CHAPTER 4

World Trade and Economic Growth

AS WORLD WAR II DREW TO AN END, much of the industrial world lay in ruins. Hunger and despair, not hope, prevailed in war-torn Europe and Asia. Political events—first in Eastern Europe, later in Asia—threatened the stability and freedom of nations on those great continents. The United States emerged from the war stronger, and more productive, than ever before. At this critical juncture in world history, the United States had a choice: to return to an isolationist, protectionist policy, as it had in the interwar period, or to assume the mantle of leadership that lay open to it. If it chose the latter route, it would have to decide what kind of postwar world to foster—one that guaranteed its own prosperity and security, while seeking to maintain weaker countries as political and economic inferiors, or one that offered all nations the prospect for prosperity and freedom enjoyed in the United States.

In looking back upon the past four decades, it is clear that the United States discharged its leadership responsibilities by helping to construct a world that offered hope, freedom, and the chance for prosperity for all who sought it. The cornerstone of U.S. policy was a vision of a world united, not divided; one in which the nations of the world were free to exchange their goods, and their ideas, for the betterment of all. Rather than trying to subjugate Europe and Japan economically, the United States sent massive foreign aid to rebuild their economies. And rather than attempting to perpetuate historical divisions within Europe in order to maintain its superiority, America dispensed the aid in a way that fostered cooperation among those countries, so that mutual economic and political cooperation would replace the hostilities of the past. Today, Europe stands on the brink of economic union, and the Organization for European Economic Cooperation formed to coordinate the distribution of American aid in Europe has evolved into one—the Organization for Economic Cooperation and Development—that includes the world's great industrial democracies.

American policymakers also recognized that trade, as well as aid, was an indispensable ingredient in postwar reconstruction. Thus, the General Agreement on Tariffs and Trade (GATT), which celebrated its 40th anniversary this past year, was formed to reduce trade barriers that had been elevated in the interwar period. These barriers, notably the Smoot-Hawley tariff, were intended to protect American jobs and prosperity, but had instead lowered world trade and incomes. The principles of open and fair trade laid down in the GATT recognized that opening U.S. markets to foster reconstruction abroad would also create jobs and prosperity at home.

Today, the fruits of this policy are apparent. The growth rates of the industrialized countries during these past 40 years are virtually without parallel. Yet some see this phenomenal success as a cause for concern. Despite enormous increases in productivity and living standards in the United States, they see the narrowed gap between living standards here and abroad as a threat, rather than as the successful culmination of American policy. They cry that the Nation must protect American jobs and American industry; that it must close its borders, thereby frustrating the aspirations of developing countries today, as well as imposing enormous costs upon its own populace. As this chapter reviews the past 40 years of trade policy, it is important to recall the devastating experience of the 1930s—a time of isolationism—as well as the remarkable explosion in economic prosperity that accompanied the openness of the postwar period. It is also crucial to recognize those aspects of the international trading system, and of GATT in particular, that can be improved upon, for these issues will constitute the agenda for the future. The Nation's goal should not be to close markets at home, but rather to continue to open markets throughout the world.

ECONOMIC GROWTH AND TRADE IN THE POSTWAR WORLD

The end of World War II left a changed political and economic map. While the United States emerged from the war greatly strengthened, the economic output and industrial capacity of many of the combatants had been sharply reduced. Economic output in 1946 was well below its pre-war (1939) level in France, Italy, West Germany, and Japan. As late as 1950, output in West Germany and Japan had not returned to pre-war levels. By contrast, U.S. output in 1950 was two-thirds larger than the pre-war level, having grown on average nearly 4.8 percent per year.

From this inauspicious beginning, the rest of the industrial world soon joined the United States in experiencing rapid economic growth. Average world output over the period 1950–86 grew at an average rate of more than 4.2 percent, nearly doubling the 2.2 percent growth rate over the period 1870–1950. Even during the economic expansion from 1870–1913, output had grown at an average rate of only 2.5 percent.

While Japan, West Germany, Italy, and France offer the most dramatic examples of this phenomenon, every major industrial country, with the sole exception of the United States, experienced faster growth in the postwar period than in the period 1870–1913 (Table 4–1). When viewed in terms of output per man-hour—a measure of productivity—the superior postwar performance is even more striking. Average productivity in the major industrial countries grew at almost 3.8 percent during the postwar period, as compared with 1.7 percent from 1870–1913. Not only was productivity growth generally higher in the postwar period than earlier, but also in many countries the growth rate more than doubled, and in Japan and Italy it more than tripled the rate in the 1870–1913 period.

Accompanying this rapid economic growth was an even more rapid increase in trade flows between countries. As can be seen from Table 4–1, exports grew quickly during the periods 1870–1913 and 1950–87, while they were relatively stagnant from the onset of World War I to 1950. Furthermore, trade has expanded more rapidly in the postwar period than in the earlier period of economic growth. The growth in world trade is attributable to a number of factors, including dramatic declines in tariff barriers throughout the industrial world and the reduction of internal barriers in Europe with the formation of the European Community (EC)—a development promoted by the United States. The expansion in trade is most notable for those countries that grew most rapidly—Japan, West Germany, Italy, and France. For the period from 1957—when the EC was formed—to 1970—by which time all internal tariffs had been eliminated—export volumes for France and West Germany increased by more than 230 percent each, while Italian exports grew by more than 425 percent. During this same period, exports from the United Kingdom, which did not join the EC until 1973, increased by only 67 percent. The comparable movements in gross domestic product (GDP) are also indicative, with output levels in France, Italy, and West Germany roughly doubling, but output in the United Kingdom increasing by only 45 percent.

The postwar expansion was not confined to industrialized countries. Some countries that were impoverished at the start of this period made remarkable strides toward joining the ranks of the industrialized world. Between 1965 and 1985 developing economies as a whole grew at an average rate of more than 5 percent. Among the most successful economic performers were Singapore, Hong Kong, and South Korea. Singapore and South Korea grew at annual rates of

TABLE 4-1.—*Output and Export Growth, 1870-1987*

[Average annual percent change]

Item and year	United States	Japan	West Germany[1]	France	United Kingdom	Italy	Canada
Real GDP:							
1870 to 1913	4.1	2.5	2.8	1.7	1.9	1.5	3.8
1913 to 1950	2.8	1.8	1.3	1.0	1.3	1.4	2.9
1950 to 1987	3.2	7.5	4.4	4.0	2.5	4.3	4.4
Real GDP per man-hour:							
1870 to 1913	2.0	1.8	1.9	1.8	1.2	1.2	2.0
1913 to 1950	2.6	1.3	1.1	2.0	1.6	1.8	2.3
1950 to 1987	2.0	6.2	4.7	4.1	2.7	4.4	2.3
Real exports:							
1870 to 1913	4.9	8.5	4.1	2.8	2.8	2.2	4.1
1913 to 1950	2.2	2.0	−2.8	1.1	.0	.6	3.1
1950 to 1987	5.2	12.4	9.3	6.5	3.8	9.0	6.1

[1] Pre-war estimates for West Germany are adjusted for territorial change.

Sources: A. Maddison, *Phases of Capitalist Development*, Organization for Economic Cooperation and Development, and Council of Economic Advisers.

more than 9 percent, while Hong Kong's annual growth rate was nearly 8 percent.

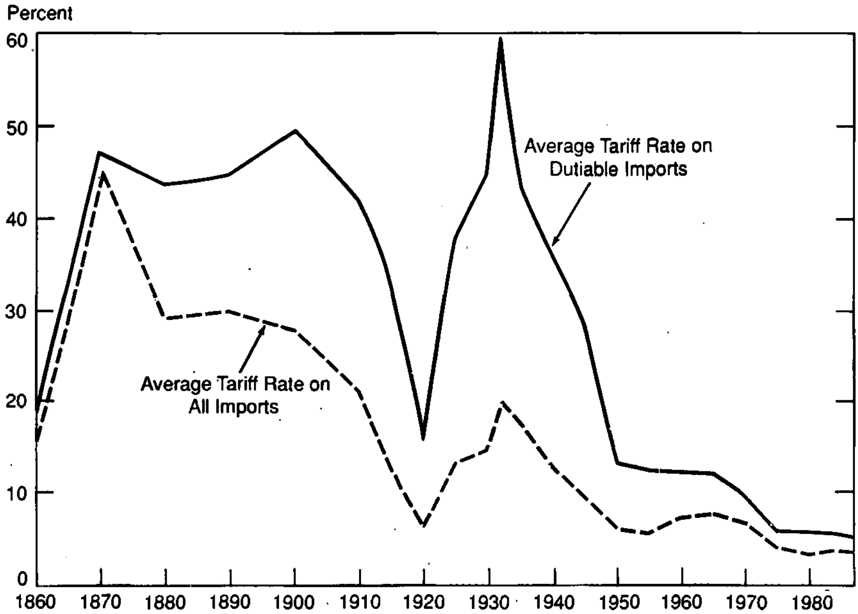
As in Europe, rapid expansion of exports accompanied fast overall growth in developing countries. Studies show that for the period 1963–85 real gross national product (GNP) per capita grew at more than 6 percent, and manufactured exports grew at more than 14 percent, for developing economies with a strong outward, trade-promoting orientation, while for the same period countries characterized as strongly inward-oriented and favoring self-sufficiency had real GNP per capita growth rates averaging 1 percent and manufactured export growth rates under 5 percent. Successful export-led growth in many developing countries could not have occurred without the liberalization of industrial country markets in the postwar period. Yet the greater successes have occurred in developing countries that have also opened their own markets to imports. Singapore and Hong Kong probably have the world's most liberal trade regimes. Although it still has much room for progress, South Korea initiated major trade liberalization efforts in the 1960s and again more recently.

TARIFF LIBERALIZATION IN THE POSTWAR PERIOD

Today, U.S. tariffs are the lowest in history, with average tariff rates on all imports under 4 percent. This dramatic reduction in tariffs represents the progress achieved by steady efforts over the past 50 years to lower tariff barriers, both at home and among U.S. trading partners. The United States had not always been at the forefront of tariff liberalization, however. In the 19th and early 20th centuries, the United States had a far more protectionist trade regime than did much of Europe. While the United Kingdom had pursued a policy of essentially free trade prior to World War I, the United States had consistently maintained high tariffs. From the end of the Civil War to 1900, U.S. tariff rates averaged nearly 30 percent on all imports, and more than 40 percent on dutiable imports, i.e., those imports subject to tariffs (Chart 4–1).

Chart 4-1

U.S. Tariff Rates, 1860-1987



Source: Department of Commerce.

The early 1900s saw several reversals in U.S. tariff policy. The Underwood Tariff of 1913 reduced tariff rates substantially, to an average of under 13 percent on all imports by 1915. But setbacks occurred following World War I, as the United States resumed a posture of political and economic isolationism. The Congress refused to approve U.S. membership in the League of Nations, and the Fordney-McCumber Tariff of 1922 brought the average tariff rate on goods subject to duties back up to nearly 45 percent by 1930. The economic downturn sparked by the 1929 stock market crash prompted the Congress to go even further, and the Smoot-Hawley tariff it passed in 1930 established the highest tariff rates in U.S. history. By 1932 the tariff rate on dutiable imports averaged nearly 60 percent. The combination of high tariffs and the ensuing depression led to a sharp decline in imports: between 1930 and 1934 the dollar value of U.S. imports fell by nearly 50 percent. But the intended goal of protecting American jobs proved elusive. Exports shrank as U.S. trading partners mounted retaliatory tariffs, and the economy continued to deteriorate.

The passage of the Reciprocal Trade Agreements Act of 1934 marked the beginning of the U.S. tariff reduction policy that has endured to the present. Using the authority to negotiate reciprocal tariff reductions on nonagricultural goods by up to 50 percent of their Smoot-Hawley levels, the United States had entered into more than 20 bilateral agreements by the beginning of World War II. This approach brought average tariff rates back down to 35 percent of dutiable imports (and 12.5 percent of all imports) by 1940. The turnaround in trade flows, aided by the economic recovery, was dramatic: from 1934 to 1939 U.S. imports and exports increased by 40 to 50 percent.

Although the trade negotiations conducted at this time were on a bilateral basis, they already embodied a principle of nondiscrimination central to the multilateral approach the United States would promote after the war. Tariff reductions were applied not only to negotiating parties but to other trading partners as well, on a most-favored-nation basis. The scope of the pre-war liberalization exercise was limited, however, as major trading nations such as Japan and many in Europe chose not to participate. The outbreak of World War II interrupted U.S. efforts toward freer trade.

U.S. POSTWAR OBJECTIVES

The United States emerged from World War II as the world's dominant military and economic power. Yet Soviet expansionism in Eastern Europe, and civil war in China, threatened global stability. Recognizing that political stability required economic prosperity, the United States adopted a policy of promoting rapid economic growth abroad. The three pillars of this policy were: a stable international monetary system to finance international transactions; an open trading system to foster global economic growth and cooperation; and economic aid to help speed postwar reconstruction. This chapter focuses on the trade component of American policy.

The economic principles that govern trade among nations are essentially the same as those that govern trade among regions of a single nation, or among individuals. Just as individuals, or States within the United States, improve their standard of living by specializing in those tasks they perform best and exchanging these products for goods produced by other individuals or States, so do nations gain from international specialization and trade. Likewise, international flows of investment, and the managerial and scientific know-how that accompany these investments, bring gains to all parties. The remarkable prosperity the United States enjoys today is, in large measure, attributable to the wisdom the Founding Fathers displayed 200 years ago when they made constitutional provision for the unrestricted flows of goods, capital, and people across State boundaries.

The gains from free international trade in goods and services are likely to extend beyond the economic sphere. Prior to the adoption of the Constitution, trade wars and other disputes were common among the original States. A contemporary observer remarked: "As to the future grandeur of America...it is one of the idlest and most visionary notions that ever was conceived...[The] clashing interests of the Americans...indicate that they will have no...common interest...a disunited people...suspicious and distrustful of each other, they will be divided into little commonwealths or principalities, according to natural boundaries...." Just as the economic union created by the Constitution led to a politically cohesive Nation, so can freer trade among nations lead to increased international political cooperation.

Embracing a policy of free trade does not imply that governments have no role in regulating international commerce. As with domestic commerce, government policy must ensure a stable economic environment, open competition, free trade, enforcement of contractual rights, and protection of intangible and tangible private capital. Governments that make unpredictable or frequent changes in tariffs or other restrictions on trade are likely to disrupt economic activity. Countries' failures to protect foreign investment or intellectual property rights reduce the returns to investment or innovation, decrease investment, and restrict the international flow of capital and ideas. Trade liberalization in one country generally benefits its trading partners as well as the country undertaking liberalization. International coordination raises the possibilities for additional liberalization efforts and the consequent gains from expanding trade. Thus, creation of a proper international trading environment requires active cooperation among nations to make and enforce the rules of the game. Recognizing the economic and political benefits of broad international participation in trade liberalization, the United States made a multilateral approach the cornerstone of its postwar trade policy.

TARIFF REDUCTIONS IN A MULTILATERAL FRAMEWORK: GATT

As the war drew to a close in 1945, the Congress authorized the executive branch to seek tariff reductions of up to 50 percent of rates prevailing at the beginning of that year. The United States worked to establish a multilateral framework for negotiations. Under U.S. leadership, an international conference was convened in 1947 to establish an International Trade Organization (ITO) that would ratify the principles of free trade and create rules for enforcing these principles. American calls for talks to reduce tariffs immediately led 23 countries to participate in tariff-reduction negotiations in Geneva later that year.

For a variety of reasons, the European nations resisted American pressure for a rapid transition to free trade. These countries felt that their economies were too weak to compete in open markets, and generally favored more interventionist economic policies than did the United States. In addition, some wished to maintain the preferential trading arrangements they had with their colonies and other countries, and hence strongly resisted U.S. pressure for a comprehensive most-favored-nation principle.

Nevertheless, the talks in Geneva resulted in important achievements, both in the reduction of tariffs and in the establishment of general trading guidelines, which were drawn up as the General Agreement on Tariffs and Trade. Although the International Trade Organization was to have superseded GATT, the Congress failed to approve it and it never came into being. Thus, GATT emerged as the major forum for conducting international trade negotiations and supervising the implementation of their results. The next section reviews the principles guiding trade policy under GATT, the extent of GATT's achievements in tariff liberalization, and its remaining weaknesses in this and other areas of trade policy.

GATT Principles

The principles on which GATT was founded are the essential features of an open trading system. The GATT's aim of trade liberalization was to be achieved on a nondiscriminatory basis (that is, following the most-favored-nation or MFN principle); trade policy was to be transparent (hence favoring tariffs over quantitative restrictions whose effects on prices are less clear); tariff reductions negotiated under GATT, or "concessions" in GATT parlance, were "bound" so as not to increase above specified levels and were not to be replaced by other trade barriers ("integrity of concessions"); GATT members were to provide "national treatment" to each others' imports in matters of internal taxation and regulation; and nations were to follow an orderly process of dispute settlement, abiding by the internationally agreed upon rules and procedures, rather than engaging in unilateral retaliatory measures that might lead to escalating trade wars.

Tariff Reductions under GATT

In retrospect, GATT has had remarkable success in reducing, and in many cases virtually eliminating, tariffs. Three of the seven completed negotiating rounds stand out for their achievements in this area.

Inaugural Round in Geneva, 1947. This first round of GATT achieved substantial multilateral tariff cuts, as reductions negotiated in some 123 bilateral agreements were extended on a most-favored-nation basis to all participants. The United States made weighted-average tariff cuts of about 20 percent on dutiable imports. Participating European countries made less substantial cuts, from generally lower tariff levels, because the Smoot-Hawley tariffs had put U.S. rates in a higher range. But the effects of European concessions were not felt until the European nations made their currencies convertible, and abandoned most quantitative restrictions, at the end of the 1950s. The favorable economic climate in the United States allowed it to confer these asymmetric reductions. With most major U.S. industries enjoying trade surpluses, the specter of U.S. protectionism—although not absent—was not dominant.

Tariff concessions in each of the four rounds held over the next 15 years were comparatively minor, in part due to limited negotiating authority from the Congress, which demonstrated an increasing penchant to protect U.S. industry from competition. The combined effect of these talks was still notable, reducing U.S. tariffs by about 10 percent.

The Kennedy Round, 1963–67. The momentum for this round came from the United States, which wanted to ensure continued trading access to the newly formed European Community. The Kennedy Administration paved the way for more rapid progress on tariffs by obtaining enhanced negotiating authority in the Trade Expansion Act of 1962. Not only did this act allow for high tariff cuts (up to 50 percent), but it also eliminated some restrictions that the Congress had earlier put in place to prevent reductions in specific industries. The Kennedy Round of GATT that ensued was even more successful than the first Geneva Round had been. In addition to reducing average tariffs on dutiable imports by more than one-third, it included much broader country coverage, as important trading countries such as Japan and West Germany had since acceded to GATT. Because the negotiating principle changed from an item-by-item focus ("request-offer" in GATT parlance) to a formula approach of automatic 50 percent cuts on all nonagricultural products with exceptions to be negotiated, the product coverage was also more comprehensive than any prior GATT round.

The Tokyo Round, 1973–79. Again using a formula approach, major industrial nations agreed to cut average tariffs by about one-third in the Tokyo Round of GATT. The phased-in reductions from this round were completed in 1987. Table 4–2 shows pre- and post-

Tokyo Round industrial tariff rates, based upon the concessions negotiated during the round and the prevailing trade flows. With weighted-average tariff levels of major industrial nations brought down to levels below 5 percent, and in most cases these tariffs are bound not to increase under GATT, a case can be made that the goal of multilateral tariff liberalization is largely accomplished.

TABLE 4-2.—*Tokyo Round Tariff Cuts by Stage of Processing, Selected Countries*

[Percent]

Country and period	All industrial products	Raw materials	Semi-manufactures	Finished manufactures
United States:				
Rates before Tokyo	6.5	0.9	4.5	8.0
Rates after Tokyo	4.4	.2	3.0	5.7
Percent cut	31	77	33	29
European Community:				
Rates before Tokyo	6.6	.2	5.1	9.7
Rates after Tokyo	4.7	.2	4.2	6.9
Percent cut	29	15	27	29
Japan:				
Rates before Tokyo	5.5	1.5	6.6	12.5
Rates after Tokyo	2.8	.5	4.6	6.0
Percent cut	49	67	30	52
Canada:				
Rates before Tokyo	13.6	1.0	14.8	13.8
Rates after Tokyo	7.9	.5	8.3	8.3
Percent cut	42	48	44	40

Sources: Director General of GATT and Congressional Budget Office.

Yet the average figures mask considerable discrepancies on individual products, as countries have retained high "tariff peaks" on items for which there is strong domestic protectionist pressure, such as textiles, apparel, and footwear (Table 4-3). Moreover, as shown in Table 4-2, nominal tariffs on raw materials and semimanufactures are lower than tariffs on manufactures. This escalated tariff structure, by reducing input costs for manufacturers, results in higher "effective protection" for processed goods than is reflected in the nominal tariff rate on these manufactures. Finally, although country and product coverage has increased considerably since the inception of GATT tariff negotiations, large areas still remain less-than-fully incorporated. Because of previous "special and differential" treatment, developing countries, including those newly industrializing economies that have made rapid strides over the past 20 years, have participated little in either the reduction or the binding of tariffs. Although tariffs have been cut on agricultural products, these cuts have been less even across countries (Table 4-3). Furthermore, agricultural tariffs are bound less frequently than are tariffs on manufactures.

TABLE 4-3.—*Tokyo Round Tariff Cuts by Industry for United States, European Community, and Japan*

[Percent]

Industry	Pre-Tokyo Round tariff rates			Post-Tokyo Round tariff rates			Percent cut		
	United States	European Community	Japan	United States	European Community	Japan	United States	European Community	Japan
Agriculture, forestry, and fisheries	2.2	7.1	18.4	1.8	4.9	18.4	18	31	0
Food, beverages, and tobacco products	6.3	12.4	25.4	4.7	10.1	25.4	25	19	0
Textiles	14.4	9.8	3.3	9.2	7.2	3.3	36	27	0
Wearing apparel	27.8	16.8	13.8	22.7	13.4	13.8	18	20	0
Leather products	5.6	3.7	3.0	4.2	2.0	3.0	25	46	0
Footwear	8.8	11.7	16.4	8.8	11.6	15.7	0	1	4
Wood products	3.6	3.3	.3	1.7	2.5	.3	53	24	0
Furniture and fixtures	8.1	8.5	7.8	4.1	5.6	5.1	49	34	35
Paper and products	.5	7.3	2.1	.2	5.4	2.1	60	26	0
Printing and publishing	1.1	3.2	.2	.7	2.1	.1	36	34	50
Chemicals	3.8	11.5	6.2	2.4	8.0	4.8	37	30	23
Petroleum and related products	1.4	1.2	2.8	1.4	1.2	2.2	0	0	21
Rubber products	3.6	5.3	1.5	2.5	3.5	1.1	31	34	27
Nonmetallurgical mineral products	9.1	5.2	.6	5.3	3.7	.5	42	29	17
Glass and glass products	10.7	9.9	7.5	6.2	7.7	5.1	42	22	32
Iron and steel	4.7	6.2	3.3	3.6	4.7	2.8	23	24	15
Nonferrous metals	1.2	2.6	1.1	.7	2.1	1.1	42	19	0
Metal products	7.5	7.9	6.9	4.8	5.5	5.2	36	30	25
Nonelectrical machinery	5.0	6.5	9.1	3.3	4.4	4.4	34	32	52
Electrical machinery	6.6	9.9	7.4	4.4	7.9	4.3	33	20	42
Transportation equipment	3.3	10.2	6.0	2.5	8.0	1.5	24	22	75
Miscellaneous manufactures	7.8	7.7	6.0	4.2	4.7	4.6	46	39	23

Source: Congressional Budget Office.

Weaknesses of the GATT Framework

The exceptions in product and country coverage for GATT-sponsored tariff reductions conflict with the basic GATT aim of achieving broad-based trade liberalization. Yet these and numerous other exceptions to GATT's main principles to foster open and fair trade have been accepted as necessary compromises in an agreement whose only teeth are those lent willingly by member countries. Because those principles ultimately embodied in GATT had been honored more often in the breach than in the word prior to the formation of GATT in 1947, it is hardly surprising that the initial exceptions list was relatively long. More telling is the fact that, rather than shrink, this list has grown longer. Safeguard clauses allow countries to take steps backward, on the overall goal of liberalization, by imposing quantitative restrictions (which also violate transparency) or by ignoring tariff bindings in the event of balance of payments concerns, injury to domestic producers (the "escape clause"), or a perceived threat to national security.

Discriminatory application of protection often occurs when countries invoke the balance of payments safeguard—as the Europeans did in the 1950s and more recently many developing countries have done. More generally, the most-favored-nation principle was sidestepped to allow the continuation of preferential trading areas in the early years of GATT; customs unions and free-trade areas were subsequently provided for even though they offer members better than most-favored-nation treatment and hence discriminate.

The GATT principle of integrity of concessions is weakened by the fact that discipline on domestic subsidies that can undo tariff concessions is not very effective. Integrity can also be violated by the use of safeguards and "grey-area" measures, such as "voluntary" export restraints—quantitative restrictions that violate GATT's spirit but not its letter. As discussed below, these and other nontariff barriers have become the major obstacle to trade liberalization. Although many GATT signatories have accepted codes limiting their use in the Tokyo Round, nontariff barriers remain an area of weakness for GATT. Although GATT does not formally provide exceptions to the use of its dispute settlement procedures, these procedures have proved sufficiently cumbersome and limited in authority that they have failed to replace the threat of retaliation in the resolution of trade disputes.

Limits on product coverage have been made by commission and omission, with the result that GATT is by and large an agreement prescribing the rules of the game for those manufactured products that are not too politically sensitive in the industrial countries. Although agricultural products are formally included, the effective exemption of two of the largest markets, the United States and the EC, has made the agreement largely irrelevant for the principles guiding agricultural trade. In the U.S. case, exceptions were granted at GATT's inception and in a waiver in 1955. And although it clearly distorts trade, the EC's border policy of using variable levies to defend domestic price supports has not been declared GATT-illegal. Due to grey-area measures, trade in textiles and apparel, and more recently in steel, takes place outside of GATT discipline. Trade in services, an expanding component of world output, has never been covered by GATT. Although protection of intellectual property rights is certainly consistent with GATT principles, the lack of specific codes of behavior on intangibles has effectively excluded them from GATT treatment.

Although GATT's membership list continues to expand, effective country coverage remains elusive. Under what is known as "special and differential treatment," wide-ranging exemptions to GATT concessions and disciplines have been granted to developing countries since the Kennedy Round. As another component of special and differential treatment, industrial countries have created "Generalized Systems of Preferences" (GSP), which allow developing countries certain tariff concessions superior to the most-favored-nation rates of GATT. At the same time, special treatment in GATT has reduced the negotiating leverage of developing countries, preventing them from gaining GATT concessions of most value to them, including reduced tariffs on manufactures and progress on nontariff measures, safeguards, and the treatment of tropical products and agricultural commodities. Although developing countries argue that they need special and differential treatment because of the less advanced states of their economies, their economic progress is hindered by the high tariffs and quantitative restrictions these exemptions have allowed them to maintain.

As the economic disparities among developing countries widen, with the newly industrializing economies such as South Korea, Brazil, Singapore, and Mexico making rapid strides in export markets, pressure is mounting in industrial countries to alter radically the special provisions. Developed countries may unilaterally end the concessionary tariffs granted to these most successful economies, as the United States recently did by graduating Hong Kong, Singapore, South Korea, and Taiwan from GSP status. In a multilateral context, the successful developing countries must be persuaded to accept GATT discipline over their own barriers. The aim is to encourage these better-off economies to provide market access to industrial and other developing country exporters more commensurate with the benefits they themselves enjoy, thereby also increasing the export opportunities for the poorest developing countries.

THE TRADEOFFS IN U.S. TRADE LEGISLATION—TARIFF REDUCTIONS VERSUS CREEPING PROTECTIONISM

Protectionist sentiment was not strong in the immediate postwar period, but some elements opposed liberalized trade. These sentiments have been on the rise. As tariff barriers have steadily fallen, other barriers to trade have arisen. Because the Congress has granted authority to negotiate tariff reductions, while at the same time channeling protectionist sentiment into legislation, a curious pattern has emerged in the trade laws of the postwar period. Trade bills needed by the executive branch for negotiating authority to reduce protection often include provisions that make it easier for firms to qualify for protection, and restrict Presidential discretion to limit protectionist measures.

Examples of this tradeoff are numerous. In 1947 President Truman, bowing to congressional pressure, issued an Executive order requiring all future U.S. trade agreements to include an escape clause that allowed the United States to renege on tariff concessions that injured domestic industry—a measure that became the basis for

GATT's safeguards on these grounds. In the 1950s the Congress added this provision to statute and strengthened it. In 1955, to win support for further tariff reductions, President Eisenhower proposed that Japan voluntarily limit exports of some cotton textiles. Under pressure from domestic coal and oil producers, the Congress, as part of its 1955 extension of the Trade Agreements Act granted Presidential authority for quantitative restrictions to be used for national security purposes.

To gain congressional support for the Kennedy Round negotiations, in 1961 President Kennedy entered into the Short Term Arrangement that restricted cotton textile exports from 17 countries. In addition to authorizing broad tariff negotiations, the Trade Expansion Act of 1962 authorized the President to withdraw tariff concessions from countries that had "unreasonable" restrictions on U.S. exports and to negotiate quantitative restraints on products that injured U.S. industry. Then, within the same year, the Long Term Arrangement regulating trade in cotton textiles was launched.

Protectionist sentiment grew in the 1970s and 1980s as some U.S. trading partners were perceived not to be offering equal opportunities for trade. Once again, enhanced textile protection, in the context of the Multi-Fiber Arrangement of 1974, was the price paid to gain congressional authorization for negotiating tariff reductions in the Tokyo Round and for fast-track congressional approval of any agreement on nontariff measures negotiated through GATT. The Trade Act of 1974 also reduced Presidential discretion in implementing International Trade Commission recommendations for protection, and introduced Section 301, a provision for countering foreign practices that "unreasonably" restrict U.S. exports.

The record of the 1980s has largely paralleled that of the 1970s. The 1988 *Economic Report of the President* documented the sharp increase in unfairness findings during the 1980s (against "dumping" at below fair prices and government subsidization of exports), cases for which no Presidential discretion exists. Nontariff barriers, for products such as steel, autos, machine tools, and textiles, have been entered into or extended. This Administration has, however, successfully resisted passage of several highly protectionist trade bills. Attempts to pass textile and apparel bills that would have increased protection for one of the most highly protected industries in the United States have been twice successfully repelled. A potentially disastrous trade bill that would have limited trade based upon bilateral trade balances has been successfully modified. While the Omnibus Trade and Competitiveness Act of 1988 has some troubling features, it also authorizes the President to reduce tariffs by up to 50 percent under the current Uruguay Round GATT negotiations.

This Administration has vigorously sought ways to expand free trade. Its attempts to open foreign markets to U.S. products have won some notable successes, while the resort to protectionist retaliation measures have been infrequent. It inaugurated the Caribbean Basin Initiative, and won congressional extension of the Generalized System of Preferences, in order to provide developing countries with ready access to U.S. markets. The United States-Israel Free-Trade Agreement was the first such agreement for the United States, while the United States-Mexico Framework Understanding should help to improve trade and investment flows between the two neighbors. Finally, the United States-Canada Free-Trade Agreement will bring tremendous benefits to both sides.

Notwithstanding the pressures for protectionism over the past 40 years, the move toward a liberal trading order has been remarkable. Tariffs on most products have been reduced to low levels, and trade flows and economic growth have responded accordingly. From 1950 to 1986 world real GDP has increased by 350 percent, while world trade, in real terms, has grown by more than 800 percent. The task for the future is to ensure that this progress continues, and that nontariff barriers are reduced.

THE SPREAD OF TRADE-DISTORTING MEASURES

Because most nations' tariffs are "bound" by GATT, the signs of increased protectionism in the 1970s and 1980s are not found in higher tariffs, but in other, often more hidden, forms of protection. Using a potentially limitless array of measures, governments distort trade flows and production decisions by subsidizing exports and domestic production, and by constricting the flow of imports. Import barriers include: assessed duties on unfairly traded products; "hard-core" nontariff barriers, such as quotas and voluntary export restraints or voluntary restraint agreements, which are poorly disguised quantitative restrictions; and "softer" nontariff measures, such as technical and health standards, which tend to distort trade if imposed for nonscientific reasons or applied in a discriminatory fashion. Many of these measures are difficult to quantify; no precise estimates of their tariff-equivalents, or their trade-distorting impacts, exist.

Yet convincing qualitative evidence of this rising interventionist and protectionist trend is available. One example of such evidence is the amount of domestic subsidies that governments supply to private industries and public corporations. Because these subsidies alter domestic production, they may distort trade flows and comparative advantage. As shown in Table 4–4, their amount has increased as a percent of GDP from 1960 to 1986 for most countries, the important exception being the United Kingdom, whose subsidy rate peaked in the mid-1970s. Two additional factors in the table qualify this observation. First, it would appear that the trend toward greater subsidization was reversed for many countries in the 1980s. Second, although the U.S. subsidization rate has grown, it is still significantly below that of other countries, reflecting the more market-oriented approach, and the sparsity of public corporations, in this country.

TABLE 4-4.—*Growth of Subsidies in Selected OECD Countries, 1960–86*

[Percent of GDP]

Country	1960	1970	1975	1980	1986
United States	0.2	0.5	0.3	0.4	0.6
Japan	(1)	1.1	1.5	1.5	1.1
West Germany	.8	1.7	2.0	2.1	2.1
France	1.6	1.9	2.0	1.9	[2]2.2
United Kingdom	1.9	1.7	3.5	2.4	1.7
Italy	1.2	1.3	1.9	2.0	[2]2.3
Canada	.8	.9	2.5	2.7	2.0

[1] Not available.
[2] Data are for 1985.
Note.—Based on national income accounts.
Source: Organization for Economic Cooperation and Development.

Countries also distort trade and compete unfairly for exports by providing export subsidies. In agricultural trade, many countries, including those in the EC and the United States, provide subsidies or rebates for exports of agricultural goods. For manufactured goods, the more common means is through "export financing," which provides subsidized credit to importers of the products. Data from the Organization for Economic Cooperation and Development (OECD) show that the implicit subsidy in export financing by 14 member countries increased by more than two-thirds from 1979 to 1982. Following successful U.S. efforts in the early 1980s to negotiate increased discipline over export credit subsidies through the OECD Export Credit Arrangement, the subsidy component in export financing has decreased substantially.

Foreign export or production subsidies unfairly distort trade, and impose burdens on domestic producers of like products. Although these foreign subsidies may actually benefit the domestic economy if it is a net importer of the subsidized good, GATT articles and the laws of many nations, including those of the United States, recognize these subsidies, as well as dumping, to be distortive and unlawful actions. Under U.S. law, dumping occurs when a foreign firm sells in the import market at a price below the price charged in the home market, or below costs as estimated by the Department of Commerce. Under the law, the United States may, subject to certain injury tests, impose duties to offset this dumping margin. Similarly, U.S. law allows duties to be imposed to "countervail," or offset, unfair advantages that accrue to foreign firms arising from government production or export subsidies.

Regardless of the intentions, or economic merits, of laws restricting dumping and foreign subsidization, their net impact can be protective. A finding that dumping has occurred can depend on estimates of costs of production if price data for the foreign market are not available. Precise cost estimates are often difficult to obtain, so a foreign firm may be found erroneously to be in violation. Furthermore, although many petitions may ultimately be rejected under these statutes, the filing, or even threat of filing, of unfair trade cases can restrict imports. It is costly for foreign firms to defend themselves against a dumping charge. Moreover, in the event of an affirmative finding, the level of import duties imposed retroactively is uncertain. The threat of such action is likely to raise prices foreign firms charge, thereby having a protective effect similar to a tariff, except that the revenue from protection is transferred from U.S. taxpayers and consumers to the foreign producer.

These legitimate procedures to counteract foreign unfair trade practices can result in cartel-like effects. Subsidization, and other distortions, are rife in the world steel market. In addition to subsidizing domestic producers, EC countries have used programs limiting imports (either through voluntary restraint agreements or minimum import prices) and internal production quotas to "rationalize" production. In 1982 the U.S. steel industry filed more than 130 dumping and countervailing duty petitions against steel imports from various foreign countries, including EC members. An extensive Department of Commerce investigation found subsidies, in some cases exceeding 20 percent, against some producers in the United Kingdom, Italy, France, and Belgium. It also found that other European producers, including the large West German producers, were either unsubsidized or received *de minimis* subsidization. The results were troubling for EC countries whose producers were found to be subsidized, as countervailing duties against their producers would effectively exclude them from the U.S. market. Ultimately, in October 1982, European producers agreed to a voluntary restraint agreement encompassing carbon steel exports from the EC to the United States.

The steel industry continued to face strong competition from countries not parties to the agreement. The industry proposed to file a large number of complaints that would have burdened the agencies responsible for making "unfairness" determinations and would have raised costs to importers. The alternative chosen was to negotiate additional voluntary agreements to reduce imports. The current agreements, reached with 19 countries plus the EC, are estimated to have an annual cost to consumers of several billion dollars and are scheduled to expire September 30, 1989. The steel industry is currently operating near capacity and, for the first time since 1981, reported significant profits in 1988.

While the United States is the dominant user of countervailing duty laws, other nations use antidumping provisions more aggressively. Of 460 countervailing duty cases reported to GATT between 1980 and 1986, more than 60 percent were initiated in the United States. But, of the 1,272 antidumping cases reported during this same time period, 27 percent originated in the United States, whereas 33 percent came from Australia, 22 percent from the EC, and 18 percent from Canada.

These actions significantly increased in the United States and abroad during the 1980s. In the United States, for example, the number of countervailing duty cases increased from an annual average of 21 during the period 1975–79 to an annual average exceeding 40 during the period 1980–86. In the EC, the number of antidumping cases reported increased from 71 for 1971–79 to 280 for 1980–86.

In contrast to antidumping and countervailing duty provisions, the protection offered through the "hard-core" nontariff measures falls largely outside of GATT jurisdiction. Table 4–5 represents one crude attempt to compare the prevalence of these barriers across countries and over time. It shows the percent, in value terms, of a country's imports that are covered by quantitative restrictions, voluntary export restraints, and nonautomatic licensing. While the numbers may not be quantitatively important, they are qualitatively instructive. They make clear that the United States is not the main offender. It is noteworthy that these barriers particularly seem to affect the exports of developing countries.

TABLE 4–5.—*Industrial Country Imports Subject to "Hard-Core" Nontariff Measures, 1981 and 1986*

[Percent]

Importer	Source of imports			
	Industrial countries		Developing countries	
	1981	1986	1981	1986
United States	9	15	14	17
Japan	29	29	22	22
European Community	10	13	22	23
All industrial countries	13	16	19	21

Source: The World Bank, *World Development Report 1987*.

SOURCES OF INCREASED PROTECTIONIST SENTIMENT

Many explanations have been cited to account for the increase in protectionist sentiment. These include the deterioration in the U.S. merchandise trade balance; the continuation of foreign subsidies and nontariff barriers; declining net exports in traditional U.S. strongholds, such as agricultural and manufactures; and a protracted period of inflation and high unemployment during the 1970s and early 1980s, which contributed to the notion that somehow imports were responsible for lost domestic jobs. Other contributory factors include a perception that the United States had lost its technological "superiority" and even its "competitiveness," and that an industrial strategy, coupled with protectionist trade policy, was needed to regain American superiority. These feelings were probably accentuated by a general belief that U.S. exports were subject to unfair barriers, a position that might have had some merit as foreign agricultural protection increased, and as the importance of service-type industries that were not (and still are not) subject to GATT discipline increased.

Despite popular beliefs, trade restrictions are inappropriate tools for attempting to reduce trade deficits. The trade balance reflects the discrepancy between national output and national expenditure, and little reason exists to expect protection to alter either of these significantly. While import protection in automobiles may reduce the trade deficit in that sector by increasing consumption and production of domestic autos, this reduction can be achieved only by diverting the resources required to expand auto production from other more productive uses within the economy.

The notion that imports cost American jobs is probably the most common argument for protection. While it is certainly true in a narrow sense that employment in an import-competing sector might decline if import protection were reduced or eliminated, this fact does not imply that total U.S. employment would fall. Rather, protection in that sector reduces the resources available for expanding output, and employment, in more efficient export sectors. Most studies of the consumer cost per "job saved" through protection put this cost at more than $100,000 per year, far exceeding the typical earnings in the affected industry. Moreover, protective policies that reduce foreign exports to the United States invite retaliation, which reduces the demand for U.S. exports, causing further inefficiencies in the allocation of resources and imposing extra costs on consumers.

Certainly unexpected increases in imports can cause temporary unemployment as workers retrain for new jobs. But the appropriate response is to facilitate labor adjustment, not to discourage it through permanent protectionist policies. Trade Adjustment Assistance, first introduced as part of the Trade Expansion Act of 1962 and significantly liberalized by the Trade Act of 1974, may be viewed as one attempt to ease this adjustment and to mollify domestic opposition to trade liberalization. The program, which is designed for firms and workers hurt by import competition, provides financial, technical, and retraining assistance to make firms more competitive and to assist relocation of workers. If adjustment through normal market forces is allowed, the displaced workers will find employment in other industries. Currently, the average period of unemployment is a brief 13 weeks. If permanent protection is offered, adjustment never occurs, and the cost of the policy remains forever. The rules governing explicit protection under the escape clauses in U.S. trade law (Section 201) and in GATT (Article XIX) recognize this danger and require relief to be temporary.

The recent economic record demonstrates that imports do not destroy domestic jobs. From 1982 to 1987 the volume of U.S. imports increased by more than 65 percent, while U.S. real GNP expanded by more than 21 percent, and employment by 13 percent. Meanwhile, West German imports increased by over 27 percent, its GNP grew by nearly 12 percent, and employment stagnated. During this period the U.S. merchandise trade balance fell sharply, while the West German trade balance rose by more than $45 billion.

Recent proponents of protectionism have focused on the use of "strategic trade" policy to promote selective, presumably high-technology, sectors. The essential notion is that economies of scale and learning-by-doing render the competitive paradigm inappropriate in these industries. Trade policy, by preserving the home market for domestic firms, or by promoting selected industries and their exports through subsidies, can be used effectively to prevent foreign competition and to increase the monopoly profits domestic firms earn from foreign sales.

These policies of targeting industries with import protection and export subsidies are harmful. The import restrictions hurt both domestic consumers and foreign producers. Because foreign countries may retaliate in kind, a situation can arise in which all countries are worse off, but no country has the incentive to reduce tariffs unilaterally. For manufactured goods, the costs of protection are likely to be even greater because the resulting market segmentation reduces the inherent benefits derived from economies of scale and product diversity. Promoting particular sectors through export subsidies is equally costly. The subsidies impose costs on taxpayers, are inconsistent with international trading rules, and invite retaliation.

Moreover, the argument for government activism is predicated on the notion that governments can effectively identify those industries that are at the forefront of technological innovation, and can devise appropriate trade policies to foster their dominance. This kind of fine-tuning, reminiscent of attempts to fine-tune the macroeconomy, presumes that policymakers have access to enormous quantities of information, wisdom, and objectivity. To be successful it also would require government officials to be able to foresee the major consequences of their actions.

If government pursues such activist policy, it is reasonable to ask what the policy response will be when it mistakenly backs a losing industry. Will it be willing to remove protection, or will it feel compelled to shelter an inefficient industry behind a tariff wall in order to avoid facing up to the mistakes it made? If business executives err, they are forced to face the cost of their decisions through the discipline of the market—lower prices, reduced output, and even bankruptcy. No such discipline is imposed on government officials, who can reach deep into the pockets of taxpayers and consumers to hide their failure. The reality seems to be that protection has been granted to sunset, not sunrise, industries and that this protection is hard to remove.

POLITICAL ECONOMY OF PROTECTIONISM

One possible explanation for continuing protectionist pressures is that economic efficiency is not all that matters; notions of equity and fairness also have considerable influence on public policy. In most developed countries, government agricultural programs, as well as the protection of some industries, are typically justified on these grounds. However, these objectives can be achieved through policy instruments superior to the trade-distorting devices that have been used.

A more likely explanation relates to other distributional consequences of trade-distorting policies. The benefits are concentrated among the relatively small number of people employed or owning assets in the protected industry. Meanwhile, the higher overall costs are paid for by the large numbers of taxpayers who foot the bill for government programs, and of consumers who pay higher prices for the goods. Because it is difficult to be informed on every issue, the many who are adversely affected by protection may not be aware of these costs. Yet those few who stand to gain from protection are likely to be well aware of the benefits. Just as with pork-barrel projects, the gainers are far more likely to make their voices heard than are those who are hurt.

It is not surprising that the Congress has traditionally been more protectionist than the President. The President, regardless of his party, responds to a national constituency, and thus needs to consider the impact of protectionist policies in a much broader context.

Senators and Representatives respond to smaller constituencies, wherein those few who gain from protection make their opinions known forcefully. If producers and workers in enough regions are affected, or if they are heavily concentrated in some regions, they can influence legislation. This President, like most postwar Presidents, has represented the voice of free trade within the government. Laws that attempt to reduce the President's discretion or authority increase the protectionist thrust of trade policy.

Protectionist efforts are most likely to be resisted when the distributional costs of protection are also highly concentrated. The steel agreements hurt domestic steel users, and recently efforts have been mounted by some of them, such as Caterpillar, to oppose renewal of the voluntary restraint agreements. Fabricators of copper wire and other copper products successfully lobbied in 1984 against protection for the copper industry, after an International Trade Commission decision ruling domestic copper producers had been injured by imports. Similarly, because the higher semiconductor prices that followed an agreement to stop Japanese dumping hurt high-technology American industries that use this product, industry associations representing the two groups have been working together to fashion policies that will be mutually beneficial and, presumably, less protectionist. By contrast, consumers of final products receiving protection, such as textiles and apparel, are in a relatively weak position to protest the costs of import restrictions.

The benefits to producers in the protected industries can be significant, and include increased profits on both the inputs and final products. One study of trade restrictions estimated annual gains to producers at $3.8 billion for carbon steel products, $2.6 billion for auto firms, $5 billion for dairy products, and more than $20 billion for textile and apparel firms. Depending on how they are administered, some of these programs impose substantial costs on foreign producers, while others essentially transfer, through higher import prices, additional benefits to foreign firms. The same study estimated that U.S. restrictions transferred benefits of $2 billion to foreign steel producers, $2.2 billion to foreign (Japanese) auto firms, and $1.8 billion to foreign textile firms. Even if these estimates are off by a factor of three, they are still prizes well worth pursuing. The even higher costs of these prizes are borne by a large group of consumers and taxpayers.

Not surprisingly, considerable real resources are spent in petitioning governmental groups that make and implement policy. Everyone, whether having spent time in Washington or not, is aware of the effort, time, and resources lobbyists spend trying to influence trade policy. Nor is the lobbying activity restricted to representatives of

U.S. firms. Department of Justice records show that in 1986 Japan spent more than $11 million on economic lobbying activity in the United States, Indonesia spent more than $7 million, and South Korea more than $4 million. The resources spent on these lobbying activities are wasted in an economic sense because they are withdrawn from potentially productive activities.

Protection in the form of licensing and quotas may lead to even greater inefficiency than tariffs. If the quotas are auctioned off, as in Hong Kong where licenses to export clothing to the United States may sell for 40 percent of the price of the clothing, then no additional inefficiency occurs. But if the quotas are allocated in some other manner, as is usually the case, then people will be willing to spend scarce resources trying to obtain them. Because the ownership of quotas confers private gains, but no gains to the economy as a whole, this rent-seeking activity is wasteful. It can be especially deleterious in less developed countries, as studies indicate that the implicit value of import licenses may have been as high as 7.3 percent of GNP in India, and 15 percent of GNP in Turkey.

THE SPECIAL THREAT OF NONTARIFF MEASURES

The opposing postwar trends toward lower tariffs, but greater use of nontariff measures, raise two related questions. First, does it matter what form of protection is used; second, why has this change in policy mix occurred?

Most economists view nontariff measures as being more costly than tariffs. Nontariff measures may circumvent U.S. laws and GATT, and may be negotiated, as was the case with the earlier restraint on Japanese car exports to the United States, even when there is no determination of an unfair trade practice, or of injury to domestic firms. Unlike escape clause relief, there is generally no provision for reducing protection over time ("degressivity"), nor is a formal time limit imposed on the protection. The agreements do expire, but they may be renegotiated, as has been the experience in textiles and apparel. Producers in these industries appear determined to maintain protection.

Quantitative restrictions are also inferior to tariffs because they cartelize the market. By granting firms more monopoly power, they lead to even higher prices. Studies indicate the restraints on Japanese automobile exports increased the price of Japanese cars in the United States by up to $1,000, and increased the price of U.S. cars by about $400. Moreover, because imports cannot respond to increased demand, unexpected shortages are more likely to develop under quantitative restrictions. Recent shortages of domestic steel forced domestic users to import more costly finished products not covered under the agreements. Hence, quantitative restrictions can undermine the competitiveness of downstream industries even more than do tariffs.

Another problem that inevitably arises is how to apply the nontariff measures. Whereas tariffs will typically be applied on a most-favored-nation basis, quantitative restrictions are usually imposed selectively, with specific limits granted to each exporting nation. The issue of selectivity versus most-favored-nation treatment is of great concern to developing country exporters, as well as to importing nations. Apart from transferring tariff revenues abroad, selectivity further distorts trade, as U.S. importers cannot import from the least expensive, or highest quality, foreign supplier.

However, under flexible exchange rates, domestic firms wishing to avoid risk may prefer quantitative restrictions. Unpredictable movements in exchange rates can affect the domestic currency price of foreign products, making the amount of protection afforded by a tariff uncertain. Quantitative restrictions insulate the level of imports, and hence domestic price, from foreign price or exchange-rate movements.

Lack of transparency often makes nontariff measures more acceptable than tariffs from a domestic political standpoint. Whereas consumers readily recognize tariffs as a form of taxation, they are unlikely to perceive the similar effect of quantitative restrictions, because the price changes are hidden. Nontariff measures are also usually more acceptable to exporting nations. The use of tariffs under GATT's escape clause requires compensation to foreign exporting nations, or allows them to retaliate. Because voluntary restraints fall in a grey area outside of GATT jurisdiction, the country imposing them need not worry about these provisions. Exporters are compensated indirectly because they can charge higher prices for the reduced amount of goods being shipped, or can divert exports to higher profit items. Naturally, the losers are consumers and taxpayers in the importing country.

A more transparent system would be highly preferable for the population at large. If the tariff-imposing nation had to reduce other tariffs as compensation, or if some of its exporting industries faced higher retaliatory tariffs abroad, an active constituency to limit the extent or length of protection would appear.

The United States has suggested one innovative strategy for dealing with nontariff measures in the Uruguay Round negotiations on agriculture. Before the effects of existing nontariff barriers can be reduced, the proposal calls for "tariffication" of these barriers—that is, converting them into tariff equivalents that will then be the basis for negotiations on barrier removal. The Japan beef and citrus agreement is a good example of the potential of this approach. The agreement calls for the phase-out, over a 3- to 4-year period, of import quotas on beef and oranges, and of Japan's Livestock Industry Promotion Corporation's import management operations. These nontariff measures will be replaced by tariffs that are scheduled to decline to 50 percent by 1993.

While confining protection to tariffs will not cause protectionist pressure to disappear, it may create stronger political opposition to increased protection. It will also make it easier to negotiate mutual reductions in trade barriers. Paradoxically, this policy may imply, as some have suggested, that laws should be modified to make it easier for firms to obtain temporary protection under escape clause criteria so that the pressure for resorting to nontariff measures is reduced.

TEXTILES AND AGRICULTURE—CASE STUDIES IN PROTECTION

Textiles and agriculture are two of the most heavily protected sectors in virtually all industrialized countries. No doubt part of the explanation is historical, given the importance of these sectors in the industrialization process. Yet implicit and explicit support and protection have been provided for protracted periods of time, with program costs far in excess of costs associated with most other forms of government intervention. Industrial country protection is significant not only for the costs imposed on domestic consumers, but also for the burden placed on developing economies.

Textiles and Apparel

Protection has been the rule rather than the exception in these industries. During the 19th century the U.S. industry developed behind high tariff walls. During the interwar period, the Great Depression and increased competition from Japan led to increased protection. Many industrial countries resorted to quotas; in 1930 the United States raised tariffs to 60 percent on woolens and 46 percent on cottons. In 1936 Japan and the United States reached an agreement to restrict Japanese exports, setting a precedent for the "voluntary" restraints of the postwar period.

Postwar liberalization of the industrial world's trade did not extend fully to Japan. Although Japan entered GATT in 1955, many countries continued to restrict textile imports from that country under Article XXXV, an annex specifically allowing nonapplication of GATT provisions to new members. The inaccessibility of the European market diverted additional exports to the United States. In 1956 the Congress authorized negotiations to limit textile imports. The following year Japan again agreed "voluntarily" to limit exports to this country.

This limit on Japanese exports led to increased U.S. imports from other countries, notably Hong Kong, whose 1960 exports to the United States surpassed Japanese levels. In response, GATT adopted the "Decision on the Avoidance of Market Disruption," which allowed restrictions on a discriminatory basis, even if actual injury had not occurred. This decision became the basis for the ensuing Short Term Arrangement (1961) and the more comprehensive Long Term Arrangement (1962).

But the Long Term Arrangement did not stem domestic protectionist pressures. From 1961 to 1972 textile imports increased by 135 percent in real terms, while apparel imports soared by well over 400 percent, with much of the growth in man-made fiber products not covered under the Long Term Arrangement. In response, the United States negotiated several bilateral agreements restricting imports of products made from wool or man-made fibers. The Multi-Fiber Arrangement, negotiated in 1973 and implemented in 1974, legitimized these bilateral agreements and provided a framework for negotiating additional bilateral export restraints. Subsequent Multi-Fiber Arrangements have extended the material, product, and country coverage, so that roughly 60 percent of world trade in textiles and apparel is now restricted, the main exception being trade among the industrial countries (excluding Japan). Recent agreements have added a "call" provision that allows the United States unilaterally to restrict products not previously covered under the agreements in response to an import surge. The current agreement, Multi-Fiber Arrangement IV, is scheduled to expire in 1991.

While the nominal tariff rates on textiles and on apparel average around 10 percent and 20 percent, respectively, the combined protection afforded by tariff and nontariff barriers is nearly 30 percent for textiles and more than 50 percent for apparel. The annual estimated cost to U.S. consumers of the protection exceeds $20 billion. Furthermore, world restrictions on trade in textiles and apparel impose an enormous burden on developing economies. These products account for 80 percent of Jamaica's manufactured exports, 72 percent of Pakistan's exports, and 89 percent of all exports from Bangladesh (100 percent of its manufactured exports). The restrictions limit exports to the main developed economies and divert sales to other importers. Some exporting nations allocate export quotas to Multi-Fiber Arrangement countries among domestic producers based upon those firms' exports to non-Multi-Fiber Arrangement importers. This method of allocating quotas leads to overshipments to these latter importers, exacerbating the pressure for additional worldwide protection.

The combined textiles and apparel sector remains one of the largest manufacturing sectors in the United States, employing more than 1.8 million workers. Over the past 25 years labor productivity in the textile industry has grown by more than 4 percent per year, above the national average, while productivity in apparel has grown by an average of 2.8 percent since 1973. Employment declined through 1986, partly because of productivity increases. In 1987 and the first half of 1988 employment stabilized in apparel, and grew in textiles. In real terms, domestic textile production has increased by more than 140 percent since 1960, while apparel production has increased by more than 60 percent. Profits rose in 1987 and the first half of 1988.

Yet the pressure to protect continues. In recent years the Administration has repeatedly had to fight even more protectionist legislation, using vetos that were sustained in 1985 and 1988. This case is clearly not one of temporary protection to allow adjustment, and the protection cannot be justified under any escape clause criteria. The question is whether tariffication could help reduce this pressure, because the social costs of this protectionist policy remain high.

Agriculture

Agriculture, like textiles, is an important industry whose relative economic significance has waned. Employment in American farming, now just over 3 million, has declined both in absolute and relative terms in the postwar period. Similarly, the value of agricultural output as a share of GNP has declined sharply during this period. Agriculture has maintained an important, although declining, share of total U.S. merchandise exports. Exports remain crucial to the vitality of the agricultural sector.

For the world as a whole, output of agricultural products has grown by about 150 percent over the period 1950–86, in contrast with the nearly 600 percent increase in manufactures. Although the volume of world trade in agriculture has increased more rapidly than agricultural output, the relative share of agriculture in world trade has declined from nearly 50 percent in 1950 to less than 15 percent in 1986.

The economic and political importance of this sector is apparent from the types of support programs that most developed economies maintain. Unlike textile programs, those in agriculture have involved both domestic and border measures, and have not only affected the volume of trade, but in several cases also actually reversed trade patterns. In terms of their impact on both taxpayers and consumers, these policies have tended to become more costly. One estimate indicates that the cost of farm policies to taxpayers and consumers in the OECD countries was about $200 billion in 1986.

The United States began using price supports and land diversion programs to increase farm family incomes before World War II. These programs continued to evolve after the war. However, relatively high market prices during the 1970s for the major crops covered by these support programs reduced the cost of farm programs to taxpayers. Program changes made in 1981 and 1985, however, combined with relatively low market prices to cause unprecedented budget outlays as well as record nominal net farm incomes. As measured in 1982 dollars, the total taxpayer cost of farm programs, which varies with market conditions, increased from under $4 billion in the early 1950s to more than $20 billion in the mid-1980s.

Because U.S. programs typically involve price supports or deficiency payments, and because the United States is a major exporter of many agricultural products, border measures are not usually needed to keep out foreign products. In some products, such as dairy, sugar, beef, and peanuts, the United States does maintain quantitative barriers on imports to support domestic producer prices. Apart from the dairy program, these other programs impose little direct burden on taxpayers, but they do result in significantly higher consumer prices. Under the domestic sugar program, for example, import quotas are adjusted annually to achieve a high domestic price. While both the protective effect and costs of the program depend upon the world price and the domestic stabilization price, current protection levels exceed 100 percent, and the estimated annual consumer costs for 1987 exceeded $3 billion. The use of export quotas rather than tariffs, and the allocation of these quotas to specific foreign exporters, resulted in a transfer to these exporters of nearly $300 million, reflecting the difference between U.S. and world prices. The additional revenue to domestic producers for 1987 was about $1.7 billion. These benefits are highly concentrated among producers, resulting in an average transfer to sugar growers of $50,000 to $100,000 per farm.

Regardless of the crop or the country, government programs significantly benefit farmers in developed countries. As documented in the 1988 *Economic Report of the President*, the producer subsidy equivalent, which measures the estimated percentage decrease in gross farm income that would occur if all of a country's internal and border measures were removed, increased sharply for the United States, from 11 percent in 1979 to 34 percent in 1986. However, U.S. farmers would benefit if all nations were gradually to remove their distortionary agricultural policies, as the President has proposed as part of the Uruguay Round negotiations.

The Common Agricultural Policy of the EC entails high producer prices and a variable levy on imports that keeps European consumer prices well above world prices. This subsidy program has transformed the EC from a grain importer to a surplus producer. To dispose of these surplus stocks, the EC adds an additional subsidy to promote its exports. In the 1987 budget year the EC received about $1.9 billion from import levies, and paid out $10.8 billion for export subsidies. These export subsidies increased significantly during the preceding decade. While benefiting importers, the subsidies create conflicts with other agricultural exporters, including the United States and producers in developing countries. The total budget of the Common Agricultural Policy was about $27 billion in 1987, and represented about 64 percent of the Community's total budget.

Japan remains a major agricultural importer despite the fact that its agricultural protection remains among the highest for developed countries. Estimated *ad valorem* tariff equivalents for many agricultural products, including rice, wheat, barley, sugar, and beef, were all above 100 percent in the middle 1980s. Domestic rice prices currently exceed five times world prices. As shown in the 1988 *Economic Report*, Japan's producer subsidy equivalent of 79 percent is well above that of any other major industrial country, and this rate had increased significantly in less than a decade. These programs result not only in taxpayer costs, but in higher prices for Japanese consumers, who spend a considerably larger percent of their income on food products than do consumers in the United States. These barriers remain because Japanese farmers are a politically potent group, and they have vigorously opposed liberalization attempts.

As with textiles, many of these agricultural programs are outside of GATT discipline, largely because of U.S. desires in the early years of GATT. The high degree of protection and subsidization in agriculture has led to significant international tension. This tension, and the massive distortion that results from these policies, constitute a major impetus behind the sweeping U.S. proposal in the Uruguay Round to eliminate all market-distorting agricultural policies. Moreover, a large portion of U.S. market-opening activities is directed toward agricultural products. These and other market-opening activities are the subject of the next section.

FREE AND FAIR TRADE

In the early postwar period the United States was prepared to accept the fact that its trading partners used nontariff barriers more than it did, because the primary U.S. aim was to foster recovery overseas. As recovery proceeded and the income gap decreased, however, Americans came to think that the responsibility for fostering trade liberalization should be shared more equitably.

Domestic protectionist sentiment has increased during the past two decades. Recently, U.S. exporters have sought relief from foreign practices that were perceived to treat their products unfairly. This sense of unfairness was exacerbated by declining U.S. agricultural exports, and the increasing importance of services and intellectual property rights, neither of which was protected under GATT discipline.

Despite this adverse political climate, this Administration has managed to sidetrack some major pieces of protectionist legislation. Political pressure was adroitly diverted toward an effort to open foreign markets to American products through the use of Section 301 of the Trade Act of 1974. The spirit of this provision is to help the government carry out its legitimate roles in fostering and maintaining a free and fair trading system. Implementation of the provisions raises some complex issues, however, especially when international agreements do not cover the alleged unfair foreign practices.

Under Section 301, as amended, the United States Trade Representative is authorized, subject to Presidential direction, to take specific actions to obtain the elimination of unfair foreign trade practices. These practices include, but are not limited to, policies that restrict U.S. exports to that country, that undermine U.S. export markets, and that deny American residents the protection of intellectual property rights. Although the ultimate sanction available to the United States under the statute is retaliation, the purpose of the process is to obtain successful resolution of the conflict, not to close American markets. In fact, few of the cases brought under this Administration have resulted in retaliatory tariffs.

If the unfair practice violates GATT obligations, then the usual dispute settlement mechanism of GATT can be used. The usefulness of Section 301 action derives from the weakness of GATT's dispute settlement procedures, and its limited coverage.

SECTION 301 IN PRACTICE

Since Section 301 was passed in 1974, about 70 cases have arisen, nearly 50 during this Administration. More than 20 cases have been initiated since 1985, 10 of which were initiated by the Administration without a private petitioner. Nearly one-half of the petitions have dealt with raw and processed agricultural products, including grains, beverages, leather, and tobacco products. The other major sources of petitions include eight filed by steel producers, nine involving service industries (such as insurance and films), four filed by footwear producers, and several recently filed by the Pharmaceutical Manufacturers Association involving intellectual property rights. The basis of many of these petitions mirrors the weakness in GATT disciplines in agriculture, and the lack of coverage for intellectual property rights and services.

The Section 301 process of market-opening has resulted in important agreements. The Japan beef and citrus agreement, which was negotiated under the threat of imminent Section 301 action, has been mentioned. Under earlier Section 301 actions the Japanese agreed to lower tariffs and end the state monopoly's discriminatory treatment of imported tobacco products. Separately they also agreed to reduce some tariffs, on a most-favored-nation basis, to compensate for GATT-illegal leather and leather footwear import quotas. Agreements with South Korea include one that increased foreign access to the domestic insurance industry, another that resulted in sweeping modifications of Korea's laws and regulations concerning intellectual property, and a third liberalizing the Korean market for imported cigarettes.

The emphasis on market-opening in the trade law has facilitated the conclusion of bilateral agreements even without Section 301 action. Examples include agreements with Japan to increase access to their domestic construction industry, to modify the procedures for government procurement of supercomputers, and to allow foreign attorneys to practice their home law in Japan. Partly because of U.S. pressure, both South Korea and Taiwan significantly reduced their tariff barriers, and Taiwan improved its intellectual property rights protection. In a recent case, U.S. petitioners voluntarily withdrew their petition against South Korea after an agreement was announced to open that country's film market significantly.

Attempts to define unfair trade practices, for the purposes of Section 301-type actions by any country, can raise complex issues. A country might, for example, undertake deregulation or privatization measures for purely domestic reasons. Nevertheless, these measures are likely to confer benefits on some foreign firms, particularly because government procurement processes are typically less open than private procurement procedures. Should the liberalized country be entitled to compensatory trade liberalization from others for its policy? This issue is unresolved and is a potential source of friction.

Another issue concerns the extent to which any government intervention in the economy is deemed to be unfair. The United States typically has more of a *laissez-faire* attitude toward economic development than other countries, particularly—but not exclusively—those in the developing world. Many of these latter countries practice active government intervention. This intervention may include subsidies to specific domestic industries, which necessarily distort trade patterns, or regional subsidies. While the latter subsidies can be trade neutral in an overall sense, nevertheless they are likely to hurt some (and help other) U.S. industries. The law is unclear as to whether such regional subsidies are unfair.

In pursuing action under Section 301 other complex problems arise. Petitioning firms want to use the process to their advantage, which sometimes means they are more interested in obtaining domestic protection from foreign competition than in opening foreign markets. Such efforts must be resisted. At times the executive branch may find itself under pressure from a domestic industry to pursue Section 301 action against a foreign practice that harms one U.S. industry but actually benefits the country as a whole. For example, if a foreign country taxes exports of a primary product, this policy will discourage domestic production and exports of that primary product, but will encourage exports of processed goods derived from it. American firms that produce the processed product will be hurt, but U.S. producers of the primary product will benefit. If the processors initiate a Section 301 action, should the United States attempt to eliminate this foreign policy because it is "unfair" and burdens U.S. processors, even though the policy's overall impact on the U.S. economy may be beneficial?

In some cases tangible evidence of discrimination against U.S. products may be difficult to obtain. In the Japan semiconductor case, an agreement was reached to end Japanese dumping of semiconductors in the United States and third-country markets and to increase access for foreign firms in the Japanese market. A subsequent sharp increase in prices raised costs for industries using semiconductors as inputs, thereby weakening the competitiveness of these high-tech firms. Tangible evidence of Japanese discrimination against U.S. firms was hard to document. The criteria used for gauging market access was the U.S. share of the Japanese semiconductor market. Because this share has not increased sufficiently, the United States has put 100 percent tariffs on $165 million worth of selected Japanese products. This is one of the relatively few such retaliatory tariffs that have resulted from this Administration's market-opening trade policy.

RECENT MODIFICATIONS IN THE LAW

Several sections of the Omnibus Trade and Competitiveness Act of 1988 dictate significant changes in the U.S. campaign against unfair trade practices. Mandatory action is now required, subject to a limited number of exceptions, if the foreign practice is found to violate a trade agreement or to be unjustifiable and a burden to U.S. commerce. The removal of discretion is likely to lead to more frequent resort to retaliation. Moreover, this provision may make it harder for the United States to obtain agreements from foreign countries to modify their practices. Under U.S. law, countries that agree to undertake measures to eliminate practices that previously were not subject to mandatory action will be deemed to have entered into a trade agreement and henceforth be subject to mandatory retaliation if the proposed changes are not fully implemented. This modification in the law may reduce the incentive for countries to agree to alter their policies.

Other sections of the law require the U.S. Government to self-initiate Section 301 investigations and to name specific countries as "unfair traders." Section 1302 of the 1988 act requires the identification of priority foreign practices, the elimination of which would have the most benefit for U.S. commerce, and of priority countries that undertake such practices. Section 1302 also purports to require the United States Trade Representative to enter into negotiations with these countries in order to obtain agreements to remove the barriers. In essence, this provision requires the government to indict a country's entire set of trade practices, not one specific aspect of its policies.

The telecommunications section of the 1988 act requires the government to investigate foreign country practices in telecommunications and decide which are most offensive, as well as which would reap the most commercial benefit for the United States upon modification. If agreements to modify them cannot be reached, the law authorizes the President to retaliate. It also directs the President, if he does take retaliatory action, to target telecommunications trade. It will be a challenge to implement these procedures in a way that opens foreign markets, instead of causing the United States to close domestic ones.

AGENDA FOR THE FUTURE

The future of the international trading system, and the way in which modifications to it are negotiated, are arguably at a crossroad. The GATT system has functioned remarkably well during the past 40 years by all but eliminating tariffs on manufactured products as a major trade impediment, but it has been far less successful in limiting other obstacles to trade. The increased reliance on nontariff measures makes further progress more difficult, notwithstanding the limited success achieved in the Tokyo Round. Expanding GATT's coverage to include important omissions, including agriculture, services, and intellectual property rights, is complex because it may require basic modifications in domestic law or policy, not just in international conventions.

The multilateral negotiating process is complicated by the increase in the number of important participants, and the consequent tendency toward bilateral or plurilateral liberalization outside GATT. While the United States, Canada, the European Community, and Japan remain the most important trading nations, the share of world trade in manufactures controlled by the middle-income developing countries has tripled, from 5.0 percent in 1965 to 15.3 percent in 1983. Individual concessions by these nations on issues such as intellectual property rights, trade-related investment measures, or trade in services are less important to the larger nations than are collective concessions. In multilateral negotiations, a free-rider problem arises because smaller nations, hoping to gain from the final package, which will be applied on a most-favored-nation basis, have less incentive to make individual concessions. This problem explains the tendency for supplemental codes to GATT to be applied only to signatories, and not to all GATT members.

The tendency toward bilateralism is evident in a variety of ways, none of which is necessarily a negative factor by itself. Bilateral agreements negotiated by the United States under Section 301, while applied on a most-favored-nation basis, nevertheless clearly have the intent of removing those trade barriers most significant to this country. The Israel-United States Free-Trade Agreement, which came into effect in 1985, has already significantly liberalized trade between the two countries. As of January 1, 1989, Israel will have eliminated duties on 80 percent of its imports from the United States. In 1987 the United States and Mexico concluded a bilateral understanding that provides a framework of principles and a consultative mechanism to improve economic relations. This understanding, in conjunction with trade liberalization programs Mexico has undertaken as part of its accession to GATT in 1986, should enhance trade flows between the two countries. The Canada-United States Free-Trade Agreement, which enters into effect this year, creates the world's largest free-trade area. The simultaneous reduction of U.S. and Canadian tariffs and some nontariff measures will expand trade between the two nations, and both will undoubtedly gain. Because the benefits of the agreement are not conferred on a most-favored-nation basis, however, other countries may not necessarily share in this gain, as some trade is diverted away from them. These bilateral agreements will be especially beneficial if they foster further multilateral liberalization.

Whether bilateral or multilateral liberalization will prevail depends significantly on two major events: the outcome of the EC integration, scheduled to be completed by 1992, and the outcome of the Uruguay Round GATT negotiations, scheduled to end in 1990.

"EC 1992"—THE SINGLE INTERNAL MARKET IN EUROPE

In 1985 the member states of the European Community undertook to eliminate all remaining economic barriers between them by 1992. Since the late 1960s the EC has been operating as a customs union with a common external tariff and no internal tariffs. Yet various nontariff barriers remain, including, for example, technical requirements that differ among member states (for instance safety standards on machinery and health standards on agricultural products) and public procurement practices that discriminate in favor of domestic suppliers. Despite the absence of tariffs, cumbersome customs procedures are required because member states have different value-added and excise tax systems. The internal market reforms are intended to eliminate or substantially reduce barriers by harmonizing tax rates, eliminating restrictive technical standards, liberalizing financial sector regulations, and enforcing intra-European competitive bidding in public procurement.

To many in Europe this liberalizing process represents the logical next step in consolidating the economic advantages of the customs union framework. Substantial gains are expected from the realization of scale economies, once technical standards are uniform across this large market, which now spans 12 countries. Financial service integration is expected to lower the cost of capital to investors, and efficiency gains are expected from more fully competitive bidding on the sizable government procurement market, from tax harmonization, and from the elimination of administrative and time costs of customs arrangements. A study done for the Commission of the EC, which has been planning the directives for the changes, puts the expected contribution to baseline GDP in Europe at 4.5 percent over the medium term, and to employment of almost 2 million new jobs. For an economic bloc that has been slow to recover from the stagflation of the 1970s and the recession in the early 1980s, a potential economic boost of this sort could provide sufficient incentive for governments to overcome domestic resistance to these reforms.

For the U.S. economy the EC 1992 reforms offer potential benefits, in addition to possible barriers alluded to in American businesses' fear of a Fortress Europe. The effects will be felt in two distinct ways: through American trade with Europe, and through American investment on the continent. As a trading partner, the United States and other countries outside the EC may lose to the extent that the easier movement of goods within Europe encourages more internal trade, and puts outsiders at a relative disadvantage. If the reforms do result in substantial European growth, however, this growth may increase the amount of the Community's external trade, including U.S.

exports to Europe. These gains will only be realized, however, if the EC remains open to the rest of the world.

The issues differ somewhat for the United States as an investor. As long as American firms located in Europe are granted "national treatment," that is, the same rights of market access as European firms, their gains from the increased efficiency of an expanded single market are the same as for their European counterparts. This issue is of considerable concern to the United States because the Europeans are considering a reciprocity standard for granting third-country financial institutions access to the newly integrated financial market. Under strict reciprocity the EC could deny entry to American firms as U.S. laws in the financial sector are not equivalent to those of the EC. Consequently, U.S. firms not already established in Europe would not benefit from the reforms.

URUGUAY ROUND NEGOTIATIONS

At the United States' urging, the eighth round of GATT negotiations was launched in Punta del Este, Uruguay, in September 1986. The work was divided into two main parts, a Group of Negotiations on Goods and a Group of Negotiations on Services. Actual negotiations began in February 1987.

While all negotiating areas are important to the United States, the main U.S. objectives are to correct the weaknesses in GATT coverage and discipline. The responsibility of the Group of Negotiations on Services is to establish principles for extending GATT coverage to trade in this expanding component of world output. The group must also negotiate sector coverage and establish basic rules on issues such as transparency, nondiscrimination, national treatment, and rights of establishment. Because trade in services often requires at least some local production, the right of foreign firms to establish local operations is crucial. Possible sectoral coverage includes areas such as insurance, construction, advertising, telecommunication services, leasing and franchising, and computer and data processing. Liberalized trade in these areas can offer significant gains to American firms.

The Group of Negotiations on Goods is split into many smaller groups covering agriculture, trade-related intellectual property rights, trade-related investment measures, tariffs, and nontariff measures, among others. The United States made its most dramatic proposal in agriculture, where the long-term U.S. objective is to eliminate all policies that distort world agricultural production, trade, and prices. This sweeping proposal includes both domestic and border measures. To increase transparency and facilitate systematic liberalization, the United States has proposed tariffication of many of the nontariff measures that are so important in agricultural programs. Successful implementation of U.S. proposals would lead to large gains in economic efficiency, and reduce the high financial cost of farm programs at home and abroad. While all nations have agreed to the principle of increasing GATT discipline over agricultural policy, including internal and border measures, major players such as Japan and the EC will need to be convinced of the desirability of the full-scale liberalization that the United States and smaller exporting nations are promoting. At the same time, comparable liberalization of trade in tropical agricultural products is of prime importance to developing economies.

Another prime U.S. concern is reflected in the group on intellectual property, where, in conjunction with other developed countries, the United States is attempting to develop a framework to enhance intellectual property rights protection. Suggested areas for coverage include patents, copyrights, trademarks, trade secrets, and semiconductor layouts. The absence of appropriate protection in these areas is estimated to cost the United States more than $20 billion per year in lost sales. Insufficient protection of intellectual property leads to underinvestment in research and development activities. Although less developed countries wish to concentrate the negotiations only on border measures, proper protection must also include internal measures and enforcement to prevent the misappropriation of intellectual property for domestic production.

In light of the substantial past achievements in tariff reductions, this issue is not as important as in previous rounds. Other groups, including those on safeguards, nontariff measures, textiles, subsidies, and GATT Articles, are striving to develop formulations for limiting the greater problem of nontariff measures. As in agriculture, tariffication of "hard-core" nontariff measures could be a first step toward their elimination. Many less developed countries wish to liberalize textile trade, and to reduce the ability of industrial economies to use safeguard, antidumping, and countervailing duty actions to protect domestic industries. On the other hand, the United States seeks greater discipline on the use of trade-distorting subsidies. Developing countries also wish to require that safeguard actions be imposed on a most-favored-nation basis. At the same time, they seek special and differential treatment concerning reciprocal tariff reductions, and their "right" to protect domestic industries. The developed economies thus far have not offered significant proposals to reduce the use of grey-area measures of protection.

Direct international investment, like international trade, is an important component in expanding world output and efficiency. Policies that inhibit or distort those flows reduce world efficiency. Many developing countries tie performance requirements to direct foreign investment. These requirements, which include technology transfer, local equity participation, minimum export levels, and balanced trade, both discourage investment and distort trade flows. Developing countries have resisted progress in this group on sovereignty grounds.

Broadening GATT coverage will be meaningless unless ways are found to enhance compliance with GATT principles. An improved dispute settlement process is an indispensable requirement to enhance reliance on GATT principles and procedures. Main proposals include the automatic right to a panel to settle disputes, the possibility of binding arbitration if both parties consent, an expedited panel process, and perhaps the adoption of a procedure whereby parties to the dispute abstain from voting. The possibility of having a strong dispute settlement process is doubtful as long as countries maintain their rights to act unilaterally, and ignore GATT reports.

A ministerial level Mid-term Review of progress in the Uruguay Round took place in Montreal in early December 1988. In 11 of the 15 groups this review resulted in agreement on proposals to be implemented or on frameworks for further negotiations for the remainder of the talks. From the U.S. perspective some of the most important progress occurred in the groups on services, dispute settlement, subsidies, tariffs, and functioning of the GATT system (FOGS). In four groups—agriculture, intellectual property, safeguards, and textiles—disagreements remained, although some progress was made in Montreal in narrowing these differences. Negotiations in these four groups will continue, and a senior officials level meeting of the Trade Negotiations Committee is scheduled to meet in Geneva in April 1989. Once agreement is reached in these four areas, the results achieved in Montreal can be implemented. The changes in FOGS and dispute settlement will be implemented on a provisional basis. Most GATT members anticipate that the talks will be successfully completed, on schedule, by the end of 1990.

The record of the past 40 years clearly demonstrates that economies that have utilized free market principles have been at the forefront of economic growth. The significant reduction in trade barriers and the ensuing increase in international trade flows have been major factors in the record growth during this period. Current U.S. proposals to phase out distortive agricultural policies, to expand trade liberalization to sectors not previously covered, and to strengthen GATT manifest the United States' desire to help construct a world trading system that is open to, and benefits, all nations. The guiding principle that government interference with international commerce should be kept to a minimum is equally applicable to internal commerce. Freeing the economy from excessive regulation allows entrepreneurs to focus on innovation, the hallmark of the American economy. Continued efforts to liberalize trade, and to reduce internal regulation, will ensure America's role as a model for the rest of the world.