreed to alter the Blair House accord's suggestions so that the UR could be concluded in time.

1. Salient Features of the Agriculture Agreement. The salient features of the Agriculture Agreement are listed below. Since the agreement applies differentially to developed and developing countries, in the main text the provisions as applicable to the developed countries are mentioned, while the parentheses contain the corresponding provision for the developing countries.

a. Market Access and Tariffication. The agreement requires that for all agricultural commodities, existing nontariff measures will be converted into tariff rate equivalent (TRE), which will then be combined with the existing tariffs, and "bound" at that rate. The combined (unweighted) average tariff would then be cut from this level by 36 percent (24 percent) over six years (ten years) in equal installments from their 1986-1988 levels. The agreement gives flexibility to countries in cutting tariffs across commodities as long as each tariff is cut by at least 15 percent (10 percent) over the six-year (ten-year)

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20 "Binding" defines the maximum rate applicable at the border.
21 For commodities for which the rates were already bound, the pre-existing rates would be the bound rates. If a particular commodity did not have bound rates but imports were restricted only by tariffs, the duty rates prevailing on 1 September were to be the bound rates. For all other commodities, the tariff equivalent of the nontariff barriers for the years 1986-1988 were to be the bound rates.
period. For commodities whose imports have faced prohibitive trade barriers, the participating countries have agreed to a “minimum access” commitment, which will initially permit import quotas equal to 3 percent (2 percent) of domestic consumption and rising to 5 percent (4 percent) at the end of six years (ten years). The agreement also obligates that, if the level of imports into a country exceeds the amount required to fulfill the minimum access commitment, then the current level of imports should be maintained.

To fulfill the quota commitment, a two-tier tariff policy has been adopted. A lower tariff rate (maximum of about 32 percent of the bound tariff rates) will be set for the quota imports while the higher “bound” rate will be applicable for the rest of imports. While the minimum access quotas are supposed to be nondiscriminatory, in practice a good deal of flexibility has been built into the agreement. For example, the sugar quota of the EU to the Lome Convention countries, the US sugar import quota, and the US meat import law were converted into a quota-tariff system with the quota countries retaining their shares allowing the importing country to fulfill its obligation of minimum market access.

Tariffication and market access are not unconditional. Annex 5 of the Agreement on Agriculture allows special treatment for some commodities in certain countries. For example, Japan, Korea, and Philippines have been allowed to delay tariffication of their rice markets by a few years. In addition, special safeguards have been built into the Agreement so that the market access commitment does not hurt domestic producer interests if there are unexpected surges in import quantities and/or decline in world prices. In these circumstances, duties, in addition to the bound rates can be charged. Since no domestic injury test is required to invoke these safeguards, they could be potentially used as tools of protection.

b. Export Subsidies. A significant reform in the agriculture sector is the agreement to reduce export subsidies. Export subsidies are defined to include outlay in the budget for payments that are contingent on export performance. These include payments to exporters of any proceeds that arise as a result of government action such as subsidies on marketing costs, internal transport and freight charges, and sales by the government of its own stocks at prices below the comparable price for domestic products.

As already noted, agriculture subsidies had become a major policy instrument for distorting international trade in this sector. The surplus agriculture production that resulted on account of high protection and support schemes was exported to the world markets with sizeable subsidies. There was no limit to the extent of export subsidies in the pre-UR regime which contributed to unpredictability of trading in these commodities and severely restricted competitive international trade. The extent of subsidized international trade in agricultural products was significant and Ingco (1995) notes that during the base

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22 The least developed countries are expected to bind their tariffs but do not have any obligations for liberalizing trade in agricultural commodities.

23 A country seeking “special treatment” need not allow quota imports of the product nor impose tariffs on the product. In return for this privilege, the country must provide market access of 4 percent (1 percent) of some other product in 1995, rising to 8 percent in the year 2000 (2004).

24 Under the safeguards as specified in Annex 5 of the Agreement, if imports exceeded a certain percentage of the preceding three-year average (referred to as the “trigger level”) or if the import prices fell below a trigger level, then additional duties, up to a maximum of one third of the normal applicable duty, could be imposed. The trigger level is defined as 105 percent of the base period imports for commodities where imports account for more than 30 percent of domestic consumption; 110 percent for base imports where imports are between 10 percent and 30 percent of consumption; and 125 percent if imports account for less than 10 percent of domestic sales. See Ingco (1995).
period (1986-1990) nearly half of world wheat trade was subsidized. Her computations indicate that “In 1986-1990, the European Union subsidized more than 95 percent of its exports of wheat and butter, more than 90 percent of cheese exports, 40 percent of its sugar exports, and more than 30 percent of its milk powder exports. US subsidized exports were largest in butter (94 percent), wheat (55 percent), non-fat dairy milk (40 percent) and cheese (23 percent).” Under the UR agreement, export subsidy expenditure will be reduced from the 1986-1990 level by 36 percent (24 percent) over six years (ten years) in equal annual installments. In addition, the volume of subsidized exports is to be cut by 21 percent (14 percent) over six years (10 years). The envisaged cuts in subsidies will be applied at the four-digit harmonized tariff system.25

The agreement, however, prohibits escalation of subsidies and also the extension of export subsidies to products not previously subsidized. Food aid is, however, exempt from subsidy reduction requirements. The agreement also excludes export credits, credit guarantees and insurance programs from the scheme, since these are subject to further negotiations. Export subsidies given within the terms of these commitments can be countervailed if injury to the domestic producer can be established.

c. Domestic Support. The UR agreement also seeks to reduce the total domestic support extended to the agriculture sector in a country. Domestic support measures relate mainly to market support prices, i.e., any policy measure that enables producers to receive a higher price than the prevailing world price, including activities that involve transfers from consumers and in the case of developing countries, to subsidies extended to inputs used in agricultural production.26

The manner in which total domestic support to agriculture will be reduced is as follows. For all agricultural commodities the total domestic support extended in the base year (1986-1988) will be computed and then aggregated. The latter, termed the “Aggregate Measure of Support” (AMS), will be capped and reduced by 20 percent over a six-year period. It is, however, noteworthy that the reduction in AMS applies at an aggregate level and not to individual commodities. This gives countries considerable flexibility in choosing the level of support they wish to extend to any particular commodity as long as the obligations toward the overall ceilings are met. Furthermore, under the de minimum provision, commodities whose level of aggregate support is less than 5 percent of the value of production, are excluded from the calculation of the AMS. Similarly, if a particular nonproduct-specific support does not exceed 5 percent of the value of total agricultural production, it does not count toward computation of the AMS.

It is significant to note that countries may exclude certain types of subsidies in computing the AMS thus reducing the range of support measures that count toward the reduction commitment. In particular, the two important support measures, the EU

25 The subsidy agreement allows some flexibility in the choice of the base period to US and EU producers of wheat and EU producers of beef. Since exports of these commodities were higher in 1991-1992 compared with the base period (1986-1990) it would have amounted to larger cuts in export subsidies in the initial years. In order to smoothen the subsidy cuts over the six-year period, the agreement allows the base period in the case of EU and US wheat to be 1991-1992 and in the case of EU beef to be 1986-1992. The change in the base period has led to peculiar anomalies whereby the ceiling for subsidized exports of EU wheat and wheat flour has been set at 19.1 million metric tons even though the base quantity from which the total reduction is calculated is 17 million metric tons. See Schott (1994).

26 The developing countries have been exempted from reduction commitments on input subsidies that are provided to “low-income or resource-poor producers.”
compensation program under the 1992 CAP reforms and the US deficiency program are excluded from calculation of AMS. Siamwalla (1995) expresses skepticism on the logic of such exemptions in calculating AMS by stating that:

The idea behind such "decoupled" income support is that the payments made by the government no longer provide incentives for farmers to produce more, and are therefore no longer trade distorting. In principle, such payments would be received by the factors of production specific to agricultural production, in particular, the farmers themselves would benefit. If the payments prevent farmers from exiting the industry, then they are trade distorting.

It should be noted that cuts in tariffs and export subsidies also count toward the 20 percent AMS reduction which effectively dilutes the effectiveness of this measure.

d. Likely Impact of the Agriculture Agreement. The Agriculture Agreement has achieved considerably less than what was expected when the UR trade negotiations began. Import liberalization resulting from agreed tariff cuts is likely to be limited because the tariff reductions envisaged are small and the impact of even these minimal tariff cuts may be diluted. Countries have agreed to 'unweighted' average tariff reduction of 36 percent over six years with a commitment to cut each tariff line by at least 15 percent over the six-year period. This gives them considerable discretion in deciding tariff cuts across commodities which makes Siamwalla observe that "...the outcome would inevitably be that significant cuts would be close to the 15(10) per cent level than the 36(24) percent level". Further, the "minimum access commitment" may not prove to be effective because countries can easily use special safeguard provisions to shield domestic producers from foreign competition.

The choice of the base period for determining tariff cuts and tariff-binding offers that countries have made will have even more serious implications for limiting trade liberalization in the sector. World prices of agricultural commodities were at their lowest in the mid-1980s, and hence the level of protection and support measures to the agriculture sector in the industrial countries were at their highest levels in the postwar period. Protection levels have subsequently come down in several countries as world prices have picked up in recent years. Using 1986-1988 as the base years for calculating the tariff equivalent of nontariff barriers and in computing the AMS clearly reduces the amount of liberalization that would be achieved, even if we ignore the fact that the agreement itself offers only modest reduction in protection and support levels.

Even more significant is the fact that countries have indulged in "dirty tariffication", i.e., the tariff bindings offered for individual commodities in the country schedules exceed the implicit tariffs in the base period 1986-1988, computed by comparing the domestic and international prices in the base period. The careful research of Ingco (1995) bears testimony to extensive "dirty tariffication" by both industrialized countries and developing countries, thus providing them higher protection in the post-UR period than that prevailing in the

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27 Annex 2 of the Agriculture agreement lists several "green box" (ostensibly nontrade-distorting and counted more in the form of general support to agriculture and rural development) measures which are also exempted in computing AMS.

28 Siamwalla correctly questions the logic of the safeguards provision, considering that they are in addition to the two-tier tariff protection, which should give countries adequate protection against import surges or price declines. The case becomes even weaker when account is taken of the "dirty tariffication" which countries have indulged in (see later in the text).
base period. Thus, while the agriculture agreement does bring the sector under WTO rules and discipline, there can be little hope that agricultural trade liberalization on account of the agreement is likely to be minimal. Inclusion of agriculture under the WTO umbrella of course has long-term implications for trade liberalization. It is likely that liberalization in this sector would be more widespread and meaningful in the subsequent rounds of trade negotiations.
# Appendix

Conference on the Emerging Global Trading Environment and Developing Asia  
29-30 May 1995, ADB Headquarters, Manila, Philippines

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