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BY THE COMPTROLLER GENERAL

Report To The Chairman
Subcommittee On International Economic Policy
Oceans And Environment
Senate Committee On Foreign Relations
OF THE UNITED STATES

Current Issues In U.S. Participation In The Multilateral Trading System

Frustration with the apparent inability of the General Agreement on Tariffs and Trade (GATT) to stem the rise of trade barriers and resolve trade disputes has led to questions about its utility and effectiveness and about the desirability of continued U.S. support for the GATT system. GAO found that much frustration with the GATT is the result of failure to resolve issues that are primarily conflicts over important domestic policies which also have trade effects. GATT principles and efforts to reduce barriers to trade are in consonance with U.S. trade policy objectives and, as an institution, the GATT provides a valuable forum for bilateral and multilateral trade negotiations. Despite difficulties, the GATT has made significant contributions to the competitive flow of world trade. GAO concludes that it is in the interest of the United States to continue to support the GATT system and principles.

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-217817

The Honorable Charles McC. Mathias, Jr.
Chairman, Subcommittee on International
Economic Policy, Oceans and Environment
Committee on Foreign Relations
United States Senate

Dear Mr. Chairman:

As you requested, we are forwarding our analysis of the international trading system and U.S. participation in the General Agreement on Tariffs and Trade (GATT). This report describes trade problems in 3 sectors, wheat, telecommunications and steel, and distinguishes between problems with the rules of the GATT and problems with contracting party compliance with GATT provisions.

As arranged with your office, unless you publicly announce its contents earlier, we will be distributing the report to other Members of Congress and representatives of the administration 30 days following issuance.

Sincerely yours,

Milton J. Socolar

Acting Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CHAIRMAN,
SUBCOMMITTEE ON INTERNATIONAL
ECONOMIC POLICY, OCEANS
AND ENVIRONMENT
COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

CURRENT ISSUES IN U.S. PARTICIPATION IN THE MULTILATERAL TRADING SYSTEM

D I G E S T

The Chairman of the Subcommittee on International Economic Policy, Senate Committee on Foreign Relations, requested that GAO make a study to determine whether the General Agreement on Tariffs and Trade (GATT) is still able to serve the purpose for which it was originally designed--a system which encourages trade in an open fashion based on widely accepted rules.

GAO's objectives in this study were to provide information on the comparative trading practices of the United States and its major trading partners; identify and evaluate the reasons for alleged widespread variance from GATT principles and rules; explore the possibility of extending GATT coverage to service sector trade; and determine whether support of the GATT continues to be in the U.S. interest. (See p. 9.)

GAO examined the applicability of GATT to agricultural trade issues which have arisen with respect to wheat, possible GATT coverage of trade in services, such as telecommunications, and the potential for using GATT safeguard measures to help respond to steel trade problems. It was recognized that the issues chosen for study involve major trade conflicts and, as such, are not representative of the issues in which the GATT has been successful in helping to reduce or eliminate trade conflicts. (See p. 9.)

To present a complete picture of the current debates in those areas selected, GAO studied the comparative practices and attitudes toward the trading system of developed and developing countries--the United States, Canada, Japan, Great Britain, West Germany, the European

Community as a whole, Australia, South Korea, Brazil, and Argentina. (See pp. 9 and 10.)

WHAT IS THE GATT AND WHAT ARE ITS PURPOSES?

World trade takes place within a system governed in part by economic and business considerations, in part by national government mandate, and in part by rules developed and agreed upon between countries. The most important in the latter category, in terms of coverage and general acceptance, is the General Agreement on Tariffs and Trade.

GATT is both a system of principles specifying the rights and obligations of its contracting parties and an institution. The principles are based on the proposition that trade should be determined by economic factors rather than government intervention. Specifically, the GATT states that through non-discriminatory reductions of barriers to trade, nations can hope to expand the production and exchange of goods to raise standards of living, ensure full employment, and expand real income and effective demand. (See pp. 1 and 2.)

The GATT is also an institutional framework within which countries subject their national policies to international scrutiny and discipline. This takes place through ongoing notification procedures, the dispute settlement process, annual meetings to set and discuss work programs, Ministerial meetings to renew GATT commitments at high levels, and successive rounds of trade negotiations. As a negotiating body, GATT's decisionmaking is primarily accomplished through consensus.

Successive tariff reductions have been made through a series of multilateral trade negotiations within the GATT. As tariffs have decreased, the GATT has been faced with new challenges posed by non-tariff barriers. In an attempt to deal with these, some member states successfully negotiated codes (agreements that modify or interpret the General Agreement) to deal with subsidies, government procurement, standards, and import licensing, among others.

In addition, the GATT has been considering new areas, such as service sector trade, which to date have not been covered and has been giving more attention to liberalizing trading practices in agriculture. (See pp. 3, 4, and 11.)

DO TRADING PRACTICES OF THE UNITED STATES AND ITS MAJOR TRADING PARTNERS DIFFER SIGNIFICANTLY?

Government intervention in domestic economies is widespread and common to all the countries GAO studied. The U.S. government intervenes in the working of the economy, but other governments often take a more interventionist approach to their economies and use a wide array of trade distorting measures. In the three sectors GAO studied, government intervention is evident for all countries studied, although the nature and extent of this intervention varies from one country to the next. (See pp. 90 to 92.)

Governmental policies and programs of wheat trading countries are key determinants of wheat trade. For example, the U.S. government intervenes directly through various programs in the production of wheat to support farm income. The effect of this intervention on trade is significant, because these programs influence both the price and supply of wheat. Through the use of variable import levies and export restitution payments, the European Community's agricultural support programs have a direct and significant effect on trade. Other countries directly control the flow of trade through state trading monopolies. (See pp. 13, 14, and 19 to 21.)

In telecommunications, a wide array of barriers have been imposed for reasons of privacy and national security, among others, to restrict market access. The most significant among these barriers are government monopolies and formal and informal market reserve policies. In terms of market access in the countries studied, the United States, with the recent deregulation and divestiture decisions, has the least restrictive market for telecommunications equipment and service imports. Great Britain, Canada, and Japan have taken initial, but limited, steps to liberalize their markets as well, although the exact

effects in terms of market access are as yet unknown. Most other countries have closed markets except perhaps for services and equipment not available from domestic suppliers. (See pp. 50 to 59.)

In steel, developed and developing countries alike have used a number of domestic support and protection mechanisms, justified on various grounds. Developing countries have used tax incentives, government equity infusions, and import restrictions to nurture emerging steel industries, while developed countries have used similar measures to ease the burden of adjustment for steel industries that have become relatively less competitive. (See pp. 68 to 84.)

ARE GATT PRINCIPLES AND RULES EFFECTIVE?

An apparent rise in protectionist actions on the part of many contracting parties has led some trade analysts to question the effectiveness of the GATT, given its apparent inability to stem the tide of protectionism. GAO's study of the steel and wheat sectors, both of great importance to the United States and other developed and developing countries alike, illustrates the nature of the protectionist actions being taken and their effects on trade. (See pp. 6 to 8.)

Due primarily to apparent agreement among the original contracting parties that domestic policy priorities should take precedence over international discipline, the GATT has not established a clear, unambiguous trade regime for agriculture. Contracting parties have applied numerous exemptions, waivers, and derogations to GATT principles, reflecting long-term discrimination in favor of agricultural products. The plethora of subsidy practices and market access restrictions, which GAO identified in its examination of wheat support programs and wheat trade, have led to significant distortions in trade and the international market for wheat. Various waivers and exemptions, coupled with unclear interpretation of specific GATT provisions (e.g., subsidies and market access provisions) have led to a series of major disputes in agricultural trade with only limited success in resolution. (See pp. 11 to 13.)

Recognizing the limitations of existing GATT provisions to address agricultural trade disputes and the increasing budgetary pressure to reduce domestic agricultural support programs, renewed attention is being given to possible improvements in GATT discipline for agricultural trade. Consideration is being given to improve the effectiveness of GATT to control subsidies, reduce market access restrictions, improve coverage of measures maintained under exemptions and waivers, and improve notification systems under various provisions to ensure better transparency. (See pp. 32 to 36.)

Although most participants do not expect rapid progress toward better GATT coverage of agricultural trade through these efforts, the United States should continue to actively participate and push for continued progress. (See pp. 34 and 35.)

In steel, numerous import restrictions, most significantly quantitative restraints imposed by the United States and the European Community, have the effect of cartelizing world steel trade and have placed virtually all exporters to the United States and the European Community under some form of import restriction. Problems in the steel industry have resulted from a fundamental shift in comparative advantage from developed to developing countries and a drop in world demand which has contributed to excess capacity in steel production. (See pp. 65 to 67 and 75 to 77.)

Despite safeguard provisions covering these import protection mechanisms, GATT has been largely ineffective in limiting these restrictions or in delineating or enforcing criteria for applying these restrictions. Discussions of a safeguard code, which would couple temporary import relief restrictions with a requirement for domestic adjustment, have yielded little to date, despite efforts of some countries to develop a code. Because it was always intended that the code would include a provision that import restrictions be only temporary, it is not at all clear that a code alone would be sufficient to address the long-term structural problems of the steel industry. Given the nature and magnitude of problems facing declining industries such as

steel, it would be unrealistic to expect the GATT to address the structural problems facing this industry. (See pp. 77 to 85.)

WHAT IS THE POTENTIAL FOR GATT COVERAGE OF SERVICE SECTOR TRADE?

Over the last decade, service sector trade has grown dramatically as has the importance of services in individual countries, even though there was no GATT agreement in this area. There are, however, significant barriers to trade, such as government monopolies, market reserve policies, and investment performance requirements. Although telecommunications trade is growing, significant segments of the industry face a wide range of barriers restricting access to a number of markets. (See pp. 40 and 50.)

If telecommunications is at all representative of other service industries, significant obstacles must be overcome in applying GATT principles to trade in services. There must be a consensus on the desirability of liberalized trade and the need for an agreement to achieve this. This will require major shifts in government policies toward competitive access to monopoly markets and deregulation or significant revisions of the definition and application of GATT rules.

Because of the difficulty of overcoming these obstacles, one approach may be to attempt to negotiate an agreement for services trade with interested GATT contracting parties, which could serve as the basis for including services in a new round of multilateral trade negotiations. Such an agreement might express the commitment of the parties to (1) observe those GATT principles which are relatively noncontroversial, such as transparency and least distortion,[1] and (2) refrain from establishing new trade barriers.

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[1]The transparency principle provides that trade regulations and procedures are open and unambiguous. The least distortion principle provides that measures taken to protect domestic industries should cause the least possible distortion to trade.

Notification and cross-notification of regulations and restrictions in service industries would promote the dialogue necessary to begin analyzing how GATT principles would apply to specific service industries. In this regard the submission to GATT of country studies of domestic service industries and the exchange of these studies between member countries has begun. These studies could form the basis on which GATT members can begin discussing trade liberalization in services generally or on a sector-by-sector basis. (See pp. 61 to 63.)

DOES THE GATT CONTINUE TO SERVE U.S. INTERESTS?

The United States espouses a trading system in which markets determine price, supply, and demand and where information on competitive and economic conditions is readily available. As noted in the February 1985 Economic Report of the President, "Comprehensive free trade is a policy objective [of the United States] because of the proven benefits of open markets. . ." With objectives focusing on removing and reducing government-imposed barriers to trade, it would appear the GATT objectives are generally in consonance with U.S. trade policy objectives. Thus, there remains a harmony between U.S. policy and interests and the underlying principles of the trading system. In addition, all GATT members, as contracting parties, aspire to these same goals. However, U.S. actions, as well as those of other GATT members, have been a compromise between these principles and domestic political pressures, resulting in increased obstacles to the competitive flow of trade. (See pp. 90, 93 and 94.)

It is in this context that the GATT as an institution is in the interest of the United States. With 90 contracting parties, the GATT provides the important function of bringing countries together to discuss a broad range of issues. Moreover, its dispute settlement procedures foster the consultations and dialogue necessary to even begin resolving differences. (See p. 94.)

The GATT is being called upon to provide guidelines and settle disputes that frequently

involve government intervention in domestic economies. Not surprisingly, it has frequently not been able to control government actions or to settle all disputes between trading partners. But to judge the GATT on its ability in all cases to force governments to change their behavior is to judge it for failing to achieve objectives it was never intended nor given the wherewithal to achieve. (See p. 93.)

To continue to be relevant, the GATT must evolve to meet demands of the current trading environment. Thus, successive rounds of multilateral trade negotiations have attempted to better define and establish some discipline for a host of domestic policy actions which heretofore were not of paramount importance because high tariffs were the major barriers to trade. (See p. 94.)

Most countries continue to espouse strong support for the principle of non-discrimination, the primary underpinning of the multilateral trading system. Despite this stated support, many countries are participating in bilateral discussions and taking unilateral actions that can violate the non-discrimination principle. In steel, GAO noted the proliferation of discriminatory bilateral arrangements to control the flow of steel products. The United States and the European Community have been major participants in this process. On the other hand, if bilateral agreements reflect GATT principles and are open to and joined by others, they serve as useful tools in bridging the gap between a lack of international consensus in a given area and conclusion of a widely accepted multilateral agreement. If countries find it necessary to use bilateral agreements to resolve trade problems, the challenge before the United States and other contracting parties is to negotiate arrangements in accordance with GATT principles and to bring these into GATT's multilateral framework and discipline. (See pp. 93 and 94.)

AGENCY COMMENTS

GAO obtained formal comments on this report from the Departments of State, Agriculture, and Commerce and the Office of the U.S. Trade Representative (USTR). The agencies generally

viewed the report as a useful assessment of current trade issues. However, they did not totally agree with GAO's conclusions regarding potential solutions of problems with the trading system. USTR expressed the view that the report "suggests that the EC's [European Community] more restrictive [steel] import program adopted in the 1970's is somehow preferable to the U.S program because of the greater degree of government intervention in EC restructuring decisions." GAO did not intend such a suggestion. Generally, GAO agrees that market forces are the best determinant of restructuring/ investment decisions. However, market forces have been seriously distorted by the broad array of quantitative import restraints protecting domestic steel producers, and markets may not be working to encourage efficient restructuring. (See p. 88.)

The USTR expressed several reservations about GAO's conclusion that U.S. and European Community actions to limit imports of steel into their markets had in effect cartelized the world steel market. GAO's conclusion was based not only on voluntary restraint agreements negotiated under the President's program but also on numerous other formal and informal agreements negotiated by the United States and the European Community which, taken together, place virtually all major exporters to these markets under some form of quantitative limit. Considering the U.S. and European Community shares of world steel imports, GAO believes the combined measures have the appearance and effect of a cartel. (See p. 87.)

The Department of Commerce stated that limitations on the report's coverage made it difficult to generalize about GATT's effectiveness and suggested that a broader view would probably have led to more optimistic general conclusions. Given the GAO objective to assess the continued usefulness of the GATT, GAO chose to focus on areas of difficulty which have called into question the continued relevance of the GATT. The safeguard, agriculture, and service sector trade issues were selected in consultation with the Subcommittee precisely because they pose significant international trade problems and because, as Commerce notes, they

"are at the heart of U.S. proposals for improving the GATT under the aegis of a new round." The USTR found GAO's approach to be a useful and valid analytical one. (See p. 10.)

Contents

ILLUSTRATIONS

ABBREVIATIONS

AD	anti-dumping
AT&T	American Telephone and Telegraph
CAP	Common Agricultural Policy
CTA	Committee on Trade in Agriculture
CVD	countervailing duty
EC	European Community
FCC	Federal Communications Commission

FCN	Friendship, Commerce, and Navigation
GAO	General Accounting Office
GATT	General Agreement on Tariffs and Trade
GNP	Gross National Product
IMF	International Monetary Fund
MFN	most favored nation
mmt	million metric tons
MTN	multilateral trade negotiations
MY	marketing year
NTT	Nippon Telegraph and Telephone
OECD	Organization for Economic Cooperation and Development
OMA	orderly marketing arrangements
PTT	post, telephone and telegraph
TPM	trigger price mechanism
UNCTAD	United Nations Conference on Trade and Development
USDA	U.S. Department of Agriculture
USTR	Office of the U.S. Trade Representative
VER	voluntary export restraint
VRA	voluntary restraint agreement

CHAPTER 1

THE INTERNATIONAL TRADING SYSTEM

World trade has grown significantly over the past two decades, with exports increasing from about $190 billion in 1965 to about $2,004 billion in 1984 and imports increasing from approximately $198 billion to about $2,058 billion.[1] The developed countries have accounted for 65 to 70 percent of imports and exports during the period. In 1984, the United States accounted for about 11 percent of world exports and 16 percent of world imports.

World trade takes place within a system governed in part by routine economic and business considerations, in part by national government mandate, and in part in accordance with rules developed and agreed upon between countries. The most important in the latter category, in terms of coverage and general acceptance, is the General Agreement on Tariffs and Trade (GATT).

THE GENERAL AGREEMENT ON TARIFFS AND TRADE

The GATT, negotiated in 1947, contains a list of negotiated tariff schedules and principles and rules governing trade of the signatories. Both elements have been modified through a series of negotiations over the years. GATT principles apply to trade in goods. Manufactured products are subject to more stringent GATT regulation; primary products, including agricultural commodities, are allowed a number of exemptions and waivers because of their "special nature." Trade in services is not covered except as incidental to trade in goods.

GATT's annual operating budget is $19.39 million for 1985. Contracting party contributions to the GATT are determined on the basis of each member's proportion of total imports and exports of all contracting parties. The 1985 U. S. contribution was $3.415 million or 14.88 percent of the GATT budget. The United States is the largest single contributor, followed by Japan, although the European Community as a whole contributes 40 percent of the GATT budget. About 70 percent of the budget is allocated to pay staff costs (including some 300 permanent professional staff and 70 temporary positions) with the remaining 30 percent allocated for other operating expenses.

The GATT provides a forum in which nations can raise, discuss, and settle disputes regarding trade between them. The

[1]Exports are on a free-on-board ship value; imports include cost, insurance, and freight.

GATT is unable to force governments to live up to their GATT obligations; its effectiveness depends largely on the commitment of the contracting parties. There are currently 90 contracting parties representing all levels of economic development and different levels of government intervention in the economy.

The GATT has influenced trade in two ways--as a value system and as an institution. It is first a statement of trade benefits and principles, defining the way in which trading relations between nations should be conducted to expand the production and exchange of goods to raise standards of living, ensure full employment, and expand real income and effective demand by reducing barriers to trade.

The basic principles which underlie the GATT are as follows.

1. The most favored nation (MFN) concept which states that the contracting parties will conduct their commercial relations with each other on the basis of non-discrimination.

2. The principle of national treatment which provides that imported products should receive the same treatment as domestically produced products with respect to internal taxation and regulation.

3. The concept that any protection of domestic industries should cause the least distortion to trade possible and that tariffs are the preferred form of protection.

4. The concept of transparency which implies that a contracting party's regulations and procedures are open and unambiguous.

5. Bilateral or multilateral consultations are encouraged as a means to settle disputes.

The GATT is also an institutional framework and an important negotiating forum within which countries subject their national policies to international scrutiny and discipline. This takes place through ongoing notification procedures, annual meetings to set and discuss work programs for the Secretariat and member committees, occasional Ministerial meetings to renew GATT commitments at high levels, and successive rounds of trade negotiations. As a negotiating body, GATT's decisionmaking is primarily accomplished through consensus. Committees made up of various contracting party representatives perform many of the day-to-day activities. The dispute settlement process uses independent panels to mediate allegations against "offending"

countries, relying on moral persuasion and peer pressure to effect change. Although at one time these groups dealt mainly with tariff levels, non-tariff measures and domestic policies occupy progressively more of their time and form the basis for most disputes.

The United States was instrumental in developing the principles and institutional framework of the GATT and has traditionally been one of the GATT's strongest supporters because of shared goals and objectives. U.S. trade policy reflects U.S. domestic economic policy; that is, reliance on a system in which markets determine price, supply, and demand and information on competitive and economic conditions is readily available. As noted in the February 1985 Economic Report of the President, "[C]omprehensive free trade is a policy objective [of the United States] because of the proven benefits of open markets..." Government intervention is considered appropriate only when the market is not capable of allocating resources to achieve some specified result, such as worker health and safety. Disciplines appropriate for U.S. objectives are embodied in the GATT for trade in goods. The Organization for Economic Cooperation and Development (OECD) has adopted several resolutions providing some discipline for trade in services,[2] but these are of a limited and non-binding nature.

Changes since the GATT's inception raise new concerns

Changes which have taken place in the trading system over the last 40 years have called into question the continued relevance of both the principles embodied in the Agreement and the institutional framework set up by the GATT. These changes have also had an impact on the role of the United States. One change is based on the very success of the GATT institution. Through successive rounds of negotiations between the contracting parties, global tariff levels have been substantially decreased. However, with the lowering of tariffs, non-tariff measures have emerged as effective means to protect domestic economies and markets. Such barriers are not as visible and do not lend themselves to removal in the same fashion that reductions in tariff levels did. These difficulties were evident in the Tokyo round of trade negotiations concluded in 1979 when, for the first time, the contracting parties attempted to expand and modify the GATT to address non-tariff measures as well as tariffs. Limited agreement was reached on clarification of rules through a number of codes, including agreements on interpreting and applying GATT's subsidy and countervailing duty

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[2]See p. 7 for a further discussion of the OECD.

provisions, technical barriers to trade, government procurement, and import licensing procedures. These codes were not adopted by the entire GATT membership and only those countries which accepted them are bound by their terms.[3]

The second change has come about because the issues facing trade negotiators today are highly contentious for the very reason that they revolve around issues so heavily in the realm of national policymaking. At the same time, the international consequences of domestic policy decisions have been increasing. There has been only limited agreement in the international community on what constitutes "acceptable behavior" with regard to the imposition of non-tariff measures, given that these measures are imposed for legitimate domestic reasons but nevertheless have a direct or indirect effect on trade. This has given rise to increasing charges that some countries act fairly and others unfairly or that some actions are fair and others unfair. These characterizations must be judged in each individual situation and depend in large part on the point of view, not only between countries, but within countries. For example, have U.S. aircraft manufacturers benefitted from Department of Defense spending more or less than Airbus has benefitted from French and British government subsidies? The difficulty in making this determination is also evident in the use of U.S. trade laws. Although a distinction is made between fair trade laws (such as Section 201, Trade Act of 1974, as amended) and unfair trade laws (the countervailing and anti-dumping statutes), there has been an apparent rise in the use of non-GATT mechanisms to resolve trade disputes regardless of the actual trade practices employed. One contribution that a forum such as the GATT can make is to encourage better definition of the parameters of acceptable behavior.

The third change, which has resulted in rising tensions, has been the growing number of countries competing for market share in manufactured products. Many of these are developing countries, given special treatment under Part IV and certain other provisions of the GATT[4] although many of their export products compete with products that continue to make up

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[3]Most of the major trading nations have signed most of the major codes.

[4]Part IV, (Articles XXXVI through XXXVIII) Trade and Development, outlines the principles, objectives, commitments and joint actions to be undertaken to integrate developing countries into the GATT. It essentially relieves developing countries from a rigorous obligation to adhere to GATT provisions.

significant portions of the industrial base of developed countries. Many developing countries feel pressed to expand exports and cut imports in order to meet interest payments on their large external debt balances. In addition, countries which make up GATT's current membership in general represent a wide variety of economic systems. In many cases, this has meant agreement is harder to reach. Conflicts have resulted, and trade restricting measures are becoming more contentious.

Fourth, development of a floating exchange rate system has had unforeseen consequences for trade. As originally envisioned, it was expected that exchange rates would be primarily determined by trade flows. However, the dominant role of capital flows and shocks to the international economy since 1971 have caused exchange rates to change by large amounts in a single year and have created serious trade problems. Floating exchange rates, although of paramount importance to a country's trading position, were not in use when the GATT was created and are not accounted for by rules of the trading system. For example, exchange rate changes may result in flexible pricing of exports without any changes in underlying costs of production or selling price denominated in home market currency. There is no question that the current strength of the U.S. dollar has had a dramatic effect on U.S. exports.

Finally, the United States no longer has hegemony in the world trading system. During the first decades after World War II, the United States maintained competitiveness in high-employment industries and therefore did not suffer major adjustment costs due to increased trade. During the 1960s, these costs, including loss of employment and industry profitability and competitiveness, became higher as U.S. labor-intensive, mature industries began to suffer the consequences of an open trading system despite overall economic growth.

During the 1970's, the U.S. merchandise trade deficit averaged 0.5 percent of gross national product (GNP). This deficit was balanced by a surplus in services and transfers, resulting in a current account balance of approximately zero during the decade. By 1980, however, the U.S. trade balance, on a balance-of-payments basis, was in deficit by about $25 billion and these deficits have continued to grow to about $28 billion in 1981, $36 billion in 1982, $64 billion in 1983, and $124 billion in 1984. The merchandise trade deficit in 1984 was about 4.0 percent of GNP.

Although current account deficits have been balanced by a surplus in the capital account until recently, import-competing

and exporting industries have suffered.[5] In addition, as the first country to return to strong economic growth after the last recession, the United States increased its imports before its trading partners could absorb more U.S. exports.

The United States has begun to retreat from its position as the primary proponent of GATT rules in the face of growing domestic economic costs and the resulting political pressures. With the loss of some competitiveness and faced with extensive government involvement in competitor countries' markets, the U.S. government has taken more aggressive actions to challenge the questionable trading practices of its competitors. In some cases, this has resulted in U.S. actions of an equally questionable nature.

These factors and an increasing level of frustration over the GATT's inability to stem the tide of protectionism and satisfactorily settle disputes, have raised numerous questions as to the relevance of the GATT. These responses are caused, in part, by false expectations which have been placed on the GATT system. In agriculture, it is apparent that the GATT was not intended to address many of the problems faced by trading countries today. And in telecommunications, the GATT is being asked to take on an entirely new set of issues. In steel, trade mechanisms have been used in an effort to resolve fundamental economic problems of a declining industry, despite the fact that many of these problems require other resolutions.

Further, questions have been raised as to the ability of one set of principles or of any institution to concurrently serve national and international interests. As countries become disenchanted with the trading system and see less value in observing its principles, the system weakens, in turn leading to further frustration by national participants. Because the United States is a major supporter of the GATT, the threat of a U.S. pullout or declining support could significantly affect the GATT's continued effectiveness.

COMPLEMENTARY FORUMS USED TO REACH AGREEMENTS ON TRADING BEHAVIOR

Frustration with the GATT has led to increased emphasis on other forums and mechanisms as a way to solve national problems. The United States shares common interests with the other

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[5]The current account includes exports and imports of merchandise and services, minus net transfer payments made to foreign residents. The capital account represents the net claims on U.S. residents that foreign residents have accepted in payment.

developed country members of the OECD, while many developing countries see the United Nations Conference on Trade and Development (UNCTAD) as an alternative. In addition, bilateral agreements have been used in a wide variety of areas. These alternatives have provided important channels to reach agreement and to avoid or settle disputes. Each one, however, differs significantly from the GATT. The OECD does not cover developing countries and its resolutions are not binding on member states. The UNCTAD is a highly political forum and has not been conducive to achieving consensus. Bilateral agreements have been limited in their product and country coverage and do not always adhere to non-discriminatory principles.

The OECD covers a range of economic and social issues of interest to its 24 developed country members, some of which are trade related. Research projects are conducted by numerous functional committees. These projects are often directed toward gaining a better understanding of the problems facing member states and serve as a basis for discussions on common policy goals and declarations and for implementing work plans. The OECD has been more active in the trade area since 1980, playing a particularly important role in the area of service sector trade. Other efforts address issues of protectionism, export credits, high-technology trade, agricultural trade, and trade-related investment measures.

The UNCTAD acts mainly as a forum for exchanging views on the state of the international trading system. Its recent work programs have addressed commodity pricing agreements and trading relations between developed and developing countries. The UNCTAD charter directs that duplication of efforts with the GATT is to be avoided whenever possible. UNCTAD has played a lesser role in trade debates.

PROBLEMS IN THE TRADING SYSTEM

Two of the most important areas in which the international rules of trade have failed to prevent contentious relations and which have put the institutional framework under pressure are trade in agricultural commodities and actions to safeguard domestic industries. Service sector trade has become increasingly contentious and some countries, particularly the United States, have been pushing for GATT coverage in this area. Each of these areas involves a variety of specific problems, including market access and subsidy disputes in wheat-related products, attempts to both liberalize and regulate telecommunications industries, and growing restrictions imposed on steel trade. Each is important to the U.S. economy and involves significant imports or exports or both. GATT attention to these areas is likely to be prominent in any new round of trade negotiations.

Trade in agricultural products

Problems in agricultural trade began with the original GATT rules, their interpretation, and their application. Because of the exemptions, waivers, and derogations imposed by the original contracting parties, little discipline is applied to trade in agricultural goods.

Although each agricultural commodity has its own unique trade characteristics, wheat is one of the more widely traded commodities. Many of the problems in agricultural trade exist for wheat or wheat-related products. Trading practices often affect competition in third country markets, bringing problems almost solely into the realm of international law. The United States presented disputes involving wheat flour and pasta to GATT's dispute settlement procedures.

In an attempt to bring more discipline to agricultural trading practices, GATT's contracting parties established a new committee on trade in agriculture in 1982. It has a large list of issues to consider.

Service sector trade

Trade in services is apparently continuing to expand despite lack of widely and commonly agreed upon general principles. To date, most discussions on services have been within OECD, which has developed non-binding codes to cover principles of service-related trade and investment. At U.S. urging, the GATT membership is now exploring issues and problems in service sector trade, but no consensus has been reached on whether any further rules or codes are needed or how they would apply if negotiations were undertaken. Discussions are also ongoing for individual sectors, and we have examined the telecommunications industry to illustrate problems in applying general GATT principles to a specific service sector as well as specific problems found in one service industry.

Actions to safeguard domestic industries

Although free trade is the commonly agreed upon objective of the GATT, certain provisions lay out derogations--conditions and procedures to restrict trade. Restrictions on imported goods in general, whether unfairly or fairly traded, seem to be on the increase; dumping and subsidies laws often are abandoned and replaced by negotiated solutions in the form of export quantity restraint agreements; and remedies are increasingly taking the form of bilateral, negotiated settlements regardless of the cause of the problem or the injury involved. There has been a blurring of the distinction between fair and unfair trade laws, criteria, and remedies.

Steel is an example of an industry which has reached a mature or low-growth stage of development in a number of countries. Numerous trade actions to restrict imports have been taken to protect such industries--a practice permitted under GATT Article XIX[6] under certain conditions. However, these actions have often been taken without meeting conditions under Article XIX and are inconsistent with other GATT principles. Developing a safeguard code to interpret and clarify Article XIX was an objective of the Tokyo round enumerated in the 1973 Ministerial Declaration. To date this has not been accomplished.

OBJECTIVES, SCOPE, AND METHODOLOGY

This review was conducted at the request of Senator Charles Mathias, Chairman, Subcommittee on International Economic Policy,[7] Senate Committee on Foreign Relations. The objectives were to provide information on the comparative trading practices of the United States and its major trading partners, identify and evaluate the reasons for alleged widespread variance from GATT principles and rules, explore the possibility of extending GATT discipline to service sector trade, and determine whether support of the GATT continues to be in the U.S. interests.

On the basis of discussions with Subcommittee representatives, we agreed to examine GATT treatment of (1) agricultural trade issues which have arisen with respect to wheat, (2) the telecommunications industry to address service sector trade issues, and (3) the use of safeguard mechanisms in the steel industry. Because of the comprehensive nature of the Chairman's request and the GATT itself, we chose to highlight problem areas in the GATT--i.e., steel and agriculture--rather than attempt a comprehensive review of all GATT activities or issues under discussion. Examining other less contentious issues may have added some additional positive observations, but the fundamental results would not have changed. Each sector selected for study is important to U.S. trade and each represents a significant set of problems for the trading community. U.S. policymakers will have to address these issues in future negotiating rounds.

To present a complete picture of the current debates in these areas, we studied the comparative practices and attitudes toward the trading system of developed and developing countries,

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[6]Article XIX is the safeguards provision of the GATT which outlines certain conditions for restricting imports.

[7]Now the Subcommittee on International Economic Policy, Oceans and Environment; see app. I.

including the United States; Canada; Japan; the European Community (EC), together with Great Britain and West Germany as individual members; Australia; South Korea; Brazil and Argentina.

We performed fieldwork between March and October 1984. In the United States and overseas, we contacted government officials responsible for each area and for overall trade policy. Whenever practical, we interviewed and obtained other information from company executives, other business representatives, and interest groups. In some cases, we relied on U.S. government and business representatives overseas. We also held lengthy discussions with officials of the GATT. We obtained assistance from experts in the academic community and reviewed a variety of published information. Appendix II lists GAO studies related to this review.

Our review was performed in accordance with generally accepted government audit standards.

AGENCY COMMENTS AND OUR EVALUATION

The Department of Commerce, in commenting on this report stated that it "suffers from the limitations imposed on its coverage . . . had time and resources permitted a broader view of the GATT's operations . . . the report's general conclusions would probably have been more optimistic." We do not believe our fundamental conclusions regarding the current issues of major concern would have been different had the scope of this effort been broader. We note in this chapter GATT's success in reducing tariffs. However, we chose to highlight the difficulty in disciplining non-tariff measures in the belief that given the growing frustration in the United States with the international trading system we could better serve the needs of Congress by distinguishing between (1) problems with the adequacy or effectiveness of GATT rules and (2) problems with contracting party compliance with GATT rules. The safeguards, agricultural, and service sector trade issues were selected precisely because they pose significant international trade problems and, as Commerce notes, precisely because they "are at the heart of U.S. proposals for improving the GATT under the aegis of a new round." As negotiations in a new round begin, congressional assessments of agreements and benefits resulting from this new round should be based on an accurate view of what can reasonably be expected from the GATT as an institution and what remains the responsibility of individual contracting parties in fulfilling their international obligations. Our analysis attempts to distinguish between these two and provide basic observations about the conditions necessary for conclusion of a successful new round of trade negotiations. The Office of the U.S. Trade Representative agreed that this was a valid analytical approach.

CHAPTER 2

GATT DISCIPLINE WEAK FOR AGRICULTURAL TRADE

GATT rules for agriculture are not clear. GATT's contracting parties have usually placed domestic considerations, such as income support for farmers or maintenance of domestic food production capacity, ahead of international trade impacts when developing agricultural policies.

This ordering of priorities was reflected in the creation of GATT and continues to inhibit efforts to strengthen GATT agricultural provisions. The GATT has evolved with some provisions that are more lenient for agriculture than for manufactured goods. These allow contracting parties' agricultural programs to function effectively in pursuit of domestic objectives even when the programs adversely affect international trade. For example, the two most contested practices in agricultural trade, subsidies and non-tariff market access restrictions, are addressed in language that is vague and consequently difficult to apply and that sets standards for agriculture that are less strict than those for other trade. Additional GATT provisions, though they give no special consideration to agriculture, allow questionable practices to continue because they authorize further exceptions to general rules or because they lack notification requirements.

Not surprisingly, this latitude for action has allowed contracting parties to develop agricultural programs with international repercussions that have adverse effects on other parties and lead directly to trade disputes. Since in many cases there are different interpretations of relevant standards, these disputes often remain intractable. Frustration with lack of progress can encourage confrontation and retaliation in lieu of amicable settlements, with damaging consequences for the countries involved and the GATT itself.

The prevalence and extensive nature of government intervention in domestic and international wheat trade illustrates quite well the weakness of the GATT with respect to agriculture. This applies particularly to major exporter subsidies which affect trade. Government intervention and resulting agricultural policies have created a system in which supply and demand are no longer the dominant influence in the production and trade of commodities. As the major wheat producer, the United States through its policies has accepted much of the responsibility for adjusting to shifts in international wheat supply and demand.

The dominance of national policies has long frustrated efforts to obtain more operationally effective GATT discipline

for agricultural trade. All countries, including the United States, engage in practices which limit imports or promote exports to the disadvantage of other countries. However, the major trading nations have recognized that greater adherence to the GATT must be obtained. This recognition is reflected by the creation in 1982 and subsequent work of the GATT's Committee on Trade in Agriculture (CTA) and in ongoing bilateral negotiations under the auspices of the GATT on specific trade disputes. Most significant among the latter is the U.S.-EC effort to resolve their broad-ranging dispute over elements of the EC's Common Agricultural Policy (CAP) which adversely affect U.S. trade.

EXTENSIVE GOVERNMENT INVOLVEMENT IN AGRICULTURAL TRADE IS UNIVERSAL

The governments we studied have extensive agricultural programs that affect international trade. Some, such as import quotas, have a direct trade effect. Others, such as farmer subsidies, are designed and adopted for domestic impact but affect production and prices to such an extent that they change international trading patterns. Programs in both categories are adopted to advance specific domestic priorities, such as higher farm incomes or greater food self-sufficiency. Taken together, the explicit trade controls and the trade effects of domestic programs constitute de facto national trade policies.

Government involvement varies according to economic development and market position

Government involvement in international agricultural trade varies considerably in directness and degree among the countries in our study. Some governments indirectly influence trade by stimulating private production, some directly regulate private trade, while others operate outright government trade monopolies.

Each government has adopted a program responsive to its own circumstances. Many factors influence these programs' design, but two are particularly important: (1) the country's level of economic development and (2) its world market position in agriculture (i.e., whether it is an exporter or an importer).

Economic development is an important determinant of any country's farm policy, and its trade policy by extension. Developed nations usually adopt programs that favor agriculture at the expense of other sectors of the economy, while developing countries do the opposite.

Developed country policies are typified by relatively high prices guaranteed to domestic producers, which effectively

transfer income to farmers from taxpayers and from domestic and foreign consumers. The family farm is imbued with high socio-cultural value in these countries, and farmers are well organized with considerable political representation.

Developing country policies are exemplified by Argentina, which taxes agricultural exports to support other sectors of the economy, including government and industry. This policy transfers income from farmers to taxpayers and non-farm economic activity. Such policies are prevalent in developing countries where rural populations are relatively less politically influential than urban residents.

Market position is another important determinant of government policy. Exporting countries generally maintain programs intended to ensure their producers a continuing share of the world market in order to meet domestic policy objectives. Good examples are the U.S. government's export credit programs and bilateral supply agreements such as that between the U.S. and the USSR that most major exporters use to some extent. Both importing and exporting nations, on the other hand, generally restrict imports to protect domestic producers. This is particularly true of developed nations, such as Japan, the United States, and the European Community.

Balance of payments can be an important consideration in determining the vigor with which promotion or protection policies are pursued. For example, Argentina and Brazil have serious international debt problems. In an attempt to alleviate these problems, Argentina, already a major wheat exporter, is attempting to increase exports, while Brazil, a major wheat importer, is working to decrease imports.

Five suppliers dominate the international wheat market

Table 1 illustrates the character of the international wheat market in the mid-1980's. First, there are relatively few export suppliers. In marketing year (MY) 1983-84 the five exporting countries included in our study accounted for 95 percent of all international sales. Second, there are many purchasers; in that same year, 21 countries purchased at least 1 million metric tons (mmt), with the USSR accounting for more than 10 percent of total purchases. Among our subject countries are four significant importers. (The EC both exports and imports because it produces too much soft wheat for its own use and not enough hard wheat). Third, the supply of wheat available for export greatly exceeds effective import demand. The major suppliers, at the close of MY 1983-84, retained in storage about two-thirds as much wheat as they exported during the year.

Table 1

International Wheat Trade of Selected Countries
MY 1983-1984[a]

Country	Exports	Imports	Exporter ending stocks[b]
	(mmt)[c]		
United States (June-May)	38.9		38.0
Canada (Aug.-July)	21.8		9.0
European Community[d]	16.0	3.6	8.4
Australia (Dec.-Nov.)	13.5		7.5
Argentina (Dec.-Nov.)	7.8		0.7
Japan		5.9	
Brazil		4.5	
Republic of Korea		2.4	

Total world trade: July 1983 to June 1984 - 103.1 mmt.

[a]July 1983 to June 1984 unless otherwise indicated.
[b]Stocks are figures at end of different marketing years; they do not represent actual total amounts available at any one point in time.
[c]Includes wheat flour equivalent.
[d]Excludes intra-EC trade.

Source: "World Grain Situation/Outlook", Foreign Agricultural Service, Department of Agriculture (USDA), Washington D.C., Nov. 14, 1984. Foreign Agriculture Circular FG-14-84. Figures for MY 1983-1984 are preliminary.

All five major suppliers have a great degree of national interest in maintaining and expanding their export sales because wheat sales are an important source of export income. The excess of supply over demand during recent years has intensified competition; exporting nations have developed numerous practices to attempt to retain or expand their market shares.

The U. S. government exercises indirect but decisive influence over world wheat markets

Wheat exports are an important source of U.S. export earnings. During the 1980's, the United States has exported about 60 percent of its annual wheat production. In fiscal year 1983 these exports were worth more than $6 billion, about one-sixth of the total value of U.S. agricultural exports.

With some exceptions, the U.S. government does not exercise direct control over this trade. Most export sales are arranged and transacted by private traders, and direct export subsidies were discontinued in 1972. However, the government's farm program, which is designed primarily to address farm incomes and not trade, has a powerful impact on the U.S. position in the international marketplace and on other suppliers. The United States is the primary stabilizing force in the international wheat market. Federal farm programs have created a system which absorbs most of the shocks that changing demand and supply conditions bring to the market. When world supplies are large and prices low, the U.S. government pays for storage and acreage diversion to absorb excess stocks and defend prices. When supplies are short, the United States benefits because it has the stocks and excess production capacity to meet increased demand. In fact, the United States is unique among major suppliers in pursuing a stockholding policy designed to stabilize domestic prices that also tends to stabilize the world market.[1] This policy tends to encourage other exporters to increase production, secure in the knowledge that the United States will absorb most fluctuations in effective export demand.

The overall U.S. wheat program has four major components--non-recourse loans, the farmer-owned reserve, deficiency payments, and acreage reduction.[2] The first two programs are designed to stabilize commodity prices, while the latter two are intended to support farm incomes. Participation in all programs is voluntary.

The non-recourse loan program guarantees farmers minimum prices for their crops. If prices at harvest are below a preset "loan rate," farmers can surrender their crops in return for a loan at the established "rate." If prices do not rise above this level after 9 months of USDA stockholding, the government takes permanent possession of the commodities as full loan repayment.

The farmer-owned reserve program extends the period of time that commodities can be held off the market as loan collateral for an additional 3 years. Grain in this program is reclaimed

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[1]See: Global Stocks of Grain: Implications for U.S. Policy. By Jerry A. Sharpler and Carol A. Goodloe, International Economics Division, Economic Research Service, USDA, Washington, D.C., May 1984. ERS Staff Report No. AGES 840319.

[2]This program also applies to feedgrains. USDA also operates price support programs for rice, cotton, oilseeds, peanuts, dairy products, sugar, tobacco, honey, wool, and mohair.

and sold by farmers if market prices rise above a pre-set "trigger release" level. Taken together, the two programs provide limits to the variability of U.S. commodity prices. The nonrecourse loan rate provides a floor to the market while the trigger release price provides a ceiling.

Deficiency payments are provided to participating farmers for income support whenever market prices fall below specified target levels. Acreage reduction--paid or unpaid diversion of land from production or payment in kind (PIK)--is an alternate income support method. Acreage reduction is designed to support farm income by reducing supplies, thereby supporting prices. Acreage diversion requirements are imposed by USDA as a precondition to participation in other farm programs whenever significant surpluses are forecast.

These programs have a decisive influence on the world market because the U.S. grain market is the largest open market in the world. International grain prices are therefore largely determined by U.S. commodity markets. Since USDA loan programs provide a floor to variations in the U.S. price, they also perform the same function for world prices.

The Agriculture and Food Act of 1981 set loan rates for the next 4 years that turned out to be far above market clearing levels. High U.S. loan rates in 1982 and 1983 provided a real floor, not only for U.S. prices but also for the entire world market, at levels higher than the uncontrolled interplay of market forces would have dictated.[3] These high prices ensured the profitability of efficient producers (Canada, Australia, Argentina) while allowing the EC to hold its export subsidies to relatively low levels.

Non-U.S. suppliers were allowed to increase production and export sales without fear of driving the price below the U.S.-defended loan rate. The government held down U.S. production through acreage reduction requirements in 1982 and, when these proved insufficient, introduced payment in kind to further reduce production in 1983. Other countries, however, felt no similar constraints and their production increased.

Table 2 illustrates the result of these policies. U.S. export sales declined about 20 percent, while stocks were increased by a like margin due to government defense of loan rates. Other suppliers increased international sales by slightly more than the U.S. contraction.

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[3]USDA lowered the loan rate for the 1984 crop by 10 percent from 1983 levels to maintain domestic and export markets. Average market prices for 1984 were above the new lower rate.

Table 2

Changes in Major Suppliers'/Production, Exports and Stocks of Wheat
(MY 1981-82 to 1983-84a)

Country	Change in production		Change in exports		Change in stocks	
	mmt	%	mmt	%	mmt	%
United States (June-May)	- 9.9	-13.1	- 9.3	- 19.3	+6.5	+ 20.6
Canada (Aug.-July)	+ 1.8	+ 7.3	+ 3.4	+ 18.5	- .8	- 8.2
European Community	+ 4.9	+ 9.0	+ .5	+ 3.2	+ .6	+ 7.7
Australia (Dec.-Nov.)	+ 5.5	+33.5	+ 2.4	+ 21.6	+2.6	+ 53.1
Argentina (Dec.-Nov.)	+ 3.7	+44.6	+ 4.2	+116.7	- .1	- 12.5
Total non-U.S. suppliers	+15.9	+15.3	+10.5	+ 21.6	+2.3	+ 9.9

aSee footnotes a-d in table 1; GAO calculations based on source given in table 1.

Table 3 clearly illustrates the extent to which the United States was willing to accumulate stocks in defense of established prices. This country is the predominant holder of stocks among the major international suppliers. The table shows that during the early 1980's the United States made an average of 44 percent of the combined exports sales of the 5 major suppliers but held about 60 percent of these countries' total stocks. No other supplier held a share of stocks that exceeded its share of total exports.

Table 3

Major Wheat Suppliers' Stockholding Behavior
(MY 1981-1982 through MY 1983-1984)
(3-year average)[a]

Country	Production		Exports		Stocks	
	mmt	%	mmt	%	mmt	%
United States (June-May)	72.3	39.4	42.7	44.2	36.9	60.1
Canada (Aug.-July)	26.0	14.2	20.5	21.2	9.6	15.6
European Community	57.8	31.5	15.7	16.2	9.2	15.0
Australia (Nov.-Dec.)	15.7	8.6	10.6	11.0	4.9	8.0
Argentina (Nov.-Dec.)	11.6	6.3	7.1	7.5	.8	1.3
Total	183.3	100.0	96.6	100.0	61.4	100.0

aSee footnotes a-d in table 1. GAO calculations based on source given in table 1. Totals may not add due to rounding.

Three additional facets of U.S. policy should be mentioned. First, the U.S. government operates programs that directly assist exports. The several export credit programs operated by the Commodity Credit Corporation financed about 18 percent of U.S. agricultural exports in fiscal year 1983 worth about $6.46 billion; 55 percent of this total was unsubsidized credit provided through GSM-102 guarantees and the remainder was concessional under the Public Law 480 (Food for Peace) and Blended Credit programs.[4] The USDA's Foreign Agricultural Service also operates several export promotion programs.

Second, the United States maintains import restrictions on several commodities. Section 22 of the Agricultural Adjustment Act of 1935, as amended, requires the imposition of restrictions whenever imports cause or threaten material interference with the operation of USDA commodity price support programs, without regard for GATT rules. The United States was granted a waiver in 1955 under GATT Article XXV to allow the restrictions

[4]The latter program combines GSM-5 subsidized credit with GSM-102 credit guarantees to provide the buyer with an overall below market interest rate.

despite their conflict with the General Agreement. Section 22 is currently invoked to allow import controls on cotton, peanuts, certain dairy products, and sugar.[5] It has been used in the past for wheat.

Third, U.S. farmers benefit from a broad range of miscellaneous government assistance programs, including guaranteed and subsidized credit, research, and infrastructure development projects (e.g., subsidies for rural utilities). This support stabilizes incomes and is intended to promote farm efficiency and productivity, indirectly helping the U.S. farmer to be an effective competitor in export markets.

The EC's Common Agricultural Policy requires substantial direct intervention in trade

The CAP gives the European Community's governing bodies an important direct role in agricultural export and import trade. The CAP was developed in the 1960's to advance several domestic objectives, most prominently the maintenance of farm incomes and assurance of an adequate domestically produced food supply. The Community's primary policy tool for pursuing these objectives is control over commodity prices for both producers and consumers.

To ensure adequate farm incomes, the EC sets internal producer prices at artificially high levels. For example, its marketing year 1982-83 reference price[6] for standard quality wheat was $201 per metric ton, $70 higher than the U.S. price for average quality wheat.

This pricing strategy has stimulated surplus production of several commodities, most notably grain and dairy products. The EC has chosen to export the grain surpluses, paying subsidies (commonly termed "restitution payments") to shippers to bring high internal prices down to world levels. The average export restitution payment for MY 1982-83 was about $68 per metric

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[5]The sugar import fee under section 22 is currently set at zero. However, sugar import quotas are maintained under headnote authority of the Tariff Schedule of the United States.

[6]The price paid by the EC intervention authority as a buyer of last resort.

ton.[7] Storage, an alternative system of government support for internal prices, is used for dairy products and wine but has not been pursued for grain because of the cost involved.

The system has no effective limits on production. Guarantee thresholds, which stipulate a lower price for deliveries above specified levels, were introduced in 1982 but they have had little impact. Thresholds are set at high levels that are unlikely to be exceeded and the penalty for over production is slight - 1 percent less in price increases for the next year for every million tons of excess production. The effects of this pricing policy on EC wheat production and exports have been pronounced: output increased by about 43 percent between marketing year 1976-1977 and marketing year 1983-84, while exports more than tripled.

To maintain the integrity of the price-based farm support system, the EC has developed a system of variable levies on imports. Levies are set on a weekly basis to ensure that imports cannot undercut domestically produced commodities. This ensures that foreign supplies are used only when domestic farmers do not meet domestic demand, at prevailing prices.

The EC's individual member states all have additional support programs for their own farmers, including social security assistance and infrastructure development. The EC Commission has estimated that the total value of these national programs is about twice that of Community spending. Unquestionably, the CAP export restitutions have a significant direct effect on trade, while these individual member state programs broaden this effect indirectly.

Argentina exercises minimal state control over wheat exports

Successful competition in international commodity markets is vital to Argentina's economy. Agricultural products supply about 70 percent of total export earnings, and wheat is the largest export crop by volume.

Although Argentina maintains a national grain board (the Junta Nacional de Granos), the government exercises less control over its agricultural trade than any other country in our study, with the possible exception of the United States. The Junta

[7]Due largely to the rising value of the dollar, the magnitude of these restitutions has declined since the end of MY 1982-83. The average payment for the first 8 months of MY 1984-85, for example, was about $10 per metric ton.

sets a national support price for wheat and a minimum export price, called the index price. Both are based on open market prices and contain no element of subsidy.

Farmers are free to sell their grain to private traders at open market prices, determined on the Buenos Aires Commodity Exchange, or to the Junta at the support price. Most sales are in fact made on the open market because farmers can obtain quicker payment in such transactions, an important consideration in light of Argentina's high inflation. Most export sales (82 percent in 1983) are made by private companies, with the remainder made by the Junta. Virtually no export credit is provided.

Argentina has made a policy commitment to increasing agricultural production and exports. The government recently announced new credit programs for farmers and an effort to increase fertilizer use. These and other assistance projects, however, are overshadowed by two key policies that discourage wheat exports. First, all grain destined for export is subject to registration with the Junta and payment of export taxes, currently 18 percent of the sale price for wheat. Second, producers do not receive the full benefit of sales because of unfavorable exchange rate policies.

Despite these disincentives, Argentina usually sells nearly all its annual wheat production at or just below prevailing world market prices after domestic needs are met. The country typically holds lower stocks than any other major exporter--about 7 percent of production during the early 1980's. This policy is carried out regardless of current prices for two reasons. First, Argentina has minimal storage capacity so wheat must be moved out of the country with as little delay as possible. Second, Argentine merchants can make a profit even if prices decline quite steeply because national costs of production are very low relative to other wheat exporting countries.

State trading organizations directly control wheat trade in the other countries in our study

State control over trade is generally used to accomplish the same goals addressed by U.S. and EC programs--export promotion and import protection--but in a more direct manner. Exporters, like Australia and Canada, use national wheat boards to expand and stabilize sales, export earnings, and therefore farm income. Importers, like Korea and Japan, use state control over imports to prevent interference with domestic agricultural support programs while allowing entry of quantities necessary to fill unmet needs. In addition to these trade policies, these

countries also operate domestic assistance programs that indirectly affect trade.

The Australian and Canadian Wheat Boards exercise monopoly control over exports

Australia and Canada each exported 70 to 80 percent of their annual wheat production during the last decade, and to achieve maximum benefits from these exports both countries have organized national wheat boards which control exports on a monopoly basis. The boards are assigned the task of maximizing exports and dispersing the resulting profits among growers. An important secondary objective of both governments is to stabilize farmer incomes. This is accomplished primarily through board operations but both countries operate additional programs for this purpose.

Both boards exercise nearly complete control over national grain marketing. The Australian Wheat Board purchases and disposes of all the wheat moving off farm in Australia, whether for domestic or export use. The Canadian Wheat Board has like control over wheat, oats and barley grown in Canada's primary producing areas.[8] Private traders operate in both countries, but only as accredited exporters for the wheat boards.

Both boards are self-sufficient, non-profit corporations. They return revenue from wheat sales to farmers in similar fashion. Farmers are given an initial minimum price for wheat upon delivery to the board. Further payments are made later, depending on success in the international and domestic markets. Board operating expenses are paid by producers out of proceeds from grain sales. Both governments are committed to covering losses if the initial payment cannot be covered by subsequent sales. However, such bail-outs are seldom necessary, e.g., one in Canada in the last 30 years, none in Australia since the system was modified to its present form in 1979. Neither board benefits from government subsidized export credit programs. However, both are enabled by government guarantees to offer some credit at relatively low market rates of interest.

As explained in the section on U.S. policies above, international wheat prices are largely determined by U.S. markets and are heavily affected by U.S. government decisions. Australia and Canada, on the other hand, are price takers in the

[8]The prairie provinces and British Columbia's Peace River Valley produce about 95 percent of Canadian wheat and barley and 80 percent of oats. For the most part, feed wheat for domestic use is excepted from this system in both countries.

international market. Although they are major suppliers, their market power does not approach that of the United States. The wheat boards do not attempt to support prices by withholding stocks. Instead, they maximize sales at the best available price. The essential similarity of the two boards' market approach is indicated by the fact that both countries average end-of-market-year stocks were about 46 percent of their average annual exports during marketing year 1981-82 through marketing year 1983-84. In contrast, the U.S. figure for this period was 86 percent.

This short-run similarity should not be taken to imply that the two boards operate in identical fashion, however. Canada has traditionally held greater stocks and has been more likely to adjust stock levels in response to changing international prices than Australia. Three factors may help to account for this difference. First, Canadian stocks may have been at higher levels over the years than the Wheat Board would like because of transportation difficulties—mainly outdated railways and severe weather. Second, the Canadian Board maintains larger stocks to meet its trade and aid commitments. Third, responsibility for holding excess stocks lies largely with the private sector in Canada but lies exclusively with the wheat board in Australia through state bulk handling authorities. The Canadian Board sets delivery quotas for farmer deliveries depending on its needs and/or ability to make sales, while the Australian Board accepts unlimited quantities from domestic farmers. The Australian Wheat Board is therefore somewhat more willing to maximize sales at prevailing price levels.

Reliance on the international market as the primary determinant of wheat farmer income holds out the likelihood of significant year to year instability. Australia and Canada have both implemented mechanisms to reduce the adverse impact of price fluctuations on farmers. Australia's guaranteed minimum price paid to farmers on delivery of their wheat, is determined by a formula that limits price variation from year to year. Canada relies completely on the market to determine average returns to farmers each year. However, the Canadian government shares with farmers on a 2 for 1 basis the cost of a stabilization fund that compensates farmers for abnormally low profit margins. Neither of these efforts shield producers from long-term cost and price trends and both therefore promote structural adjustment. Both countries also attempt to stabilize sales through extensive use of long-term bilateral supply agreements.

Other Australian assistance is negligible and has little if any impact on trade. The most important among several Canadian programs is a subsidy on grain transportation, known as the "Crow's Nest Pass" rates agreement prior to its 1983 revamping.

Total government expenditures on grain transportation are scheduled to remain at C$900 million to C$1 billion annually for the remainder of the decade.

Japan and Korea exercise extensive control over imports

Japan and Korea are significant wheat importers because wheat products have become increasingly popular in both countries since World War II and neither can begin to satisfy demand through domestic production. Japan has produced just over 10 percent of the wheat it consumes annually since 1980, while Korea has managed to produce less than half this rate.

Japan and Korea closely control imports to protect domestic grain support schemes from being undermined by inexpensive foreign imports. Government commitment to national food self-sufficiency is an important motivating factor in both countries. Korea recently abandoned domestic support for wheat production but continues to subsidize other commodities.

The two countries encourage domestic grain production and maintain farm incomes through state purchasing. Government agencies (in Korea, the quasi-governmental National Agricultural Cooperative Federation; in Japan the Ministry of Agriculture, Food and Fisheries) buy domestically produced commodities at relatively high government-set prices and resell them to consumers at lower prices, effectively transferring income to the farm sector.

Japan and Korea also operate several additional agricultural support programs, but they are of secondary importance in comparison with government purchasing programs. The Korean government subsidizes fertilizer production and farm credit. Japan funds farm investment projects and also pays farmers to divert acreage away from rice (a commodity in chronic surplus) to other crops, including wheat.

To ensure that lower priced imports do not vitiate domestic price supports, both countries limit sales by foreign suppliers to particular amounts arrived at by calculating residual need after domestic production is consumed. In Japan, the Food Agency controls wheat imports and sets the resale price of imported wheat so as to make a profit. These profits balance out the cost of subsidizing domestic production of wheat and other commodities. Korea maintains a comprehensive set of restrictions to limit agricultural imports. For example, tariff rates are high and variable for most commodities (Korea maintains a flexible tariff system wherein levels for designated goods can be adjusted every 6 months) and import licenses are

required in many instances.[9] The tariff on wheat imports, however, is relatively low at 5 percent.

Until 1984, the Korean Flour Millers Association carried out domestic support and import protection efforts for wheat. Korean millers formerly paid into a fund the difference between relatively low wheat import prices and government-set break point prices. These funds were then used to reimburse millers for their purchases of relatively high priced domestic wheat from the government. The Korean government has decided to abandon support for domestic wheat farming, however, because of unfavorable returns to producers compared with other crops and unsuitable growing conditions.

Brazil directly controls wheat imports

Brazil is both a major importer and a major exporter of agricultural commodities. It ranks fifth in the world in wheat imports despite a declared government goal of self-sufficiency in that product. It is a major world supplier of soybeans, coffee, and frozen concentrated orange juice. Acute balance of payments and debt problems have intensified the government's concern for limiting imports and promoting exports. However, the International Monetary Fund's (IMF) austerity plan for Brazil has required cutbacks on some of the country's existing agricultural support programs.

To minimize wheat imports, the Brazilian government subsidizes domestic production, imposes import quotas, and provides farmers with subsidized credit. The government purchases the entire domestic wheat crop at a pre-set price and resells it to users at a lower rate. To prevent cheaper imports from undercutting this subsidy system, an import quota is set equivalent to expected need after all domestic production is consumed. Domestic sales of imported wheat are also subsidized. In fact, the government has in the past absorbed 50 to 60 percent of the cost of wheat on behalf of consumers through these subsidies. However, these subsidies were to be phased out between 1980 and 1985.

The combination of lower support prices and more expensive credit may produce lower wheat harvests, requiring greater imports or less consumption.

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[9]In response to U.S. requests, Korea liberalized trade barriers on several products in 1984, including wheat.

GATT'S RELATIVE WEAKNESS IN AGRICULTURAL TRADE HAS LED TO SERIOUS TRADE DISPUTES

The commitment shared by many governments to pervasive intervention in agriculture has made it difficult for GATT negotiators to obtain agreement on substantial restrictions on national behavior. The vagueness of several key GATT provisions and numerous exceptions for agriculture reflect this problem. This relative leniency has, in turn, encouraged development of national trade policies that lead the contracting parties into intractable disputes. As GATT's Committee on Trade in Agriculture has noted:

> "All the countries which have furnished information [to the Committee] on their agricultural policies [23 countries and the EC] apply a more or less extensive panoply of restrictive practices affecting both imports and exports: customs duties, sanitary and phytosanitary regulations,[10] various prohibitions, state trading enterprises, quotas, subsidies, various forms of price support, voluntary restriction agreements, etc."

International concern in this area has centered on establishing clearer GATT discipline over export subsidies and market access restrictions. There is also support for broadening GATT coverage to trading practices not presently controlled, including those maintained under waivers and exceptions, and for improving transparency. Wheat trade can provide examples of controversy in each area.

GATT has not controlled the use of agricultural export subsidies

The EC's use of export restitution payments is a basic point of contention in the wide-ranging U.S.-EC agricultural trade dispute. This fact alone is sufficient to make the subsidies issue a major concern for all the contracting parties. Failure to resolve this dispute could embroil the two largest GATT trading partners in a serious trade conflict, jeopardize ongoing efforts to improve GATT provisions, and threaten the Agreement's basic viability.

Canada, Australia, and Argentina share U.S. objections to EC export subsidies and support U.S. efforts toward their abatement. However, it should be noted that these countries (in addition to the EC) have also registered their displeasure with

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[10]Phytosanitary regulations protect the health of plants.

U.S. concessional export credit--particularly the Public Law 480 and Blended Credit programs--which they feel are unfair subsidy mechanisms for acquiring and expanding U.S. markets at their expense.

GATT language concerning subsidies illustrates the contracting parties' failure to agree on a clear instrument that sets boundaries for acceptable behavior. The provisions are more lenient for primary products (which include agricultural commodities) than for other trade, and they are vague. They are consequently difficult to interpret, either for policy-making guidance by the contracting parties individually or for dispute settlement by the contracting parties collectively or for GATT panels.

Article XVI, the basic GATT rule on subsidies, neither prohibits subsidies on agricultural exports nor clearly delineates allowed practices. Section A, which addresses all subsidies, commits the contracting parties only to discuss problems when "serious prejudice" to another party is caused or threatened. Section B, which concerns export subsidies specifically, sets different standards for non-primary and primary products. Export subsidies on non-primary products are prohibited if they result in export prices lower than those in the producer's domestic market. The standard for export subsidies on primary products, however, is less clear. Contracting parties are admonished to "seek to avoid" such subsidies, but are allowed to retain them provided they do not result in acquisition of "more than an equitable share" of world export trade in the subsidized product. In determining any practice's conformity with these rules, an undefined set of "special factors" which affect trade in the product is to be considered.

The GATT Subsidies Code[11] was developed during the Tokyo Round to improve this regime. For agriculture, however, the Code's contribution has been limited; the amended language is characterized by the same weaknesses as the old. For example, the Code prohibits without qualification export subsidies on non-primary products but retains complex standards for determining the acceptability of export subsidies on primary products. Many terms crucial to the interpretation of these standards remain vaguely defined and are amenable to varying interpretations.

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[11]Formal title: Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade.

U.S. attempts to curb EC export subsidies through the Code's dispute resolution procedures illustrate GATT weaknesses quite well. The United States has contested EC export restitutions on two wheat products, wheat flour and pasta. Both of these actions originated in complaints by U.S. producers under Section 301 of the U.S. Trade Act of 1974, as amended. Before taking more active measures, the President, through the U.S. Trade Representative, is required to consult with the offending party. Such consultations have typically led directly to the formation of GATT panels of experts to render opinions on the conformity of disputed practices to various GATT provision.

GATT panels were formed and delivered opinions in both the wheat flour and pasta cases. The wheat flour panel found EC export restitutions to be subsidies within the meaning of Article XVI and commented that it would be desirable for the EC to limit their use. However, the panel could not determine that the Community's practices had violated any standards for legality established by GATT. It concluded that ". . . solutions to the problem of export subsidies in this area could only be found in making the pertinent provisions of the Code more operational, stringent, and effective in application." This is a good example of the difficulties encountered in attempting to apply vague standards to trade practices. Such difficulties, though present in the pasta case, did not prevent the panel from reaching a definite conclusion (albeit without unanimity). The pasta panel found that EC subsidies were illegal because pasta is not a primary product.

The fate of both panel reports illustrates another important limitation to the effectiveness of GATT dispute settlement--this one a direct result of the application of the national sovereignty principle. Although most panel reports are accepted, albeit reluctantly at times, neither of these reports have been officially adopted by the Committee of Signatories of the Subsidies Code. Widespread dissatisfaction with the wheat flour report, particularly on the part of the United States, has held up adoption of this report because it does not clearly condemn EC subsidies. The EC has largely been responsible for preventing adoption of the unfavorable pasta report. This situation testifies to the fact that no contracting party can be forced to accept an interpretation of the rules that is to their disadvantage.

To demonstrate its determination to effect change in EC practices, the United States has adopted its own subsidy programs for use in North Africa, a traditional EC market. In 1983 surplus government wheat stocks were used to subsidize the sale of 1 million tons of wheat flour to Egypt. In 1984 USDA's Blended Credit program was targeted almost exclusively to North African wheat markets, with about $414 million in total sales.

Market access restrictions proliferate despite GATT coverage

Market access restrictions have received less attention than subsidies from U.S. trade negotiators in recent years because of overriding U.S. concern with EC export restitutions. However, restrictive practices are widespread and exert significant influence over agricultural trade; for many contracting parties they surpass subsidies in importance.

Market access for agriculture is more restricted than for other kinds of products, primarily because of unbound tariffs and non-tariff measures (NTMs). Throughout its existence GATT has emphasized that market access restrictions should be primarily effected through tariffs bound at a given level under Article II. Parties wishing to raise tariffs are required to negotiate compensation with those adversely affected. If adequate compensation is not offered, affected parties are free to withdraw substantially equivalent concessions. This policy works to keep tariff levels lower than they would be otherwise. However, the contracting parties have been relatively unwilling to rely on this regime for agricultural goods.

Fewer tariff lines are bound for agricultural commodities than for other exports. Unbound tariffs allow countries to change tariff rates at will without negotiating with or compensating their trading partners for any resultant injury.

Non-tariff measures are more widespread in agriculture than in other areas and take a variety of forms, including quotas, licensing, minimum pricing, and seasonal restrictions. GATT's Article XI, which addresses non-tariff measures, suffers from the same weaknesses that make Article XVI ineffective--greater leniency for agriculture and vague language. It places a general ban on non-tariff measures but allows significant exceptions for grading and marketing standards and for protection of farm support programs that restrict domestic production or are designed to remove temporary surpluses. In addition, the standards by which any practice's conformity with the GATT are to be judged are difficult to interpret.

All of the governments in our study restrict market access for wheat. As we have already noted, importing nations typically impose quotas (e.g., Korea, Japan, Brazil). Import of wheat into Canada is permitted only when the Wheat Board judges domestic supplies to be inadequate. Variable levies are used by the EC to achieve the same end. The exporting nations in our study also restrict wheat imports. An Australian prohibition of imports was lifted in 1984. However, stringent phytosanitary regulations remain an effective trade barrier. Argentina has an

outright ban on wheat imports. The United States reserves the right to impose import restrictions under section 22 of the Agricultural Adjustment Act which was granted a waiver by the GATT. It has been noted that the granting of this U.S. waiver during GATT's formative years and its maintenance since that time have provided a precedent and a continuing example for other contracting parties' use of market access restrictions to protect domestic agriculture.

An important point of contention in market access is the proposed EC ceiling on the import of U.S. non-grain feeds - most importantly corn gluten feed. The United States obtained duty free access for those products during the Dillon and Kennedy rounds of the multilateral trade negotiations. Since then, U.S. sales have risen above 3 million metric tons per annum. The EC views these imports as disruptive of its current attempts to rationalize the CAP and has proposed imposing stiff tariffs on imports above the 3.4 mmt level. The EC is offering compensation as required under GATT's Article XXVIII, which addresses renegotiation of bound concessions. However, the United States is vehemently opposed to this proposal because it sees the European Community attempting to use a trade restriction to address a domestic problem, thereby requiring non-EC countries to adjust to the market distortions caused by the CAP. Further, the United States believes that conceding this issue may provide the EC with a precedent for later adoption of additional restrictions, including quotas on an even more important U.S. export, soybeans. If the EC carries this proposal through, the United States has indicated that it may retaliate by restricting selected EC exports, e.g., wine, again with the possibility of spiralling into a wider trade conflict.

GATT coverage of agricultural trading practices is incomplete

Existing provisions allow GATT only limited control over agricultural trade. Numerous other restrictive practices are exempted from scrutiny through exceptions and waivers of general GATT rules. The lack of effective notification requirements in key GATT articles exacerbates this situation by allowing maintenance of questionable practices without international scrutiny. Moreover, far fewer tariffs are bound for agricultural commodities than for manufactured goods.

Two provisions of the General Agreement allow contracting parties to maintain certain practices that contradict GATT principles. First, the Protocol of Provisional Application of the GATT signed by the original members and subsequent Protocols of Accession require contracting parties to apply GATT Articles III through XXIII "to the fullest extent not inconsistent with existing legislation." Since there is no requirement for

countries to notify what practices are considered covered by this "grandfather clause," the exact extent of protection it provides is unknown. However, it has been used to defend grain market access restrictions in the past.

The second provision is Article XXV, which allows the contracting parties to waive any GATT obligation for a particular party by a two-thirds majority vote. As already noted, the U.S. section 22 waiver was granted under the terms of this Article.

The notification requirements in GATT articles do not effectively promote transparency in agricultural trade. This lack of transparency, in turn, allows countries to maintain restrictive policies fairly easily. We have already noted this weakness with regard to GATT's Protocols of Accession and Provisional Application. Article XI dealing with quantitative restrictions has no requirement that these restrictions be notified to the GATT. It is therefore difficult to know how extensively countries are taking advantage of this Article's "loopholes." There are some indications that notifications of restrictions are improving as the GATT Secretariat has undertaken an effort to catalogue tariff and non-tariff barriers in both manufactured and agricultural goods.[12]

The reporting required on Article XVI subsidy practices appears to be comprehensive, but nations have not fully complied with the requirements. Some contracting parties do not submit any information at all, while others provide very limited reports.

Article XVII, which addresses state trading enterprises, requires that state traders conduct business solely in accord with commercial considerations. It requires notification of which goods are so controlled and allows any contracting party affected by these operations to request information. Despite these provisions,the marketing operations of state traders are largely conducted outside public scrutiny. This lack of information is troublesome in agriculture because of the great extent of state control over international commodity trade. For example, the United States has no direct access to information about the credit and pricing practices of the Canadian or

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[12]See GAO Report: "Catalogues of Non-Tariff Measures Affecting International Trade." Forthcoming.

Australian wheat boards and official requests for information have met with limited success.[13]

MARGINAL IMPROVEMENT LIKELY IN GATT

Major changes in national trading practices or in the GATT principles guiding them are unlikely in the near term. The present regime, with its evident lack of discipline, reflects the consensus among contracting parties that the success of domestic agricultural programs is more important than international trade liberalization. As long as the parties retain this ordering of priorities, basic changes to ameliorate limits on free trade will be slow in coming.

However, marginal change in favor of better GATT discipline is likely. The major trading nations have recognized that the present situation needs improvement, as reflected in their commitment to ongoing multilateral and bilateral negotiations under the auspices of the GATT.

The Committee on Trade in Agriculture is working toward trade liberalization through more effective GATT rules

The GATT contracting parties created the Committee on Trade in Agriculture in November 1982 to develop recommendations for improving GATT rules. The CTA was instructed to review and make recommendations on each of the issues discussed above, i.e., the effectiveness of GATT control over subsidies, possible liberalization of market access restrictions, coverage of measures now maintained under exceptions and waivers, and development of an improved notification system to ensure better transparency.

The CTA's recommendations were submitted and approved by the contracting parties in November 1984. At that time, the CTA was assigned to develop these recommendations into a comprehensive framework addressing substantially all trade problems in the area. This framework is to be submitted at the GATT's November 1985 meeting and is to serve as the starting point for substantive multilateral negotiations. The recommendations provide a firm base for developing more comprehensive and efficacious GATT rules, particularly for market access restrictions, export subsidies, and improved transparency.

Section 1 of the recommendations makes clear their general tenor, stating that:

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[13]The Foreign Agricultural Service does, however, obtain information on wheat board sales after the sales have been made.

> "The conditions should be elaborated under which substantially all measures affecting trade in agriculture would be brought under more operationally effective GATT rules and disciplines, with particular reference to improving terms of access to markets and to bringing export competition under greater discipline, . . ."

These recommendations spell out how this is to be accomplished. GATT coverage is to be expanded by "reinforcing the linkages under Article XI (quantitative restrictions) and Article XVI (subsidies) between national policies and trade measures in a manner which more clearly defines the limits to the impact of domestic agricultural policies on trade." If successful, this effort would reduce the likelihood of a confrontation being rendered insoluble by the defense that objectionable trade practices cannot be challenged because they are merely the unavoidable external effects of domestic programs. This reasoning has been used, for example, by the EC to resist external pressure for change in the CAP.

The CTA is assigned the task of delineating ways to improve specific GATT rules on both quantitative restrictions and subsidies. The recommendations state that all quantitative restrictions as well as "other related measures affecting imports and exports," and all subsidies, "including export subsidies and other forms of export assistance including subsidized export credit" are to be "brought within the purview of strengthened and more operationally effective" GATT provisions. More complete coverage of trading practices is to be ensured by extension of greater GATT discipline to restrictions maintained under waivers and other exceptions, state trading activities, voluntary restraint agreements, variable levies, unbound tariffs, and minimum import price arrangements.

The United States and the EC were unable to agree on a single approach to improve Article XVI, so the CTA was assigned to develop two alternatives. The first, preferred by the EC, would improve the application of existing rules while the second, preferred by the United States, would add a general prohibition of subsidies, subject to carefully delineated exceptions. It remains to be seen whether this difference of opinion will stymie future attempts to develop more effective control over subsidies.

To improve transparency, the CTA recommended a regular review of all policies and measures affecting trade in agriculture through a comprehensive notification system adopted for this purpose.

The U.S. and the EC have attempted to resolve their agricultural trade differences through bilateral discussions

The United States and the European Community have engaged in several bilateral efforts to resolve their agricultural trade disagreements. They have attempted to reach accord on the pasta and wheat flour panel reports outside the direct auspices of the Subsidies Code Committee. As required by GATT's Article XXVIII, they have discussed the EC's proposed restriction of corn gluten feed imports. Also, an informal bilateral working group on GATT's subsidies rules met on several occasions during 1983 and 1984. To date, these efforts have not produced agreements of any import, although they have clarified both parties views. Periodic bilateral discussions continue. However, the primary focus of negotiations is currently the CTA.

Budgetary and political consequences of continuing the present situation are a real impetus for change

Two powerful stimuli are working to promote international movement toward better trade discipline: domestic budgetary pressure and the adverse international political consequences of maintaining the present system.

The mounting expense of farm support programs is a major concern in several of the countries we examined. Internal pressure for reform is present in each case. For example, the EC's CAP absorbed about two-thirds, or $16.5 billion, of the total EC budget in 1983, while Japanese, Korean, and Brazilian programs also incurred significant costs. The rising cost of the CAP prompted some minor reforms during 1984, with a promise of more to come. As already indicated, Korea and Brazil have acted to cut back on farm spending. The Japanese government recently lowered the payments made to farmers who divert rice acreage to wheat. In the United States, unprecedented farm program expenditures, including the record high net expenditure of $18.9 billion[14] in 1983 have set the stage for an in-depth examination of farm policy during deliberations on the 1985 farm bill.

The potential international political and economic costs of failure to reach a new accord on agricultural trade are very great. Settlement of the U.S.-EC dispute is of great importance to the continued health of the world trading system. In

[14]Costs of the payment in-kind program were $9.4 billion of the total $18.9 billion and Public Law 480 foreign assistance absorbed another $1 billion in net expenditures.

addition, protectionism must be reduced if the developing countries are to become full-fledged members of the international trading community. In keeping with Part IV provisions of the GATT, it is in the best interests of all countries that developing countries be given the opportunity to market their products internationally; the developing countries benefit directly from their exports, and they earn foreign exchange to repay external debt and to purchase developed nation goods. Since many developing countries rely heavily on agricultural exports to earn foreign exchange, the CTA was specifically assigned to take full account of their needs in considering its mandate.

Adoption of the CTA's recommendations is only the first step toward better GATT discipline

The contracting parties' adoption of the CTA's recommendations at their November 1984 meeting signifies only agreement on an agenda for substantive work and does not commit the contracting parties to make any changes in their own policies or in GATT. Negotiations within the CTA over the next year will provide a good indication of how much farther the contracting parties can proceed toward agreement on detailed new rules.

Beyond this, real change in restrictive trade practices will be possible only through a mutually advantageous exchange of concessions. Discussions to this end could take place within the framework of a new round of comprehensive multilateral trade negotiations, recently called for by the United States and Japan.

Better GATT discipline will not eliminate U.S. trade difficulties

The United States should continue to pursue marginal improvements in GATT discipline over trade in agriculture--a sector in which this country has historically enjoyed a comparative advantage.

More effective limitation of export subsidies, such as EC restitution payments, would reduce the participation of noncompetitive suppliers in the international market and transfer sales to efficient producers. Abatement of market access restrictions, likewise, would allow efficient exporters to supply markets presently supplied by expensive and/or highly subsidized domestic production. Other major exporters support U.S. efforts to reduce the scope of market distorting trade practices, particularly those maintained by the EC. Significant budgetary pressures are also pushing the contracting parties toward change.

While working toward better international regulation, however, U.S. policy-makers need to recognize that foreign trading practices are only one of several factors that are contributing to this country's agricultural trade difficulties.

As noted in the discussion of individual country programs and policies above, U.S. farm programs over the past few years have encouraged foreign competitors to increase production for export by establishing a relatively high floor under the international market price of wheat. This country has been willing to defend that price by removing U.S. production from the market. The resulting decline in U.S. export sales has been aggravated by several independent phenomena--the rising value of the dollar against other currencies, the fall in worldwide effective demand caused by recession and widespread credit difficulties, and the negative impression left on purchasing nations by U.S. agricultural embargoes.

The impact of any single factor on export sales is extremely difficult to determine. However, we note that one Department of Agriculture study[15] ranked increased foreign production first among several factors to which the decline in U.S. wheat exports from MY 1980-81 to MY 1982-83 has been attributed. Exchange rate changes and foreign indebtedness were also important. EC policies, however, were found to have minimal impact.

It should also be remembered that the United States itself maintains restrictive trade practices similar to those which it is trying to remove from other countries' trade programs. The U.S. retention of the section 22 waiver and its recent use of subsidized export credit could seriously undercut its arguments in favor of greater control over access restrictions and subsidies, respectively.

In attempting to maximize the benefits this country can obtain from its comparative advantage in agriculture, then, U.S. policymakers cannot focus exclusively on the restrictive trade practices utilized by our trading partners and/or competitors. The international repercussions of U.S. farm and trade programs must also be taken into account.

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[15]John Dunmore and James Longmire, "Sources of Recent Changes in U.S. Agricultural Exports", by International Economics Division, Economic Research Service, USDA, Washington, D.C., 1984, ERS Staff Report No. AGES831219.

AGENCY COMMENTS AND OUR EVALUATION

Department of Agriculture officials agreed generally with the conclusions in our report. They did, however, express concern that bilateralism is a limited approach in dispute settlement. (See app IV.) We agree with USDA's views that bilateralism is a limited approach and have clarified our assessment of this matter in chapter 5.

USDA officials also expressed the view that although governments intervene in agricultural markets, the degree of intervention is a significant factor in the ability of a country to meet its policy objectives without disrupting trade and hence in the ability of a country to accept stricter GATT obligations. We note (p. 12) that the degree of intervention in agricultural markets varies significantly from one country to the next and the effects of such intervention may differ significantly. It is not clear that, simply because EC export restitutions have a direct effect on trade while U.S. programs tend to affect trade indirectly, stricter GATT obligations would be more difficult for the EC to accept.

USDA disagreed with our including a discussion of the U.S. section 22 waiver in this chapter, stating that "while accurate, [it] is not relevant to the discussion of wheat." We assume USDA makes this point because section 22 is not currently being invoked for wheat, as we note on page 19. Relative to the GATT, however, this discussion is particularly significant as a "precedent-setting" waiver, as we discuss on page 30; therefore we believe it is extremely relevant to the chapter. Moreover, because the United States can impose import restrictions under this section if imports threaten the viability of domestic support programs, it remains a significant aspect of U.S. farm programs; thus it is relevant to a discussion of tariff and non-tariff barriers to trade.

USDA suggested that we delete our comparison of EC wheat and wine and dairy policies because it could be misleading, since the same comparison can also be made with a number of other products. We recognize that the comparison can be made for numerous other products. We cited these products because the most significant surpluses have occurred in wine and dairy products, creating storage problems and concerns that these surpluses will be dumped in the world market.

The U.S. Trade Representative commented that some of the presentation in this chapter was "unbalanced, particularly in the comparative assessment of U.S. and EC policies and actions." We have made some clarifications, but the essence of our arguments in this section remains the same. As we note on page 15 most U.S. direct export subsidies were discontinued in

1972, and as we note on page 28, the subsidized wheat flour sale to Egypt was made in response to EC subsidy programs. While taking no position, we describe the arguments of other countries relative to the U.S. Public Law 480 and blended credits programs. Food aid programs are not defined by the United States as subsidies; however, given that food aid programs have a stated "market development" purpose, other agricultural exporters may argue that such programs are tantamount to subsidy programs. We agree with the Trade Representative's comment that the draft appeared to understate the distortions of EC national subsidies compared with U.S. domestic subsidies and have made revisions accordingly. Similarly, we have made changes to reflect the fact that the United States was not alone in its dissatisfaction with the wheat flour report (p. 28).

CHAPTER 3

EXTENDING GATT PROVISIONS TO SERVICES MAY BE DIFFICULT

Efforts to bring discussions of service sector trade into the GATT, a priority for U.S. negotiators for several years, originally met with strong and widespread opposition from developed and developing country contracting parties alike. As some countries realized the importance of services to their economies and the desirability of such an effort, the 1982 GATT Ministerial Declaration invited interested countries to compile studies on their domestic service sectors. By the November 1984 annual meeting of contracting parties, GATT had received such studies from 13 countries. This is the first phase in a 4-point work program agreed to at the 1984 meeting. Nevertheless, negotiations to reduce barriers to service trade and attempts to forge a GATT agreement on services continue to face considerable opposition by some member countries. Such negotiations will have to deal with elements heretofore not considered within GATT's purview and there is no consensus on whether and how to approach these issues. All countries are not convinced that they stand to gain from a services agreement in the GATT.

The service sector represents a larger proportion of national production and employment than does the goods sector in many countries. The United States is the largest service exporter, though as a percent of GNP several countries depend more on their services exports. Despite the significance of services to national economies, there is no international agreement providing overall discipline or principles to govern trade in services.

A broad range of industries are classified in the service sector. We examined the telecommunications industry because it illustrates a number of barriers and their effects on trade, some of which are similar to those in other service industries. We also examined barriers to trade in telecommunications equipment because the inability to export equipment can very often preclude provision of telecommunications services in a given market.

Countries vary widely in their ability and willingness to promote exports and accept imports of telecommunications equipment and services. Government monopolies and market reserve policies are the most significant barriers to trade in telecommunications equipment and services. Specific trade principles, particularly national treatment and non-discrimination, may do little to liberalize this trade. The complex issues in

telecommunications lead to the conclusion that much compromise and negotiation will be necessary to obtain a widely accepted international agreement. To the extent that problems in the telecommunications industry reflect those in other service industries, agreeing on principles to govern service sector trade as a whole will be very difficult.

Much of GATT's success to date has been in lowering tariffs to goods trade. Trade in services is replete with non-tariff barriers which are far more difficult to remove, in part because they are hard to quantify.[1] As a result, negotiators may have to abandon traditional trade negotiating techniques and develop a new way to reduce barriers to trade and ensure equivalent concessions between participating countries. Broad support does not yet exist for a meaningful international agreement. As an alternative, an agreement with the objective of preventing new restrictions in services trade could represent an interim achievement and provide the basis for discussions in a new round of trade negotiations.

SERVICE SECTOR GROWING IN SIZE AND SIGNIFICANCE

The Trade and Tariff Act of 1984 defines the service sector as economic outputs which are not tangible goods or structures, including but not limited to banking, insurance, transportation, communications and data processing, retail and wholesale trade, advertising, accounting, construction, design and engineering, management consulting, real estate, professional services, entertainment, education, and health care. In 1983, the U.S. service sector, not including services provided by the government, contributed approximately $1.86 trillion or 56 percent of a GNP of $3.3 trillion, and accounted for 50.6 million jobs (compared to 23.6 million in the goods-producing sector, excluding agriculture). Table 4 depicts trade for the countries in our study.

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[1]GAO discusses these difficulties in a forthcoming related report entitled The Difficulty of Quantifying Non-Tariff Measures Affecting Trade (NSIAD-85-133).

Table 4

Value of Merchandise and Service Exports, 1982

	Services[a]	Merchandise	Total	Services as % of total
	(billions)			
Argentina	$ 1.4	$ 7.6	$ 9.0	15.6
Australia	3.7	20.8	24.5	15.1
Brazil	1.7	20.2	21.9	7.8
Canada	7.3	70.5	77.8	9.4
Fed. Rep. of Germany	29.3	171.9	201.2	14.6
Japan	20.4	137.7	158.1	12.9
Korea	6.3	20.9	27.2	23.2
United Kingdom	28.5	97.0	125.5	22.7
United States	38.4	211.0	249.4	15.4

[a]In compiling these statistics, we excluded Investment Income and Other Official (Government) Goods, Services, and Income from the services category.

Source: GAO, based on Balance of Payments Yearbook, 1983, Part II, International Monetary Fund, and discussions with the U.S. Trade Representative (USTR) on composition of data.

Worldwide, the service sector has taken on greater significance than goods. Its share of GNP and employment exceed those for goods production in such countries as Canada, Japan, and the United Kingdom.

Worldwide service sector trade equalled approximately $374 billion in 1982 compared with $1,687 billion in goods trade. Despite this comparably lower trade figure, service sector trade increased 83 percent from 1977 to 1982 compared to goods trade which increased 73 percent. U.S. exports of services exceeded $38 billion in 1982.

A COMPREHENSIVE, MULTILATERAL AGREEMENT ON THE SERVICE SECTOR DOES NOT EXIST

Despite the growing significance of the service sector, there are no comprehensive multilateral rules for trade in services. The GATT covers services only to the extent that they are incidental to goods trade. There are, however, some individual sectoral agreements and there have been some multilateral discussions involving service trade. For example, the

Organization for Economic Cooperation and Development adopted codes as early as 1961 in an attempt to liberalize service sector trade and to reduce regulations that hamper the international flow of funds. More recently, OECD has encouraged service sector trade discussions and urged members to cooperate in removing obstacles to trade. Numerous bilateral agreements, such as Friendship, Commerce and Navigation treaties and investment treaties, cover trade in various service industries.

The 1982 GATT Ministerial meeting initiated a program for interested parties to gather and exchange information on service sector trade issues. This program is continuing and, as of the 1984 meeting of the contracting parties, the Secretariat has formally become involved in supporting discussions. It remains unclear, however, whether this program will lead to negotiations for a multilateral agreement on trade in services.

The Organization For Economic Cooperation And Development

OECD members have agreed to attempt to reduce or abolish obstacles to the exchange of goods and services and to maintain and extend the liberalization of capital movements. Four OECD codes address (1) invisible operations, (2) right of establishment, and (3) national treatment--provisions which are particularly important to trade in services, and (4) transborder data flows.

The Code of Liberalization of Current Invisible Operations, adopted in 1961, may be the most comprehensive multilateral agreement on the service sector. The Code calls for members to eliminate restrictions on current invisible operations among members. Current invisible operations include not only services trade but also income on assets abroad, official transactions, and fees and royalties. All member countries have reserved some restrictions from Code coverage. Such reservations must be justified to the OECD, but the maintaining country may continue the restriction as long as it wishes without penalty. For example, all members but the United States maintain certain reservations in the area of insurance.

The OECD Code of Liberalization of Capital Movements commits members to progressively abolish "restrictions on the movements of capital to the extent necessary for effective economic cooperation". This Code lists specific capital movements that should occur without restriction. The first states that a member country should allow non-residents to create or extend a wholly owned enterprise, subsidiary, or branch or to acquire full ownership of an existing enterprise. This form of direct investment contains many elements of the right of establishment (discussed later in this chapter) which is important to the

service sector. As with the Invisibles Code, various member countries have made some reservations and only the Federal Republic of Germany, Iceland, and the United Kingdom have agreed to adhere to the Code in total. The United States has accepted the Code in principle with reservations. Efforts are currently underway to update the Code to include services.

The 1976 OECD Declaration on International Investment and Multinational Enterprises aimed to strengthen cooperation in these areas. Although not specifically focused on services, certain provisions of the Declaration, such as national treatment, are important to firms involved in the service sector overseas. The Declaration states that member nations should give foreign owned companies treatment that is equal to that of domestic-owned companies "in like situations".

According to the Department of Commerce, on April 11, 1985, OECD ministers approved a Declaration on Transborder Data Flows. This declaration supports OECD work on trade in services and commits member governments to maintain and promote the open circulation of data and information.

There are two major limits on the effectiveness of OECD agreements: (1) they apply directly only to the 24 OECD members, although members are encouraged to extend benefits to IMF members, and (2) members can easily exempt themselves from any portion of the codes with no penalty, although such derogations must by justified and temporary. The extent of such exemptions seriously detracts from the codes' value.

Bilateral agreements affecting trade in services

Bilateral agreements that affect trade in services fall into two categories: (1) applying certain principles to all sectors and (2) sectoral agreements.

The broadest bilateral agreements that apply to services are Treaties of Friendship, Commerce, and Navigation (FCN), which are designed to establish a framework for mutually beneficial economic relations between the treaty parties. As of December 1983, the United States was party to 43 FCNs. Most provide most-favored-nation treatment or national treatment for signatories. In many instances, Treaties of Friendship, Commerce and Navigation treat services in the same manner as goods. The United States began a new program in 1981 to negotiate bilateral investment treaties designed to provide certain guarantees and protections for foreign investors, thereby providing a stable and predictable legal framework for those wishing to establish service or other industries overseas. Currently, the United States is party to agreements with Panama,

Egypt, Senegal, Haiti, and Zaire. The United States concluded a free trade agreement with Israel which incorporates a declaration on liberalizing services trade. Discussions with Canada on services are still at a very early stage.

Bilateral agreements covering specific sectors are predominant in aviation, shipping, and telecommunications. These agreements, which guarantee access to each other's market and set fare structures, are based on the concept of reciprocity.

Although bilateral agreements provide discipline which otherwise might not exist, they are by definition limited to two countries and in some cases to specific sectors. Since they provide preferential treatment to some countries and not others, they may be viewed as undesirable in that their restrictions could be discriminatory and trade distorting. On the other hand, bilateral reciprocity agreements could provide a stepping stone to conclusion of a multilateral agreement in services.

Because of limitations in OECD arrangements and bilateral treaties, the United States is pursuing a multilateral agreement covering all sectors and a large number of countries. The GATT is currently the forum for these discussions.

General Agreement On Tariffs And Trade

GATT rules cover trade in goods and extend to services only when they are "incidental to goods trade". The GATT primarily concerns itself with barriers at the border, such as tariffs. Therefore, a wholesale extension of the GATT to services would not be easy to achieve, if for no other reason than service trade barriers often are not at the border.

The United States has been the prime advocate of bringing service sector discussion into the GATT. However, we were told by a number of country representatives that the United States has not received support because (1) the U.S. position has not always been clearly defined and (2) the GATT should successfully resolve the "old" problems, such as subsidies and safeguards, before starting into new areas. Supporters of the effort to bring services into the GATT argue that continuing efforts are needed on all trade issues to prevent a surge of protectionism.

As a result of U.S. pressure at the 1982 GATT Ministerial, members agreed that the contracting parties

(1) were invited to undertake national examinations of service sector issues;

(2) were invited to exchange such information among themselves; and

(3) would study the national examinations and other information in 1984 and consider whether any multilateral action was deemed appropriate and desirable.

To date, 12 countries and the EC have produced country studies.[2] The contracting parties in their November 1984 meeting moved forward in their negotiations in agreeing to the following

(1) The Chairman of the contracting parties will organize the exchange of national examinations.

(2) The GATT secretariat will support the exchange of information.

(3) The Chairman will report on progress to the contracting parties.

(4) The contracting parties will review the results of the national examinations and other information at their November 1985 session and will consider whether any multilateral action on services is "appropriate and desirable."

Thus, the 1984 agreement enlisted the support of the Secretariat and set out a specific work program for services, although the decision on whether multilateral negotiations are appropriate and desirable was postponed.

Opinions expressed by representatives of a number of countries makes it apparent that there is not a clear consensus on the desirability or need for a multilateral agreement covering the service sector. Many developed countries agree that such an agreement is desirable but prefer a period of study before negotiations begin. Some countries hold that each service industry has unique characteristics and concerns and, therefore, concluding a service-wide agreement would be, at best, difficult and not very useful. These countries urge a sector by sector approach. A number of key developing countries object to even discussing services in the GATT at this time.

Services trade has increased despite the lack of an international agreement and many developing countries do not see a need for a multilateral agreement, based on their belief that they could not effectively compete with developed countries.

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[2]Canada, United States, Netherlands, United Kingdom, Japan, the EC, West Germany, Sweden, Finland, Norway, Switzerland, Denmark, and Italy.

Finally, there is no agreement as to how GATT principles, such as national treatment and non-discrimination, could apply to services, whether their application would be desirable, or whether principles currently not in the GATT are needed. The potential application of these principles is examined in the following section.

TRADE PRINCIPLES MUST BE MODIFIED FOR SERVICES

Discussions on developing an international discipline for trade in services often turn to GATT principles to determine whether they could serve as a framework for a value system as they have for goods trade. Despite the major reservations of many countries concerning the need for a service sector agreement and the significant differences concerning the proper forum to negotiate such an agreement, developed countries at least agree that GATT trading principles would have to be modified, as discussed in the following sections.

Non-discrimination

A number of countries have expressed concern over unconditionally extending the principle of non-discrimination or most-favored-nation status to cover trade in services. As a result, discussions in the OECD now focus on conditional application of non-discrimination/MFN.

Precedents for the conditional application of MFN exist in the GATT. As an example, preferential treatment is accorded developing countries, and Article XXIV permits the creation of free trade areas and customs unions which give preferential treatment to members of these organizations.

Bilateral reciprocity agreements are currently commonplace in various service industries. These bilateral agreements provide preferential treatment and could be protectionist and trade distorting because the benefits are shared only by the two signatory countries. However, reciprocity agreements may act as an intermediate stage between no access and total multilateral access. Some countries may be willing to ease their extensive government regulation of service industries only if they are assured of benefiting from like deregulation in other countries.

Conditional application of MFN--i.e., not automatically applying benefits of an agreement to all GATT signatories--may be a way of attaining such deregulation since it would allow certain groups of countries to trade in a manner that appears to be discriminatory even though they may be party to a multilateral agreement. For example, some developing countries could

call for preferential treatment in services, particularly in view of international agreements that provide developing countries greater participation in markets, such as the UNCTAD Liner Code.[3] Further study will probably also be necessary on GATT Article XXIV actions involving customs unions and free trade areas. The OECD codes have established a precedent for allowing exceptions to the principle of non-discrimination for members of special "custom unions".[4] Further, noting that the GATT currently allows countries to form free trade areas in goods, the United States has suggested that countries should be allowed to take on higher levels of obligation in trade with each other to form free trade areas in services. How these situations will be treated in a multilateral agreement on services remains to be seen.

National treatment

The principle of national treatment has two definitions.

1. GATT definition - according to Article III of the GATT, products of a contracting country imported by another contracting country should receive the same treatment as domestically produced products with respect to regulation and internal taxation.

2. OECD definition - foreign-controlled enterprises operating within a member country are to receive treatment no less favorable than domestic enterprises. This refers to enterprises producing goods and/or services.

The distinction between the two concepts is that the GATT definition covers products crossing the border while the OECD definition refers to the treatment of firms established within a foreign country--essentially the distinction between trade and investment.

The GATT concept implies that, if countries must apply protective measures, they can do so at the border without violating the national treatment principle. Trade in services does not necessarily occur at the frontier but rather within the

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[3]This Code contains a provision guaranteeing developing countries a portion of all shipping that departs from or arrives at their ports. It was concluded in 1974. The United States does not subscribe to the Code.

[4]A grouping of countries which have agreed to apply customs regulations and tariffs preferentially within the grouping. The European Community is one such union.

host country or, if the service is provided from abroad, it may travel invisibly across borders through international communications networks. This makes protection of domestic industry through duties, as the preferred method of achieving the least distortive protection under the GATT, very difficult. Any protection applied through internal taxation or regulation would likely violate national treatment.

Two questions arise in current discussions on national treatment in service sector trade. The first concerns the type of activities which should be afforded national treatment coverage. For example, should national treatment be extended to

--imported services;

--the ability of service companies to initially establish operations in foreign countries (a restatement of the right-to-establish principle); and/or

--the "rights" of foreign subsidiaries once they have established in a host country?

This coverage is significant because in this form it would obviate the need for a separate principle of right to establish.

The second question is whether GATT, a forum heretofore limited primarily to trade in goods, is an appropriate forum for the interpretation of national treatment principles which cover investment.

Transparency

Transparency is a trade principle requiring that countries have open and unambiguous regulations and procedures. It could be of critical importance to the service sector, since many barriers to services trade are in the form of domestic regulation, whose impact on trade is unknown or unclear. The principle of transparency has not been a significant point of contention in discussions about a service sector agreement, which have focused on the mechanics of applying transparency. At a minimum, transparency would require countries to make information publicly available on policies and procedures which have an inhibiting effect on trade. Agreeing to notify the GATT of such barriers would be a significant step toward negotiating an agreement on services trade.

Least distortive regulation

The notion of least distortion to trade in the GATT is a critical concept, given that government regulation of various

services is extensive. The GATT states that governments should strive to limit protection and generally assumes that a tariff is the preferred form of protection to minimize distortion to trade. Given that tariffs, in many cases, are not a viable form of protection for services, this principle would have to be modified to call for the prevention of unnecessary obstacles in domestic regulation--a concept similar to that in the GATT Agreement on Technical Barriers to Trade (Standards Code).[5]

A significant problem in applying this principle is the identification and definition of regulations and the extent to which they restrict trade, despite apparently legitimate domestic policy reasons for the regulation. The procedures outlined under the Standards Code on how standards should be prepared, adopted, and applied may be a precedent for clarifying this principle relative to service trade.

Dispute settlement

The GATT dispute settlement procedures provide a means for enforcing this binding multilateral trade agreement. Under Article XXIII, if a country believes a benefit "is being nullified or impaired or that the attainment of any objective of the agreement is being impeded" by the actions of another contracting country, it may initiate dispute settlement procedures. A multilateral agreement on trade in services would need dispute settlement procedures to provide a means for resolving conflicts over service sector trade.

Right to establish

The right-to-establish principle, not a GATT principle, calls for allowing a foreign entity to establish a stable, material installation in the territory of another country. This principle is included in some bilateral agreements as well as in the Treaty of Rome which established the European Economic Community.

In the service sector it is sometimes necessary to operate within a country to be competitive within that market. Examples are banking, construction, engineering, and insurance. The right to establish is therefore necessary for a foreign entity to conduct business in these markets. A 1983 survey of selected companies in Fortune's 500 Service Directory revealed that 71 percent saw a restriction on the right of establishment as a significant interference in trade.

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[5]The Code was negotiated during the Tokyo MTN Round to ensure that the adoption of standards and technical regulations would not create unnecessary impediments to trade.

Some countries consider the provision of services within a foreign country to be in the realm of foreign investment, not trade. They claim that for trade to exist the service must be generated in one country and delivered to and consumed in another country. It is argued that the regulation of investment is a sovereign right.

If a country's regulations require establishment for the provision of a service (such as insurance), then the country's adoption of the principle of national treatment would grant a foreign entity the right to establish. The United States has determined that the principle of right to establish need not be part of a service trade agreement because if the principle of national treatment discussed on page 47 were adopted to its fullest extent, it would incorporate the right to establish. If however, this broad application is not accepted, firms that need to establish for competitive rather than regulatory reasons could be in jeopardy, and a separate principle of right to establish would be desirable.

TELECOMMUNICATIONS BARRIERS DEMONSTRATE OBSTACLES

Barriers to trade in services may include investment performance requirements, exclusionary import policies, discriminatory treatment of foreign firms, discriminatory government procurement, and government monopolies. These barriers may reflect economic or non-economic concerns, such as national security or individual privacy. The degree of restrictiveness of these barriers varies from one industry to another.

Our study of the telecommunications industry points out how these policy and regulatory mechanisms can act as barriers to trade in services and the difficulty of applying trade in goods principles to trade in services. A key point in this context is the extent to which these barriers preclude provision or sale of equipment, thereby precluding provision of services. As a result, we discuss restrictions on provision of both telecommunications equipment and services, despite the fact that restrictions on equipment are covered by the GATT as it presently stands.

The world market in telecommunications equipment and services exceeded $200 billion in 1983 and is expected to double by 1990. U.S. telecommunications service revenues (both domestic and international) were approximately $91 billion in 1983, representating employment of about 1.1 million people. Potentially more important, telecommunications is becoming inextricably linked with trade and commerce. It now provides the highway system for banking, finance, and insurance that roads, rails, and shipping provide for trade in goods.

The telecommunications industry can be segmented into two distinct areas--the provision of service and the supply of equipment. The provision of service includes both local and long distance telephone and telegraph service (basic service) as well as "value-added networks" involving the manipulation of data, including data transmission, mobile telephones, and paging services (enhanced services). The supply of equipment has two segments (1) network equipment, which includes all the infrastructure from the customer's wall connection outward, such as switching equipment, transmission equipment, and cables, and (2) customer premise equipment, which includes what a customer could connect to the line, such as telephone handsets, computer modems, and telephone answering machines. These distinctions are important because the degree of access allowed to foreign competitors varies significantly across these market segments.

Government policies inhibit telecommunications trade

Barriers to trade in telecommunications services include government ownership and control of the basic system, discriminatory legal and procurement policies, market reserve policies, restrictions on the processing and transmittal of data, investment performance requirements, safety and design standards, tariffs on equipment, and a lack of copyright protection for software. Governments use various combinations of these policies to control the flow of information and to regulate their domestic telecommunications markets. Very often these policies have been adopted for legitimate domestic economic, national security, or political reasons. Nevertheless, their impact on trade can be significant, albeit in some instances, indirect.

In many countries, telecommunications services are provided by government monopolies, commonly referred to as the Post, Telegraph and Telephone (PTT). To preserve the integrity of the domestic communications system and the income of these monopolies, PTTs exercise complete control over the basic network system and strictly regulate the use of any attachment to this system. Both foreign and domestic entities are, for the most part, precluded from competition with the domestic PTT. Moreover, through their regulatory powers, PTTs are able to control the number of suppliers of equipment and services and the nature and content of these services, thus restricting competition for foreign and domestic entities. In addition, PTT procurement practices often favor domestically produced equipment.

Market reserve policies have similar effects on trade. A government may "reserve" specific segments of the market for domestic producers--most often for industrial development pur-

poses but for national security reasons as well. In some instances, governments have required that data processing take place within the given country, most often to encourage development of indigenous capability but also to overcome concerns about individual privacy and national security. Other mechanisms for restricting foreign competitors are the conditions attached to foreign investment, known as investment performance requirements.

Safety and design standards also inhibit trade. While most countries impose standards to maintain system integrity, some of the more stringent requirements and approval processes either make equipment too costly or approval more time consuming for imports to effectively compete. High tariffs are also used by some countries on certain equipment imports. A final government policy affecting trade in telecommunications is the lack of protection for proprietary rights to software in some countries. Software is essential to providing some enhanced services and without protection companies are often not willing to enter the market.

The countries we studied fall generally into three categories based on their restrictions on equipment imports and the provision of services. One category (the United States) has relatively few restrictions; the second (Canada, Japan, and the United Kingdom) has liberalized portions of the telecommunications market but major restrictions remain; the third has relatively closed telecommunications markets (West Germany, Argentina, Korea, Brazil, Australia).

Least restrictive

The U.S. government seeks to minimize its involvement in the telecommunications market and places maximum reliance on private enterprise and competition. This competitive environment resulted from government actions in recent years which have significantly altered the U.S. market. Federal Communication Commission and court decisions led to deregulation and to the breakup of the American Telephone and Telegraph (AT&T) monopoly, leaving the equipment and service market open to both domestic and some foreign competition. AT&T faces both foreign and domestic competition in the provision of long-distance service. In addition, the enhanced service market is generally open to foreign participation although current penetration is limited. Imports, mostly of equipment, have increased five-fold from 1979 to 1983.

The following government actions have structured the current environment.

--In 1956, the U.S. courts began liberalizing the market by allowing certain equipment not

manufactured or purchased by Western Electric (an AT&T subsidiary) to be attached to the telephone system.

--In 1968, the Federal Communications Commission (FCC) allowed "foreign" (i.e., non-AT&T) devices to access the network. This cleared the way for independent companies to market residential phones and interconnecting devices.

--In 1969, the FCC permitted competition with AT&T long-distance service by allowing MCI to construct and operate communication service between St. Louis and Chicago.

--In 1976, the FCC allowed licensed carriers to purchase and resell line capacity from other carriers. This resulted in competition in the long-distance market.

--In 1982, AT&T accepted a court proposed divestiture agreement. This agreement allowed AT&T to expand into unregulated businesses but forced it to divest itself of its local companies and to follow other pro-competition practices.

While foreign penetration in the low-technology end of the equipment market has been prevalent, inroads have also been made in the provision of service. As of January 1984, three wholly owned subsidiaries of foreign firms were operating in the United States; two provide only international resale services, but the British-owned Cable and Wireless North America owns a series of firms, including a voice resale carrier and an enhanced service provider.

In general, both foreign and domestic firms are allowed to provide basic services, enhanced services, network equipment, and customer premise equipment. Current practices include resale or leasing of existing lines, interconnection of private lines to the public network, direct sale of equipment to the consumer, and protection of operating software. In addition, the U.S. policy is to support the free flow of information but to place some restrictions on foreign equity. As a result, the U.S. telecommunications service and equipment market has become very competitive. Although all market areas are open to foreign entry, certain aspects of those areas remain closed.

An important barrier to foreign entry into the U.S. market is the Federal Communications Act of 1934 which restricts foreign ownership of more than 20 percent of capital stock or foreign participation as director or officer in a corporation engaged in radio communications. The Act defines radio communications to include microwave, satellite, and television transmission. For basic services this precludes foreign entry into

microwave and satellite networks. It also precludes foreign entry into paging and mobile telephone enhanced services.

The U.S. government's current policy of minimizing regulation of the telecommunications market followed decades of relatively protectionist policies. It can be argued that the earlier policies enabled the industry to achieve its current competitive and technologically sophisticated position. Further, government procurement has been a significant source of demand for U.S. industry.

The following U.S. government actions aided the industry.

--The Willis-Graham Act of 1921 endorsed a policy of consolidation of telephone companies and the establishment of legally franchised monopolies.

--This and subsequent legislation led to the development of the Bell system. Prior to divestiture, AT&T was the largest corporation in the world.

--The Communications Satellite Act of 1962 created Comsat and encouraged the development of satellite communications technology. This encouragement played a key role in making the United States a leader in satellite technology.

--The federal government is the largest telecommunications consumer in the United States, with procurement of services and equipment in excess of $10 billion in fiscal year 1981. While this consumption is not directed toward supporting the industry, it nonetheless is very beneficial to the industry.

Although some restrictions to foreign operations still exist and past government policies helped to protect and strengthen the domestic industry, it is clear that current U.S. policy is to assure the opportunity for full competition in both the telecommunications service and equipment markets.[6] As a result, relative to the other countries studied, the United States has the most liberal telecommunications market.

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[6]However, legislative initiatives are seeking to condition U.S. policies toward foreign telecommunications providers on reciprocal foreign treatment of U.S. providers.

Moving away from restrictive policies

Canada and the United Kingdom offer a relatively liberal environment for telecommunications trade. They rely on private enterprise and limited competition to shape their markets. Both governments have in recent years opened their enhanced service markets to foreign and domestic entry and allow manufacturers to directly sell customer premise equipment. These changes were encouraged by decisions of the Canadian Radio - Television and Telecommunications Commissions (CRTC) in 1982 and 1984, and by the British Telecommunications Act of 1981. Japan's parliament in late 1984 approved two bills that may ease entry into its telecommunications market; the implementing regulations were issued in April 1985.

Both Britain and Canada have provided a limited framework for competition in the provision of basic services. In Britain, the 1981 Act allowed the development of a separate and independent network, Mercury Communications Limited, which has less than one percent of the British telecommunications market. As envisioned, Mercury will offer advanced digital business communications services based on optical fiber and microwave networks. The British Telecommunications Act of 1984 further reduced British Telecommunications' influence over the market by creating the Office of Telecommunications to regulate the industry. Moreover the act allowed for the privatization of British Telecommunications. However, it limited the operation of the national public networks to British Telecommunications and Mercury through 1990. As a result, while Britain has introduced limited competition in the provision of basic service it has precluded further domestic competition and any foreign entry.

Canada has two national telecommunications systems, Telecom Canada and CNCP Telecommunications. Telecom Canada is an unincorporated association of the largest telephone company operating in each province plus the domestic satellite carrier. Bell Canada is by far the largest operating company in Telecom Canada with 58 percent of the Canadian telephones in 1983. CNCP is a partnership of the telecommunications divisions of the two major Canadian railroads. In addition to the two national systems, there are more than 150 smaller telephone systems. Domestic local and long distance public voice telephone is provided by Telecom Canada member companies and by other telephone companies and cooperatives. These companies enjoy a monopoly in their respective operating areas. Telecom and CNCP compete in providing public switched data network and switched teleprinter services. While there are no explicit restrictions on foreign ownership of Canadian basic telecommunications carriage facilities, most Canadian carriers are Canadian-owned. Principal exceptions are British Columbia Telephone Company and

Quebec Telephone, both indirectly owned and controlled by U.S.-based General Telephone and Electronics Corporation. The Canadian government considers telecommunications facilities important and any proposal to extend foreign ownership would be considered on a case-by-case basis. Representatives of Canada's new government have indicated that it will introduce legislation designed to welcome foreign capital investment, which could have significance for the telecommunications sector.

While neither Canadian nor British law prohibit foreign competition for network equipment, there is a close relationship between domestic manufacturers and purchasers. In Canada the two largest network providers are vertically integrated with equipment manufacturers. For example, Bell Canada Enterprises includes not only the largest service provider but also Northern Telecom Ltd., the major telecommunications equipment manufacturer, and Bell Northern Research, the largest private industrial research and development organization in Canada. According to a Department of Commerce report this relationship may be the greatest obstacle to outside entry and is very similar to the U.S. industry structure prior to divestiture.

Based on 1983 estimates, British Telecommunications procures approximately 90 percent of all network equipment sold in the United Kingdom. Traditionally procurement has favored three British firms, and British Telecommunications is emphasizing British products for its modernization efforts. For example, System X, the cornerstone of those efforts, is supplied by the prime contractor, Plessy, a British firm. As a result, the import share of network equipment was less than half that of customer premises equipment in 1983.

According to an official of British Telecommunications, the flow of data across borders is not considered an issue in Great Britain. However, it has created some concern in Canada. Canada's 1979 Clyne Committee[7] concluded that the government should regulate transborder data flows before Canada lost control of information vital to maintaining national sovereignty. The Bank Act of 1980 requires that banks process information on their Canadian personal accounts in Canada or keep a duplicate record of any information sent outside of Canada for processing. The cost of maintaining duplicate records has precluded bank operators from using foreign information-processing services. Neither Canada nor Great Britain generally allow the resale of leased lines.

Our analysis suggests that government support of the telecommunications industry has been more direct in Britain than

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[7]Consultative Committee on the Implications of Telecommunications for Canadian Sovereignty.

Canada. Prior to the Telecommunications Act of 1981, telecommunications was owned and run by the government as part of the British Post Office. From 1981 to 1984, British Telecommunications was established as an independent government corporation. The 1984 Act authorized shares of the company to be sold publicly. With these changes, the government's involvement with the company is declining. Conversely, Canada's government support of telecommunications appears similar to that in the United States, with government involvement in the 1920's and 1930's helping to form the current system. The Canadian government also sponsors new telecommunications initiatives, such as funding to support field tests of Canadian "Office of the Future" technology.

Both Canada and Britain have taken major steps to liberalize their markets for enhanced services and customer premise equipment. In addition, both countries foster domestic competition with their basic service providers. While neither offers a market as liberal as the United States, both users and providers view these markets as moving toward increased market liberalization.

Arising out of the Tokyo Round negotiations of the Government Procurement Code, the United States and Japan concluded two bilateral agreements on procurement of equipment by Nippon Telephone and Telegraph (NTT) and access to Japan's interconnect market. In applying these agreements on an MFN basis, Japan committed to open its domestic telecommunications market, which is among the world's largest, to foreign competition. Although significant sales resulting from these agreements have been slow in coming for a variety of reasons, there is general consensus that these agreements have been a useful first step toward liberalizing the Japanese telecommunications market.

Japan, with strong persuasion from the United States, is taking further steps to liberalize its telecommunications market. Laws providing opportunities for competition in both basic and enhanced telecommunications services and for the "privatization" of NTT passed the parliament in late December 1984. Recent negotiations between the United States and Japan have further resulted in a simplification of registration procedures for large scale value-added networks (VANs) including (1) developing more objective criteria for determining classification of VANs, (2) reducing the number of technical standards required for equipment compatability with the Japanese network, and (3) making procedures for development of technical standards and regulations governing telecommunication services more transparent. These new laws and procedures are expected to help foreign firms gain greater access to the Japanese markets. However, it will take some time to study and evaluate the impact of the changes.

Most restrictive

Argentina, Australia, Brazil, Korea, and West Germany have government ownership or tight government control over the provision of telecommunications services. In most cases one telecommunications entity has a monopoly over provision of basic domestic service. One exception is Argentina, where the Swedish firm Ericson has retained 9 percent of the telephone service. In some cases, the exclusive right to provide service is allocated to separate carriers for domestic and international services.

In Australia, two publicly owned statutory authorities--the Australian Telecommunications Commission and the Overseas Telecommunications Commission--essentially have monopolies on the provision of domestic and international telecommunications services, respectively. Regulations governing access to, and use of, telecommunications services reinforce the monopoly powers. In the Federal Republic of Germany, the Deutsche Bundespost has with few exceptions the exclusive right to provide telecommunication services. As in some other countries, the Bundespost is a government monopoly. The powers of the state to govern telecommunications are written into the Republic's Constitution and the government maintains restrictions on the use of telecommunications services. No private companies--either foreign or domestic--are permitted to engage in message switching, and the resale of leased line capacity is restricted.

Equipment exporters face reserved market segments, high tariffs, and strict standards in these countries. Market reserve policies attempt to reduce dependence on foreign imports of technology, equipment, material, and components that compete with domestic capability. Argentina has a market reserve on some products, such as small computers, but Brazil is the most extensive user of such policies. The Brazilian government has also been actively engaged in requiring foreign affiliates operating within its borders to sell their majority equity to Brazilian firms.

High tariffs are also used to inhibit telecommunications imports. For example, Australia imposes a 30 percent tariff on many equipment imports; its Industry Assistance Commission 1984 draft report stated that, "[T]here have been no cases in recent years in which Australian companies tendered a technically suitable product and a lower price was available from overseas sources after applications of the tariff".

While standards may not be designed to inhibit imports, they nevertheless can make it very difficult for imports to economically compete with domestic products. In West Germany, type approval is required for practically all equipment used in,

or connected to, the public telecommunications network. According to industry observers, to obtain this approval, equipment must meet some of the most rigid and comprehensive standards in the world. These high standards help West Germany keep its level of equipment imports relatively low.

Many of these countries have additional policies that constrain potential foreign entry or operation, such as restrictions on transborder data flow and questionable practices for software protection and valuation.

Brazil, and to a lesser extent West Germany, restrict the flow of information across borders. In 1978 Brazil adopted policies to enhance its domestic informatics industry and to maintain control over decisions affecting transborder data flows. The government believes that the lack of information resources in a country can generate a serious dependence on foreign entities, so data processing must be performed within the country and the use of data bases outside the country is not allowed. West Germany allows any party to collect and distribute data via the public networks. However, if parts of this data are to be transferred to foreign countries via leased circuits, the Deutsche Bundespost requires that the data be processed before it reaches the international leased lines.

Software protection is a key element in the fusion of communications and data processing. In Korea and Brazil, software is not protected against unauthorized copying. As a result, companies are reluctant to bring software into such markets, thereby inhibiting their ability to compete. Software valuation has also become an important issue. In Argentina and Brazil, software imports are valued at the transaction value, i.e., the price actually paid for the goods, not just the value of the carrier media (i.e., tape or disc), resulting in considerably higher import duties for software.

Summary observations

In sum, Argentina, Australia, Brazil, Korea, and West Germany protect the markets for their telecommunications industries. They allow little or no direct competition to their service providers and restrict import of equipment. Some also impose transborder data flow restrictions, equipment standards, market reserve policies, inadequate software protection, and more protective software valuation practices. These countries seem to view their telecommunications industries as a domestic preserve and are less interested in opening their markets to trade.

Competitive pressures, user demand for new services, and advancing technology contributed to the liberalizing changes in

the United States, the United Kingdom, and Canada. These pressures also played a major role in Japan's actions. As these forces spread and countries fall increasingly behind from a competitive standpoint, they may lead to similar liberalizing trends elsewhere.

GATT PRINCIPLES DO LITTLE TO LIBERALIZE TRADE IN THE TELECOMMUNICATIONS INDUSTRY

The telecommunications industry with its many trade restrictions demonstrates the difficulties that will be encountered in attempting to apply various GATT principles to achieve a more liberal trade environment and increase the flow of services. The dependence of telecommunications services on equipment, the preponderance of government ownership and/or control of service providers, and the domestic objectives that have led to extensive regulations will complicate the application of GATT principles to telecommunications trade. Without major changes in the industry itself, or modification of the principles heretofore applied, it will be extremely difficult to negotiate and implement a GATT agreement that will have any real effect on telecommunications trade.

Coverage of telecommunications equipment

Article III of the GATT generally exempts government procurement from GATT coverage. Thus, in the many countries where telecommunications systems are government-owned monopolies, trade in telecommunications equipment is not covered by general GATT principles. The GATT Government Procurement Code, generally designed to remove that exemption, had little effect on purchases of telecommunications equipment because most signatories specifically exempted their PTT's from Code coverage. In countries where telecommunications equipment imports are covered by GATT principles, the GATT Standards Code was intended to overcome design and technical barriers by setting up rules on how equipment standards should be prepared, adopted, and applied.

Industry structure makes applying trade principles difficult

Market reserve policies restricting provision of telecommunications services to domestic suppliers are inconsistent with the principle of national treatment. Because such policies are designed to bolster the capabilities of the domestic industry, governments may be reluctant to change or eliminate them. Article XVII, covering state trading enterprises, creates an MFN obligation for government monopolies but in essence exempts such entities from the principle of national treatment. Thus,

without significant change either in the nature of the market or in GATT Article XVII, government monopolies in telecommunications could continue to operate in a preferential position in domestic markets.

The principle of transparency appears to be one that could be applied to the field of telecommunications, but would probably do little in and of itself to liberalize trade. Its effect would be to provide those companies attempting to sell services and/or equipment in a country information about which segments of the market are not open to competition (due to market reserve or other restrictive policies). If properly applied, transparency would also allow companies to be aware of, and comment on, the various regulations and standards proposed or in place.

The GATT recognizes that countries protect domestic industries. In telecommunications, government regulations encourage domestic development, protect domestic privacy, and ensure the technical integrity of the communications system and national security. GATT principles also state that any protection put into place should aim at creating the least possible distortion to trade. Determining the extent to which a given domestic regulation provides the least distortive protection to achieve a given objective in the telecommunications industry will undoubtedly be subject to varied interpretation and significant discord. Nevertheless, the burden of proof is on the imposing country. The fact that many of these regulations are implemented for important and sensitive domestic policy reasons makes it difficult to conclude that the principle of least distortion to trade would yield much in the way of trade liberalization. Because tariffs imposed at the border are most often inapplicable to trade in services, many countries will also see discriminatory domestic regulations as their only means to protect domestic industry.

CONCLUSIONS

Telecommunications is one of the fastest growing industries in the service sector. In addition, many other services industries such as banking, tourism, and insurance are becoming "more international" and thus more dependent on telecommunications networks for operations. Many countries are expanding and modernizing their domestic telecommunications networks and are attempting to develop and broaden their enhanced international services. At the same time, however, most countries have restricted their markets to prevent the free flow of trade and investment. Government protection of domestic PTTs has limited trade by denying outside companies the right to offer basic services, restricting the enhanced service market, and encouraging procurement of domestically produced equipment. Market

access has been further limited by transborder data flow restrictions, equipment standards, and issues concerning software protection and valuation.

It appears that significant changes would have to occur in the structure of telecommunications markets for GATT principles to be relevant. For example, government monopolies would have to be curtailed for the principles of non-discrimination, national treatment, and the right of establishment to be meaningful. That would require significant changes in government attitudes about the necessity of strict control over national communications systems. Some liberalization may occur as business is lost to countries that have more liberal, technologically advanced and therefore more competitive, communications regimes. The complexity of this service industry alone may provide compelling justification to pursue a service-sector wide agreement first. Even then, it may be necessary to work toward a multilateral agreement in telecommunications to address specific problems of that industry. Although no one industry is representative of the service sector, each may provide problems just as difficult to resolve as those described above. Consequently, we do not expect short-term successes from current U.S. efforts.

If telecommunications is at all representative of other service industries, significant obstacles must be overcome in applying GATT principles to trade in services. There must be a consensus on the desirability of liberalized trade and the need for an agreement to achieve this. This may require either major shifts in government policies toward competitive access to monopolistic markets and deregulation, or significant revisions of the definition and application of various GATT provisions and principles.

Because of the difficulty in effecting changes of this nature, it may be prudent in the short-term to pursue an agreement that would include the principles of transparency and least distortion to trade, and would also seek to prevent the establishment of new barriers to trade in services. If such an agreement were concluded in the GATT it could usefully serve as the basis for inclusion of services in a new round of multilateral trade talks. With agreement achieved in November 1984 to include the GATT Secretariat in ongoing exchanges of information in country studies and numerous subministerial level meetings being held between now and the beginning of a new round, the forum and time necessary to achieve such agreement is available. A significant obstacle to achieving this agreement will no doubt be objections raised by developing countries, and negotiators will likely need to agree on some form of preferential treatment for these contracting parties in order to bring

them into the negotiating process. Notification and cross-notification of regulations and restrictions in service industries, a process already begun through the submission of country studies, would promote the dialogue necessary to begin analyzing how GATT principles might apply to a specific service industry permitting trade talks to occur on either a horizontal or sector by sector basis. By including services in a new round of trade talks along with agriculture and manufactured goods, increased options are created for trading off concessions between sectors and thus it may be that an increased number of contracting parties, both developed and developing, would participate. Given the precedent established in the last round of trade talks in the conclusion of a series of codes, good potential exists for conclusion of a service sector trade code or a code on a specific sector.

Because of the regulatory nature of barriers in many service industries and the difficulty in quantifying their effects, negotiators may have to abandon the notion of equivalent concessions which has been the traditional mechanism of tariff negotiations. Instead negotiations may have to focus on ensuring that specific barriers create the least distortion to trade possible while still meeting national objectives. Regardless of the final thrust of the negotiations, it is likely that a new approach to negotiations will be necessary to achieve liberalization in service sector trade.

Negotiating any agreement covering services trade will not be easy. The most contentious issue will no doubt be defining national treatment--i.e., does it incorporate the notion of right to establish. Including this investment issue under the national treatment principle would be tantamount to an agreement that GATT does extend to investment. The traditional uneasiness of countries to place "sovereign" investment issues under international scrutiny would be a major obstacle to concluding such an agreement.

Over the last decade, service sector trade has grown dramatically as has the importance of services in individual countries, despite the lack of a multilateral agreement. Nevertheless, an agreement to prohibit new barriers and on the broad principles necessary to discipline service trade would undoubtedly promote increased trade. Since no clear consensus exists on the desirability of any agreement, the main advocates may be forced to make major trade concessions to gain general acceptance of service sector discipline and liberalization. Moreover, careful preparation is necessary; failure to achieve agreement once negotiations begin could be harmful for the GATT, both as an institution and a value system. These considerations should figure largely in any policy decision to push for a GATT agreement. Care should be taken to ensure that an agreement is

not concluded at the expense of the underlying GATT objective of mutual gain through expanded production and exchange of resources.

AGENCY COMMENTS AND OUR EVALUATION

On the basis of developments since the November 1984 meeting of the contracting parties, we agree with USTR's view that progress in disciplining services has become more likely. Although we expect negotiations to be difficult, we do see potential for including service sector trade as an agenda item in a new round and further potential for conclusion of a service sector code. Such a code should have a positive effect on services trade; however, it may be limited by the number of contracting parties willing to sign it. Brazil and India, two highly influential developing country members, have expressed serious reservations.

On the basis of comments received from a number of reviewers including the USTR, we have attempted to better clarify our approach for an agreement in service sector trade. We had intended that our "statement of intent" be an agreement forming the basis of an agenda for including services in a new round of multilateral trade talks. This agreement, in our view, should espouse the principles of transparency and least distortion and should also seek to prevent the establishment of new barriers to trade. This type of agreement would provide a solid basis for negotiation of services in a new round and could serve as an agenda statement for this purpose. We have made several revisions to the report to clarify and elaborate on what, in our view, are the pros and cons of such an approach.

In addition to the points discussed above, we have made revisions to this chapter on the basis of technical comments made by other agency and expert reviewers.

CHAPTER 4

PROTECTIONIST MEASURES RATHER THAN GATT SAFEGUARDS ARE USED TO HELP MAJOR INDUSTRIES

GATT principles face one of their most critical tests when trade actions are used in response to fundamental problems of declining industries. Such industries typically face a host of problems such as declining demand, unemployment, and import competition, which generally have significant political and economic impact. GATT Article XIX permits safeguard relief for industries suffering as a result of fairly traded import competition. As our case study of steel indicates, however, countries have tended to avoid the use of Article XIX because of its stringent requirements and a perception that it does not provide an adequate solution for industries in secular decline. Moreover, GATT provisions and codes, and related national statutes to deal with unfairly traded imports, e.g., subsidies and dumping, are generally considered inadequate to deal with problems of major declining industries. The process of filing and determining cases and imposing remedies is often abandoned and replaced by administrative, negotiated solutions without reference to dumping or subsidy margins. As a result, there has been a significant rise in the number of actions taken outside the purview of Article XIX, which in many instances may violate other GATT provisions. The rise in these so-called grey area actions has led to renewed calls to develop a realistic and responsive GATT safeguard code. The United States continues to support this effort despite the contracting parties' inability to conclude such a code over the last decade.

In assessing the role of the GATT and any future safeguard code it is important to recognize that GATT provides a disciplinary structure to trade. To the extent that trade remedies are appropriate resolutions to problems facing a given industry, GATT provides general guidance for the structure of these resolutions. Where an industry's problems go beyond basic trade problems, trade actions consistent with the GATT are unlikely to resolve the difficulties, and pressures will remain strong to negotiate grey area trade barriers. In these cases, it is clear that domestic actions to facilitate and encourage industry adjustment will likely be necessary.

SHIFTS IN INTERNATIONAL STEEL PRODUCTION HAVE LED TO TRADE FRICTIONS

Governments view steel as a critical basic industry in which market intervention or the lack thereof has high and sensitive political, economic, and national security consequences. Actions taken to address domestic concerns about the steel

industry have had direct and indirect implications for trade and consequently the multilateral trading system.

Although many nations may not have cost- or quality-efficient steel producers, they are willing to pay a price (whether through consumers or taxpayers) to develop and/or maintain a significant integrated steelmaking capacity. Countries consider the capability to manufacture steel products critical to their industrial base.

Over the last decade, the problems in steel trade have been caused primarily by increased productive capacity in excess of world demand. Cyclical declines in demand have occurred alongside of significant adverse long-term trends. For example, steel intensity[1] declined by 21 percent in developed countries between 1970-81 (and nearly 40 percent in the United States since 1974). This is believed to be an inherent feature of maturing industrial economies; as increases in income and level of economic development occur, demand for steel declines. In addition, substitution of cheaper or more efficient products, such as high-strength plastics, aluminum alloys, and reinforced concrete, has exacerbated the decline in world demand. Finally, with the downsizing of automobiles since the 1973 oil shortage, demand for steel has also declined. The auto industry has been a major customer of steel firms, using about 20 percent of U.S. carbon steel production in 1983.

Two of the more important developments affecting trade in steel have been that (1) the share of worldwide steel production traded has increased and (2) steel production and consumption in developing countries has increased. The share of steel production traded has more than doubled in the last 30 years. While 10.7 percent of steel output was traded in 1950, 25 percent was traded in 1980. Levels of steel consumption and production are also increasing in developing countries, although total world demand has declined. Many developing countries produce steel for both domestic and export markets. In fact, between 1977 and 1982, the largest increases in capacity relative to domestic demand took place in Korea and Brazil, which have been net exporters of steel since 1979 and 1978, respectively. In 1967, Western Europe and North America accounted for a 74-percent share of non-Communist nations' steel production; their share was 58 percent in 1983. In comparison, developing countries' share increased from 6.3 percent to 17.6 percent, and Japan's share went from 17.9 to 24.1 percent during the same period.

This change in trade patterns reflects a long term shift in comparative advantage from the developed to developing nations.

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[1]Defined as steel consumed per unit value of GNP adjusted for inflation.

Access to the necessary capital (whether through government or private sources or international lending institutions such as the World Bank) has enabled these developing nations to build new steel plants with state-of-the-art technology. The technological edge resulting from a newer average age of plant and equipment, combined with their low labor costs, has given developing countries a competitive advantage for many steel products over most developed nations irrespective of subsidies. In addition, an impetus to fully pursue this competitive advantage is provided by the need of many of these developing nations to export to meet their external debts. Table 5 shows shifts in capacity for several of our case study countries.

Table 5
Western World Steel Capacity[a]
And Apparent Consumption[b]
(1973-1984)

	Effective Capacity						Apparent Consumption
Year	United States	European Community	Japan	Developed countries	Developing countries	Western world	Western world
	mmt						
1973	134	152	117	450	42	492	496
1974	133	155	120	456	43	499	498
1975	131	172	122	474	47	521	431
1976	137	171	128	488	50	538	459
1977	132	167	137	496	58	554	457
1978	132	166	138	494	61	555	477
1979	130	166	136	493	65	558	512
1980	128	164	138	493	67	560	488
1981	130	162	138	493	75	568	489
1982	129	160	137	491	79	569	428
1983	126	151	137	477	84	561	436
1984[c]	113	148	137	462	92	554	481

[a]Effective capacity is the maximum operating rate at which steel plants produce their optimal product mix.

[b]Apparent consumption is production plus imports minus exports.

[c]1984 figures estimated.

Source: OECD statistics appearing in Steel Production and Trade Outlook, Paine Webber, Nov. 30, 1984.

The result of this situation, in which an increasing number of nations are committed to develop or maintain their steelmaking capacity in the face of shifting comparative advantage, increasing global overcapacity, and decreasing demand, has been extensive government intervention in steel trade on behalf of domestic industries.

The viability of a nation's steel industry can affect its economy in a number of ways. These include effects on employment and downstream industries and, in developing countries, on foreign exchange reserves. For countries with declining steel sectors, reliance on imported steel gives rise to fears about the subsequent stability of prices, reliability of sources, and security of supply lines. Many countries consider a certain level of capacity necessary for defense purposes and some attach a factor of prestige to steelmaking capacity as the traditional hallmark of an industrialized nation. Further, closing steel plants is expensive in terms of the unemployment costs shouldered by the government, industry, and employees. Developing countries are engaged in building their own infrastructure and anticipate growing domestic markets for their newly built steel industries. Meanwhile, they depend on exporting excess production in order to help with their balance of payments and external debts.

GOVERNMENTS USE VARIED POLICIES TO SPUR OR PROTECT THEIR STEEL INDUSTRIES

Governments have taken a wide range of policy actions to protect, develop, and/or restructure their steel industries. They have used tax incentives, employment, antitrust, and other policies on the domestic level to effect desired changes. National strategies and programs, in turn, determine the trade policies employed, whether it be the promotion of exports, protection against imports, or a combination of policy measures. Several types of government assistance provided to national steel industries are listed on page 69.

To facilitate our analysis of government intervention in the steel sector, we divided our case study nations into two broad groupings. The first category of countries, emerging

Illustrative List of Government Assistance to Domestic Steel Industries

Country	
Argentina	1. Export-based over-rebate of indirect taxes
	2. Preferential export financing
	3. Post-financing of exports
	4. Equity infusions
	5. Loans/loan guarantees
	6. Preferential pricing of "oil residue coal"
	7. Capital tax exemption
	8. Import duty exemption
Federal Republic of Germany	1. European Coal and Steel Community loans and guarantees
	2. European Coal and Steel Community interest rebates
	3. European Coal and Steel Community labor aids
	4. European Coal and Steel Community research and development
	5. European Investment Bank loans
	6. Capital infusions
	7. FRG investment premium
	8. FRG/state regional aid
United Kingdom	1. Equity infusions
	2. Loan forgiveness
	3. Regional grants
	4. Government equity investment
	5. Preferential loans
	6. European Coal and Steel Community preferential loans
	7. European Investment Bank preferential loans
	8. Regional aids
	9. Interest relief
	10. Labor-related aids
	11. Export loans
	12. Preferential rail rates.
Brazil	1. Export credit premium
	2. Tax rebates
	3. Preferential export financing
	4. Exemption from tariffs/capital equipment tax
	5. Income tax exemptions
	6. Accelerated depreciation
	7. Tax exemptions on export earnings
	8. Long-term loans
	9. Capital investment tax rebates
	10. Government provision of equity capital
	11. Loan guarantees
	12. Short-term export financing
	13. Other export financing
Korea	1. Preferential export financing
	2. Export tax incentives
	3. Tax incentives for government-owned firms
	4. Tax incentives for steel firms
	5. Preferential port & utility rates
	6. Tariff incentives
	7. Special export zone

Source: Report of State of the Industry Subcommittee of the President's Steel Advisory Committee, based on information collected from Department of Commerce investigations of countervailing duty cases.

producers, consists of Brazil, Argentina and Korea. These countries have small but growing steel industries. The second grouping, mature producers, consists of Japan, Canada, the United States, the EC and member nations, Germany and Great Britain, and Australia.

Each country includes many types of steel-producing firms--ranging from modern high-technology plants to less modern or efficient plants. Although our categorizations are broad generalizations about the status of the industry in each country, such generalization enables us to analyze and summarize government policies toward the steel industry.

Common objectives were pursued by each group of producers--to maintain competitiveness and modernize. The specific country approaches described below reflect the range of policy responses available to governments to achieve specific objectives. Some policies are steel specific, while others apply to all industrial sectors. Domestic policies range from tax to procurement to labor policies. Trade policies that nations may use include import protection mechanisms, such as tariffs, or export incentives. Lastly, such policies may be informal or codified and may be long term or arise out of short-term crisis.

Steel industry is a priority sector in developing countries

Emerging steel producers are oriented toward developing and maintaining an efficient, modern steel industry. In general, their capacity is increasing.

For the most part, industries in these countries enjoy modern plants, low labor and/or raw material costs, and ease in exporting due to modern ports. For example, labor costs in 1984 were $1.63/hour in Brazil and $2.15/hour in Korea. By comparison, average labor costs in the U.S. industry were $20.24/hour.[2] There has also been substantial government intervention in the form of funding, management, and/or ownership.

These countries view a vital steel industry as essential for national security and economic development. Korea, for example, views steel as the linchpin industry to industrialization. All three nations have designed their capacity to meet domestic as well as export demand. For example, in 1983 the steel sector was Brazil's third largest export earner. Argentina and Brazil cite their external debt, some of which has been

[2]U.S. Department of Labor, "Hourly Compensation Costs for Production Workers in Iron and Steel Manufacturing, 20 Countries, 1975-84," Jan., 1985.

incurred in building steel plants, as a critical reason for their focus on exports.

All three countries have government ownership of a significant part of their industries and have provided some degree of financial support to their steel industries. In all three case studies, the government provided low interest loans, "buy national" procurement policies, and equity capital to support the growth and capacity expansion of their industries. These governments have also been willing to guarantee loans from international development banks such as the World Bank, Asian, or Inter-American Development Bank. The steel producers of all three countries were also able to tap external private capital.

Mature producers attempting to maintain or regain competitive position

Mature country producers are generally attempting to rationalize their steel industries by scrapping old and inefficient capacity and enhancing competitive facilities. The more important domestic policies pursued by these countries are to stimulate investment and modernization through tax policies, such as accelerated depreciation and investment tax credits, and to ease labor adjustment through worker retraining programs. The level of government intervention in these industries varied widely.

The German steel industry consists of 9 major and numerous minor companies. It is largely private. Eighty-five percent of British steelmaking capacity is in the government-owned British Steel Corporation, although the current government plans to gradually privatize it. The U.S. steel industry is composed of 13 fully integrated companies and over 60 smaller, semi-integrated companies, all privately owned. The Australian steel industry is dominated by one large private company with annual sales comprising 3 percent of Australian GNP. The Japanese industry is composed of 5 major, fully-integrated firms, all privately owned, and numerous smaller producers, while the Canadian industry is dominated by 4 large integrated producers with about 90 percent of production privately owned. The steel industry has played an important role in the industrial development of each of these economies. In our case study nations, steel continues to have a prominent role and significant political and economic importance because of its size and number of employees.

Mature producers vary widely in terms of their competitiveness when compared with each other and the competitiveness of individual firms in a given country's industry. Within this category of producers, Japan, Canada and West Germany tended to be the most competitive producers, generally. However, there

are firms in the U.S. specialty, minimill, and integrated sectors which are highly efficient, competitive producers as well.

The steel industry in Japan received significant government assistance to expand capacity through much of the 1950's, 1960's, and early 1970's. This came in the form of direct government loans, tax benefits, and government-supported loans from other financial institutions. The industry, in general, is considered efficient and competitive and has traditionally registered strong export performance. Recent government assistance has focused on the non-competitive electric furnace mill segment of the industry to reduce capacity and, to a lesser extent, to assist in worker adjustment.

Canada provides tax and other incentives for its manufacturing industries as a whole. Those most significant for steel have been a relatively low corporate tax rate, tax incentives to encourage limited new investment and modernization, and grants for research and development. Some direct assistance to two steel companies has been offered at the provincial level to avoid local employment problems. In addition, several firms have been allowed to enter into joint ventures in iron ore mining.

European Community steel producers are participating in a Community-wide steel policy which seeks to reduce capacity and phase out national subsidies. The program provides for mandatory price, production, and import controls under the European Coal and Steel Community's "manifest crisis" Article 58 provision.[3] These controls are in place for all producers regardless of national government policies.

West Germany's steel industry is relatively competitive and has, until recently, received little government support with the exception of facilities in the depressed Saar region. On the other hand, the government-owned British Steel Corporation which produces the bulk of Great Britain's steel, has received significant government assistance. Capacity and employment in both countries has decreased under the EC's rationalization program. All national subsidies under the rationalization program are to be phased out by 1986.

Australia has instituted a program in which the government provides bounty payments to manufacturers of certain steel products which are made from domestic materials and sold to domestic users. The payments are designed to ensure that Australian producers retain 80 to 90 percent of the domestic market and

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[3]Article 58 of the Treaty of Paris which created the European Coal and Steel Community in 1951.

control production levels. In addition, the industry can take advantage of measures such as buy-national policies, research and development and export development grants, and special income tax deductions based on capital costs for plant and equipment.

The United States has no formal rationalization or capacity reduction program for the steel industry. In general, rationalization has occurred through individual company actions, such as plant closures, layoffs, product line phaseouts, or bankruptcies prompted in large part by depressed economic conditions. In the early 1980's, the United States accelerated its depreciation provisions, and eased antitrust guidelines to permit mergers, joint ventures, and joint research and development projects. In addition, the industry may take advantage of (1) investment tax credits, (2) more flexible compliance with water pollution regulations and (3) a temporary "stretchout" provision allowing qualified companies to defer compliance with Clean Air Act standards if funds are used instead for modernization (until December 31, 1985). The industry also temporarily benefitted from the safe harbor leasing tax provisions allowing companies which could not take advantage of their investment tax credits due to losses to "sell" them (1981-1983).

Finally, under the President's program, authorized by the Trade and Tariff Act of 1984, to negotiate voluntary restraint agreements (VRAs) with major exporters to the United States, U.S. steel companies are expected, as a condition of import relief, to commit substantially all of their net cash flow from steel operations for reinvestment and modernization and commit one percent of this cash flow to worker retraining. Although this is a first step toward adjustment when import relief is granted, numerous implementation problems remain to be overcome.

Changing responses to changing trade conditions

A predominant concern of most producers is to maintain a stable share of trade in world steel markets. The shift in comparative advantage, the increasing number of steel producing countries, decreased global demand, and the importance of steel trade to the countries studied have all led to increased protectionism and increased antagonism in steel trade. Table 6 shows shifts in import penetration for several of our case study countries over the last decade.

In addition to the domestic policies outlined above, steel producers have adopted numerous protectionist policies to cope with these factors. Many government officials and steel industry analysts now argue that there is no free trade in steel. Because the United States and the European Community are the largest markets for steel imports, actions taken by these

countries have had a dramatic effect on the level and composition of trade flows.

Table 6

Import Penetration for Steel Markets In Selected Case Study Countries

Country	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
	Percent									
United States	11.5	12.6	11.8	12.5	16.4	16.4	14.0	15.2	17.3	21.9
Canada	18.9	26.0	14.9	13.5	14.7	16.9	16.2	12.8	24.8	15.2
Japan	0.3	0.4	0.2	0.3	0.4	0.6	2.2	1.8	2.6	3.3
EC	8.6	6.6	9.0	11.6	13.0	12.1	11.7	12.1	9.6	12.8
Korea	96.3	87.6	72.0	53.3	49.4	54.2	46.0	44.5	32.0	38.4
Brazil	26.2	42.8	31.2	13.1	9.8	7.6	5.8	5.9	9.1	4.8
Australia	15.2	16.4	8.8	11.7	15.0	13.2	8.6	10.4	14.7	16.7

Source: Organization for Economic Cooperation and Development, as contained in a forthcoming report of the State of the Industry Subcommittee of the Steel Advisory Committee.

All of the countries we studied use some form of import protection for steel and several use vigorous export promotion programs. Korea, Brazil, and Argentina have strict enforcement and monitoring of import licensing justified under the balance of payments (Article XII) or infant industry (Article XVII) provisions of the GATT. In addition, they have used various export incentives to encourage exports of steel, including short-term export loans (Korea), export tax rebates (Brazil, Argentina), and countertrade arrangements (Brazil).

In Canada, imports primarily make up the difference between domestic production and changes in demand over the business cycle. Imports rarely exceed 15 to 18 percent of the market and are generally controlled through strict enforcement of Canadian unfair trade laws, particularly dumping provisions.

Although Japan has no formal import restraint program, it has recently changed its generalized system of preferences program to increase prices of developing country steel imports. Moreover, allegations have been made by numerous U.S. and foreign steel interests that Japanese trading companies have limited their procurement of foreign steel, which would appear to be supported by the low level of import penetration cited in table 6. However, this data could also reflect that Japanese producers are considered to be the most efficient and competitive in a broad range of product categories.

Australia, in implementing its domestic rationalization program, has reduced the price of domestically produced steel, making imports less attractive. With implementation of the government's payments to domestic producers described earlier, Australia did away with its tariff-quota system except as these apply to countries under its general system of preferences.

Although these policies have an effect on trade, because of the size of their markets the most important determinants of the nature and flow of steel trade are actions taken by the United States and the European Community. Table 7 lists their import restrictions. The U.S. integrated industry, in a state of secular decline generally, began to seek relief from imports in the late 1960's. It has initiated numerous petitions and been granted import protection under U.S. fair and unfair trade laws, including (1) duties and quantitative restraints in response to antidumping (AD) and countervailing duty (CVD) cases, (2) orderly marketing agreements (OMAs) in specialty steel in response to a safeguard or escape clause (section 201, Trade Act of 1974, as amended) case, (3) an arrangement with the European Community negotiated in lieu of dumping and countervailing duties, and (4) 5-year voluntary restraint agreements negotiated in lieu of tariff and tariff-quota remedies in an escape clause case for carbon steel. In addition, a trigger price mechanism (TPM) for imports was in place from 1978 to 1982. These responses put virtually all major exporters to the United States under some form of import limitation.

Table 7
Steel Trade Restraints, 1969-1984

Action	Years	Imposing Country	Targeted Countries
VRAs	1969-71	U.S.	EC, Japan
VRAs	1972-74	U.S.	EC (now includes UK), Japan
VRA	1972-74	EC	Japan
VER	1976	EC	Japan
OMA	1976-80	U.S.	Japan (with all other suppliers in a basket category) (specialty steel)
TPM	1978-82 (excluding 3/80-10/80)	U.S.	All foreign suppliers
VRAs & Basic Price System	1978-1986	EC	Australia, Austria, Brazil, Bulgaria, Czechoslovakia, Finland, Hungary, Japan, Korea, Norway, Poland, Romania, South Africa, Spain, Sweden
VRA	1982-85	U.S.	EC (carbon steel)
VRA	1982-86	U.S.	EC (pipe and tube)
OMA	1983-87	U.S.	Sweden, Austria, Japan, Canada Poland, Argentina, Spain (with Brazil, Korea, and EC in a basket category) (specialty steel)
VRAs	1984-89	U.S.	Australia, Brazil, Japan, Korea, Mexico, South Africa, Spain Finland, Hungary, Czechoslovakia. (carbon steel)

Source: Compiled by GAO from various official government sources.

U.S. actions to restrain steel imports are not tied to any specific domestic rationalization program. Under the Trade and Tariff Act of 1984, however, the Congress expressed its view that the steel industry must take steps to become competitive during a 5-year period of import relief. The Act provided the authority for the President to negotiate restraint agreements to limit imports of steel to between 17 and 20.2 percent of the market. USTR has negotiated 10 such agreements and the U.S.-EC arrangement has remained intact through this process. The U.S. industry has filed additional unfair trade cases in an attempt to encourage the administration to negotiate further agreements. Through these agreements and the specialty steel tariff increases and OMAs negotiated in 1976 and 1983, the United States has restricted access of most exporters and a broad range of steel products to the U.S. market.

The EC since 1978 has negotiated 15 bilateral agreements setting price and volume limits on exports to the European Community. Countries signing these voluntary restraint agreements (VRAs) may export to the EC at prices 3 to 6 percent below EC established "basic" prices without being subject to antidumping suits. Basic prices are determined on the basis of full cost prices of the most competitive world producer of a given product. Because internal delivered prices--prices at which EC-produced steel is sold in the EC--are lower than these basic prices, imports are discouraged. As a result, quotas established in these VRAs are rarely filled. Those countries not signing VRAs are automatically subject to antidumping suits if exports are priced below basic prices. Through this system of price and import controls, the EC has effectively restricted access to its market. EC bilateral agreements are considered the external component of its ECSC Article 58 steel industry rationalization plan and as such European Commission officials stated that they are expected to be phased out by 1986 with completion of the EC rationalization plan.

As the United States and the European Community have negotiated these agreements, the predominant concern of exporters has been to preserve whatever market share they can. U.S. agreements have tended to preserve market shares of traditional suppliers. Thus, the EC has maintained on average a 5 to 7 percent share of the U.S. market with varying degrees of market penetration depending on product category under the U.S.-EC arrangement. Japan has maintained roughly a 6 percent share of the market through voluntary restraint. Some other exporters, particularly new market entrants, upon seeing these allocations may feel pressured to participate in this market allocation process or run the risk of losing access to the market entirely. The same is true in terms of allocation of the EC market. This market allocation process has the effect of cartelizing the world steel market.

In protecting their steel markets against imports, countries have adopted trade remedies with little regard to whether problems in steel are trade problems. Moreover, by adopting similar remedies for dumped, subsidized, and fairly traded steel, mature producers have increasingly blurred that distinction. The result has been to bypass the use of GATT remedies for the myriad problems faced by the steel industry.

HAS GATT WORKED FOR STEEL?

In assessing the role of the GATT, it is important to remember its purpose--to provide structure and discipline to trade between nations. GATT principles can provide some order, fairness, and discipline to trade and, to the extent that trade remedies are appropriate to the basic problems, can overcome

problems which prevent trade expansion. Furthermore, GATT principles can be useful in resolving disputes to the extent that signatories are willing to adhere to its procedures and remedies. It is, therefore, critical to distinguish those problems of the steel industry that can be addressed through trade remedies and those that necessitate non-trade solutions.

The steel industry illustrates quite clearly that problems in a declining basic industry go beyond trade solutions. As we have already discussed, the problems in the steel industry have resulted primarily from a fundamental shift in comparative advantage from developed to developing countries, and the international disequilibrium in supply and demand. Reductions have been made in steel producing capacity, but a serious overcapacity still exists. Due to political, social, and economic costs, some nations are unable or unwilling to substantially reduce their steel making capacity. The heavy debt burden of many developing countries has made it essential that these countries export products, including steel, while reducing their imports. On the other hand, developed countries have tended to protect their steel industries from these more competitive imports and have also faced the developing country challenge in third country markets.

Developed nations have attempted to address the steel industry's problems through import restrictions through both fair and unfair trade mechanisms in the GATT. However, given the nature and magnitude of these problems, it would be unrealistic to expect the GATT to address and regulate the variety of problems facing the industry. GATT can address fair and unfair trade problems but not the factors that have led to the structural problems in the steel industry.

Stringency of Article XIX safeguard provisions has contributed to use of grey area actions

The architects of the GATT recognized that there could be times when nations would need to restrict trade to provide temporary relief to domestic industries threatened with serious injury as a result of concessions granted through GATT. Under Article XIX, the safeguard clause, nations can provide emergency relief from imports.

Article XIX has explicit provisions as well as provisions implied when taken in context with other GATT articles. Serious injury to a domestic industry must be present or threatened for a nation to restrict imports. This injury must be the result of or caused by the imports in question. The countries involved must hold consultations concerning the action to be taken and report to the GATT (transparency provision). Finally, if

countries do not agree on the action during such consultations, the affected parties have the right to retaliate by suspending substantially equivalent concessions or obligations which they have made under the GATT, subject to disapproval by the contracting parties.

In addition, Article XIX is generally interpreted to mean that import restrictions should be temporary and applied in a non-discriminatory fashion (i.e., on a most favored nation basis). The concept of compensation provided by the importing country has evolved as a means to avoid retaliation by affected exporting countries.[4]

The stringency of Article XIX features, particularly the serious injury standard, MFN application, and the potential for demands for compensation, has made recourse to Article XIX a last resort measure. The United States has been among the most frequent users of Article XIX through its escape clause provision, section 201 of the Trade Act of 1974, as amended. In addition, questions have been raised as to the adequacy of a temporary restraint under Article XIX to help industries experiencing long term structural decline such as steel or textiles. Although Article XIX was clearly intended to be used in exceptional rather than routine and normal circumstances, the plethora of alternative, grey area actions that have been taken instead was not envisioned when the GATT was created. These grey area actions, due to their flexibility, have been increasingly used, distorting trade patterns and imposing economic costs.

The grey area actions discussed below are taken outside the purview of Article XIX, but within the purview of the GATT to the extent they are inconsistent with other GATT provisions.[5] Voluntary restraint agreements are administered by the exporter and may or may not be formally negotiated. Under voluntary export restraints (VERs) a nation may act unilaterally to limit its exports without consulting the importing country. VERs are administered by the exporter. Orderly marketing agreements are administered by the importer and are commonly negotiated on a

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[4]Article XIX states that the affected party is free to suspend substantially equivalent concessions or other obligations under the Agreement. Since this would presumably be a further move away from liberalization, compensation in the form of lowered import barriers in other goods paid by the importing country is an alternate possibility. This too, however, is usually a difficult requirement.

[5]These include but are not limited to Article I which requires most-favored nation treatment and Articles XI and XIII which address application of quantitative restrictions.

government-to-government basis, thus tending to be more formal than a VRA. Nations may also enter into price undertakings to trade specific goods at specific prices or into industry-to-industry arrangements, which are often not publicly disclosed and whose effects are hard to quantify. Most countries have tended to use quantitative restraints rather than tariffs when implementing these arrangements.

Since grey area actions do not have to be reported to the GATT, a country can protect a domestic industry without first establishing injury or a causal link with imports and without previous consultation. It can single out only one or two nations for restraint and impose quotas or tariffs for an indefinite period. Because affected countries do not formally challenge these measures under Article XIX or other GATT articles, such grey area actions have been relatively easy to initiate and maintain.

Use of grey area actions has led to significant distortions in international trade. Although these distortions may be no more severe than those that might result from Article XIX actions, they are generally viewed as potentially more troublesome because they do not meet the standards established under Article XIX for taking import restraint actions. Grey area actions have been criticized because they protect declining and inefficient industries and freeze the existing structure of trade. When such actions extend to the entire market, entry of new suppliers may be prevented. Efficient producers will move to find new markets, artificially diverting goods from the restricted market to other open markets thereby increasing protectionist pressure in those countries. In addition, third parties which may have lost potential sales have not complained to the GATT because the distortions which result from such grey area actions are difficult to quantify and it is therefore difficult to show injury.

Grey area actions in the form of quantitative restraints involve serious economic costs. The importing country government forgoes revenue which could be collected through duties to offset the general welfare costs of import restraint. It may, however, be willing to shoulder these costs in order to impose grey area actions selectively, targeting only certain countries, thereby hoping to avoid retaliation. Consumers of the importing country pay higher prices for both the domestically produced and imported product. However, the protected firms prefer the certainty of quota-type arrangements which ease competitive price pressures, allow greater control of supply, and provide greater market share certainty. Foreign producers perceive advantages in such arrangements because they also get market share certainty and higher prices for their products. They capture the economic "rents" or the extra profit margin they realize from

the higher prices to consumers that are the result of artificially restricting supply. For its part, the restraining government may agree to grey area actions to avert relatively greater protectionism, such as unilateral import quotas.

Inadequacy of unfair trade remedies has contributed to use of grey area actions

The GATT has extensive remedies and procedures through which nations may address unfair trade practices. There is international acceptance of the principle that duties can rightfully be imposed to address unfairly traded imports. In the United States the process of filing and administratively resolving cases in the steel industry has often been abandoned and replaced by negotiated solutions outside the purview of dumping and countervailing duty statutes. What is increasingly occurring is a blurring of the distinction between fair and unfair trade in developing remedies. Negotiated quantitative restraint agreements cover most steel trade and often have been entered into regardless of margins of dumping or subsidies, or the existence or extent of injury. In other cases, when these mechanisms have been utilized, they have been insufficient to redress the magnitude of problems faced by industry or ineffective in addressing the unfair trade problem.

GATT mechanisms to address unfair trade practices include Article VI, Article XVI, the Antidumping Code, and the Subsidies and Countervailing Duties Code. Article VI stipulates criteria for imposing antidumping and countervailing duties. Article XVI states that use of subsidies should be avoided and requires reporting of subsidies and consultations with affected parties. The Antidumping Code attempts to strengthen and clarify the provisions of Article VI. It provides relief from injurious dumped imports and attempts to ensure fair and equitable treatment of all parties involved in antidumping procedures. The Subsidies and Countervailing Duties Code seeks to control the impact of subsidies on trade flows in international commerce. It attempts to strengthen and clarify GATT provisions in order to ensure that a signatory's subsidies do not injure the trading interests of another signatory, and that countervailing measures do not unjustifiably impede trade.

In the case of U.S. steel, GATT's unfair trade remedies as implemented through national laws and regulations do not often run their full course. Companies file cases to get government action and the government has often intervened and used other measures to avoid the political and economic risks entailed in allowing the unfair trade cases to be concluded and sanctions to be applied. Exporting countries either initiate or agree to such grey area actions for reasons discussed earlier. Examples of such cases involving steel include the U.S. trigger price

mechanism (TPM) instituted in 1978, the U.S.-EC Arrangement of 1982, and the 15 bilateral VRAs negotiated by the EC with major steel trading nations since 1978.

The TPM established a system of import reference prices, below which dumping investigations would be triggered. It was based on the average production costs of the low-cost Japanese producers and was developed for the steel industry by the U.S. government in 1978 in return for the withdrawal of a number of antidumping cases filed against Japanese and European producers. According to some trade policy analysts, in bypassing the unfair trade laws, (1) the U.S. government regained control over trade relations and avoided an expanded trade conflict with Europe, (2) the U.S. steel industry achieved a degree of protection from the surge of foreign imports, (3) exporters to the U.S. market gained higher prices and a degree of stability in market access, and (4) both the administration and the exporters averted a threatened unilateral and legislatively mandated quota by the U.S. Congress.

The TPM, however, began to fall apart in 1980 and 1981 and finally collapsed in 1982 with the filing of numerous unfair trade cases by the U.S. steel industry against producers in the European Community. The EC was concerned about the internal effects of resolving these cases and an apparently imminent finding of subsidization. For its part, the U.S. government, already involved in several non-steel disputes, wanted to avoid further strains on U.S.-EC relations. Accordingly, at the EC's request, the United States entered into negotiations for a settlement. The U.S.-EC Arrangement Concerning Trade in Certain Steel Products was concluded in return for the withdrawal of 44 unfair trade cases brought by 8 U.S. steel producers against producers in 7 European countries. The EC pledged to limit export volumes of 10 product categories to certain market share allowances from November 1982 through December 1985. The Arrangement was to be monitored by the Department of Commerce through an EC system of export licensing and enforced by the United States with authority to block specified imports if they violated the export limits set. Pipe and tube products were included under a separate agreement.

The Arrangement answered both the United States and EC needs by its government-to-government character (control) and by delineating set market shares (market stabilization). The EC was concerned that the unfair trade cases would undermine its fragile cohesiveness and that of its internal restructuring plan if some European producers (i.e., Great Britain, France, Italy, and Belgium) were shut out of the lucrative U.S. market while others (i.e., West Germany, Luxembourg, and the Netherlands) were not. Steel industry analysts and government officials also told us that an EC-wide quantitative restraint was to the U.S.

producers' advantage. If duties had been imposed in the unfair trade cases, West German and Dutch producers would have been able to continue exporting freely into the U.S. market and could have used their excess capacity to capture market share lost by the other European producers proved to be trading unfairly. Further, U.S. producers also benefitted in that the range of products covered by the Arrangement was more comprehensive than the products which would likely have been restricted as a result of the AD/CVD cases.

The EC has negotiated 15 bilateral restraint agreements with exporters to the Community since 1978. The EC used exemptions from its unfair trade laws as an incentive for exporters to negotiate price and quantity agreements. These VRAs are designed to complement the steel industry adjustment plan and to restrict steel imports to established exporters and market shares. Countries exporting to the EC without VRAs are subject to antidumping cases if their products are priced below EC basic prices. The result is that an artificial market status quo is maintained, with no delineation between fairly or unfairly traded products or determination of injury to the domestic industry.

The second area of difficulty with unfair trade remedies has been that in those countries where AD/CVD mechanisms have been used extensively, GATT remedies have simply been insufficient to address the magnitude of problems faced by developed countries' steel industries. These industries cannot solve their problems by relying solely on trade measures. It is unrealistic to expect GATT unfair trade remedies to ameliorate the non-trade problems faced by a declining industry--such as declining demand, high production costs, or aging technology--and to stop or reverse a shift in comparative advantage.

A third area of difficulty with use of unfair trade remedies has been that their implementation in many countries has been fraught with procedural problems. In some instances, this has made it difficult to secure relief through domestic dumping and countervailing duty statutes. For example, Canadian steel producers stated that their antidumping laws have been unduly slow. This is important to them because Canada has historically relied on its antidumping laws to a much greater extent than its countervailing duty laws when seeking import relief. In June 1984, the Special Import Measures Act was enacted, which will allow the government to act swiftly when Canadian commercial interests are determined to be adversely affected by imports. In another example, U.S. steel producers have charged that the U.S. unfair trade laws have been inadequate to protect them against dumped or subsidized imports. AD/CVD cases must be filed separately for each product from each country alleged to be unfairly traded. Not only is pursuing these cases costly and

time-consuming but it is also usually only incrementally helpful: as one unfair trader in one product line is eliminated, another steps in to take his market share and/or it begins to ship another product. U.S. steel producers say that this product-by-product and country-by-country process does not allow them to mount a much needed "pattern" or macro solution to the unfair trade problem in the U.S. market. According to Department of Commerce officials, the four major users of AD/CVD legislation, the EC, Canada, Australia and the United States, have recently modified their laws and/or procedures. These modifications are expected to overcome many of the problems discussed above. Whether they, in fact, will streamline the process and provide more effective relief, however, remains to be seen as the modifications have all been made within the last year.

Simply put, the political, economic, and social stakes in the developed countries are sufficiently high that these countries have found it necessary to use grey area actions to protect their steel industries. The examples just discussed illustrate this tendency as well as the increasing tendency to blur the distinction between fair and unfair trade in developing remedies. Thus, by taking grey area actions in lieu of traditional GATT fair and unfair trade mechanisms, nations exercise their rights to protect domestic industries without necessarily fulfilling the obligations established by GATT principles.

Grey area actions at variance with GATT principles

Grey area actions pose a threat to the GATT for four major reasons. First, a pattern of protectionism by sector has evolved in industries such as steel, machine tools, consumer electronics and textiles. Second, permanent protection for weak domestic industries has costs to the domestic and international economy. This trend runs counter to the purpose and underlying themes of the GATT: to encourage trade liberalization and to discipline trade restricting actions. Further, economists stress that it makes no economic sense to single out the most competitive (and thus, often disruptive) suppliers, although it may be politically expedient. Third, the victims of grey area arrangements are often (1) third country industries which are efficient producers and could potentially capture market shares that have been allocated to less competitive producers or (2) third countries whose industries face greater import competition caused by trade diversion from newly limited or closed markets. These affected third parties have difficulty proving injury and therefore cannot claim compensation or take retaliatory measures when grey area actions are taken. And lastly, the concept of non-discrimination embodied throughout the GATT has come to be almost totally disregarded, with a disproportionately adverse effect on new, and presumably more efficient, market entrants.

Because of these problems, countries have attempted to negotiate a safeguards code. It has been hoped that such negotiations could result in more uniform non-discriminatory application of Article XIX actions; prevent a further drift toward sectoral approaches to trade, such as the multifiber arrangement in textiles; ensure that import protection is temporary; and strengthen the GATT by increasing adherence to the injury standard, notification, and transparency provisions.

PROBLEMS AND POTENTIAL FOR A SAFEGUARDS CODE

In discussions on developing a safeguards code, the most basic change under consideration is to reject the MFN principle and permit countries to take actions selectively. Advocates of selectivity, such as the EC, state that it would provide needed flexibility in taking safeguard actions, targeting only the nations causing injury and not the more established exporters. This would also reduce the potential costs of using Article XIX and encourage nations not to use grey area actions. These same "advantages" of selectivity are also the reasons why other nations oppose the concept of selectivity. They state that lowering the costs of Article XIX and exempting it from the fundamental GATT principle of non-discrimination would make its use too easy and allow protectionism to undermine the GATT itself.

Developing countries believe that they would be the most hurt by selectivity. How a nation defines injury could determine its ability to act selectively and the extent to which these actions are discriminatory. If imports are not damaging at 12 percent of the market but are considered injurious at 16 percent, some, including the EC, believe that they should be able to identify and apply restrictions on this marginal 4 percent of imports. As this allocation is determined on the basis of historical market share, it in effect restricts the access of the most recent entrants to the market. Developing nations believe that their exports would thus be unfairly and selectively targeted and restricted and that developed countries would be allowed to maintain market share without regard to comparative advantage or trade practices.

Safeguards Code negotiations-- no progress to date

Several nations, including the United States and Japan, have recently reiterated calls for negotiation of a safeguards code. The United States has consistently stressed the need for a comprehensive understanding on safeguard actions in the belief that nations will take safeguard actions and should do so under GATT discipline. Safeguard negotiations failed during the 1979

Tokyo Round of MTN because participants could not agree whether nations should be allowed to take Article XIX actions selectively. In 1984 USTR proposed to GATT signatories a "building block approach" to safeguards. This approach attempts to identify elements of safeguard actions on which signatory nations presently agree. USTR envisions that this approach would serve to spur negotiations of the more difficult "stumbling blocks," such as grey area actions and differential treatment for developing countries. According to U.S. officials, however, there is no consensus on this or any approach; no progress was made at the most recent GATT meeting of the contracting parties in November 1984.

In part because of frustration over lack of progress, the United States and Canada entered into a bilateral safeguard understanding in February 1984, delineating how they will notify and then impose Article XIX safeguard actions and grey area actions. According to USTR, the provisions regarding compensation and retaliation apply only to Article XIX actions. USTR officials stated that the understanding is non-discriminatory because any other country with similar interests may be party to the understanding.

As noted earlier in this chapter, some contracting parties have found Article XIX to be inadequate in the case of steel because of its temporary nature. Under Article XXVIII, providing for renegotiation of bound tariffs, a contracting party could raise specific tariff bindings permanently on the condition that affected parties are consulted and compensation agreed to. We understand, on the basis of discussions with GATT officials, that this idea is being surfaced as a potential alternative or complementary solution to the international steel problem and grey area actions. Because of the compensation requirement in Article XXVIII, this solution may not overcome all of the problems associated with Article XIX actions. Nevertheless, from a GATT perspective, an Article XXVIII action may be appealing for several reasons: (1) it is a tariff adjustment, the preferred method of protection in the GATT, rather than a quantitative restraint; (2) it requires payment of compensation to any and all affected parties; and, (3) given the GATT's success in negotiating tariff reductions, provides potential for the actions to be reversed.

It appears that the differences in developing an approach to negotiating a safeguards code reflect economic tensions and the problems which result when many nations take and maintain discriminatory trade restrictive actions due to overriding national interest. It is clear that negotiations must provide both incentives and sanctions to ensure that countries join the system and abide by its recommendations. However, grey area actions are generally designed to respond to fundamental

domestic rather than trade causes; thus pressures to restrict imports through such actions will remain.

CONCLUSION

Recourse to GATT mechanisms cannot resolve the problems of the world steel industry--problems that go beyond trade between nations to issues of changes in demand, global oversupply, technological change, and sensitive national security and employment issues. Where these problems are trade specific, GATT principles and mechanisms can be useful in providing some order, fairness, and discipline to trade. Increasingly, however, nations have ignored GATT provisions, preferring what is perceived as less costly, more flexible, informal negotiated approaches. Therefore, in cases like steel where governments are under strong domestic pressure to take some action, the GATT approaches have been bypassed. In the process, there has been an increasing tendency to blur the distinction between fair and unfair trade in developing remedies. Continued recourse to grey area actions is at variance with the fundamental principles upon which the GATT was so painstakingly built.

Concluding a safeguards code may or may not lead to greater adherence and support for GATT's procedures and remedies. Many of the problems of steel industries in developed countries are fundamentally structural, but they have directly affected international trade. However, even with a safeguards code, pressure to use grey area measures will likely continue when the problems at issue are fundamentally structural rather than trade specific. In such cases, a safeguards code can, at best, help to make responses to larger problems of decline less disruptive to a market trading system strongly supported by the United States. It is clear that in cases like steel, domestic actions, whether government- or market-induced, are necessary to facilitate and encourage structural adjustment of industries.

AGENCY COMMENTS AND OUR EVALUATION

The USTR expressed several reservations about our analysis of U.S. actions on steel and the world steel environment. In particular, it stated that the "President's program [VRAs negotiated under the Trade and Tariff Act of 1984] has neither the purpose nor the effect of cartelizing steel trade." We agree that this program alone does not have such an effect. However, our discussion of this issue cites numerous additional formal and informal import restraint measures by the United States and the European Community which, taken together, allocate a large majority of the steel imports in these markets to specific exporting countries. Considering the U.S. and EC shares of world steel imports, we believe the combined measures have the appearance and effect of a cartel.

USTR commented that the report "suggests that the EC's more restrictive steel import program adopted in the 1970's is somehow preferable to the U.S. program because of the greater degree of government intervention in EC restructuring decisions." We did not intend to convey such an impression. Generally, we agree that market forces are the best determinant of restructuring/investment decisions. We would note that even with the scheduled conclusion of the EC's program at the end of this year, the EC forecasts that its steel industry will still be left with significant overcapacity, which clearly calls into question the effectiveness of the program. However, market forces have been seriously distorted by the broad array of quantitative import restraints protecting domestic steel producers, and market forces may not be working to encourage efficient restructuring.

USTR further notes that the President's program was "brought about by unfairly traded imports and diversion because of closed foreign markets." As we note in our report many of these agreements have been negotiated to prevent imposition of duties on products found to be traded unfairly, i.e., dumped or subsidized products. We also state that, in the case of some exporters, agreements have been reached in the absence of determinations of unfairly traded imports, most notably with Japan and, until recently, Korea.

State contended that Japan is a closed market to steel imports. As we note in this chapter, allegations have been lodged against the Japanese that their trading companies have limited steel imports. Import penetration ratios would seem to support this allegation. However, as we noted, the same data is consistent with the acknowledged efficiency and competitiveness of the Japanese steel industry.

The Department of Commerce raised strong objections to our conclusion that antidumping and countervailing duty statutes are "generally considered inadequate." We agree with Commerce's view that such a conclusion is unjustified on the basis of an examination of one industry. In fact, our view is that these statutes may be very effective and adequate in protecting competitive domestic industries from unfair import competition. On the other hand, in the case of steel where many segments of the industry are not competitive for the reasons discussed in this chapter, we don't believe these statutes are adequate or sufficient to assist the industry. First, and perhaps foremost, these laws were never intended to address problems of long-term structural decline; rather, they are intended to provide relief from unfair trade practices through imposition of duties to counteract margins of dumping or subsidies. Secondly, both the administration and the steel industry acknowledge that these

laws can often be cumbersome, costly, and very time consuming to implement and as a result, relief is often "too little, too late." For these reasons, we believe it is unrealistic to expect these laws to ameliorate the non-trade problems faced by industry in long-term structural decline--e.g., declining demand, high production costs, aging technology--or to stop or reverse a shift in comparative advantage.

We have made several changes throughout the chapter to clarify our conclusion. In addition we have made minor revisions in the chapter to reflect technical comments from both agency and outside experts.

CHAPTER 5

CONCLUDING OBSERVATIONS

The examples presented in the preceding chapters can be interpreted as painting a rather bleak picture of GATT's ability to successfully resolve the world's trading problems. The continued existence of unresolved disputes challenges not only the principles of the GATT but also the value of the system itself. However, this lack of success does not support the conclusion that violating GATT principles or acting through some other forum to resolve disputes is preferable or more effective.

A perception that the GATT as an institution has diminished relevance does not lead to a conclusion that it is no longer useful. It is possible to respond to changes in the balance between national and international interests which, intentionally or not, restrict trade flows by carefully modifying the institutional framework and rules. Codes negotiated during the last round of trade negotiations and the introduction of new areas under the GATT umbrella are examples of attempted modifications which for the most part have been adopted in a manner consistent with GATT's underlying objectives and basic principles.

The United States espouses a trading system in which markets determine price, supply and demand and where information on competitive and economic conditions is readily available. With objectives focusing on the removal and/or reduction of government-imposed barriers to trade, it would appear that GATT objectives are generally in consonance with U.S. trade policy objectives.

In practice, the U.S. government intervenes in the market, although in the trading arena, foreign governments often take a more interventionist approach to their economies and use a wide array of trade-distorting measures. With a successful lowering of tariffs as the means to control trade flows, non-tariff measures which often have unknown and unmeasurable effects have become more apparent. In many cases, these are viewed as legitimate government actions, but they nonetheless have an extra-national impact. The issues facing trade negotiators today are highly contentious because they revolve around issues so heavily in the realm of national policymaking. At the same time, the international consequences of domestic policy decisions are increasing.

There is a growing perception that some of these actions are fair and some are unfair. There is wide disagreement not only between countries but within countries as to what is fair and unfair. The distinction between fair and unfair actions is becoming increasingly blurred in dispute resolution, particularly when they involve complicated industrial policies.

A process within a multilateral system must be found that allows countries to bridge the gap between the sovereign actions of one country and the impact of those actions on other countries. The United States continues to push for modification in the GATT, but it is also pursuing bilateral agreements on trading relations. Presumably, bilateral agreements are easier to conclude. A bilateral agreement in consonance with GATT principles can act as a stepping stone toward broader agreements. However, many disputes are such that conclusion of a bilateral agreement to resolve the dispute may still prove an inadequate resolution. Thus, for this strategy to be successful on a broader scale, i.e., under a multilateral umbrella, countries must eventually be willing to make domestic adjustments in any national policies which violate underlying GATT principles.

Given current negotiating positions the likelihood of achieving changes in the GATT to resolve trading problems varies among the areas we reviewed.

AGRICULTURAL TRADE AND WHEAT

Domestic interests have been and continue to be strong in the agricultural area. The need for food security and the political strength of farm groups puts agricultural commodities in a special category in most countries' trade policies, a status also reflected in GATT. No agreement has been reached on a code of behavior which would lessen the effect of domestic unilateral actions on a country's trading partners.

Many exemptions, disagreements in interpretation and failures to abide by GATT rules were noted in agricultural trade. Most of these are reflected in GATT's Committee on Trade in Agriculture work program. However, the most contentious areas have been closely related to important national policies and objectives. Accordingly, the United States has singled out the reduction or dismantling of export subsidies practices by the European Community as one of its priority objectives. This is, in part, because any loss of its export markets adversely affects domestic U.S. support programs, again a reflection of the relative importance placed on domestic impact.

Whether U.S. agricultural programs should be developed based on their domestic or international impact is a major issue expected to be under discussion during upcoming debates on the 1985 farm bill. An equally important question is whether the U.S. agricultural sector will be competitive if many or all barriers to its exports are negotiated away. It is clear that programs to date have unintentionally encouraged increased worldwide commodity production, in turn helping other countries to be competitive and expand their market share.

TELECOMMUNICATIONS AND SERVICE SECTOR TRADE

Government presence in national telecommunications industries is long-standing. Problems have come to the fore as telecommunications equipment and services exports have become attractive for a few countries. The United States has placed high priority and expended much effort on bringing discussions on service sector trade into GATT. U.S. efforts have met with some success to date.

As trade in goods did 40 years ago, trade in services now faces entrenched national policies which may be used to restrict trade, with no general framework within which to define parameters or negotiate changes. The trade effects of most non-tariff regulations often are not known and not measurable. This makes the concept of mutual concessionary reductions, used in the past to develop tariff schedules, difficult to negotiate. In addition, countries have not agreed that a decrease in restrictiveness is beneficial. Without such basic agreement, multilateral negotiations will be difficult and protracted.

The U.S. Trade and Tariff Act of 1984 reflects the administration's intention to pursue a services agreement; it gives the President, for the first time, negotiating authority to reduce or eliminate international barriers in services trade. It contains, in addition, enhanced retaliatory powers for the President and the Office of the U.S. Trade Representative. One or several bilateral agreements, such as that consummated with Israel and under discussion with Canada, may further U.S. trading interests in services. But without access to other large country markets, many of which are members of the GATT, these agreements will not substitute for a broad-based multilateral agreement.

SAFEGUARD ACTIONS AND THE STEEL INDUSTRY

Protectionist actions are being taken in a way not envisioned by GATT's Article XIX. Instead of temporary measures taken for exceptional reasons, protective measures are increasingly taking the form of long-term coordinated systems of protection in several industrial product categories. In developed countries, these tend to be mature industries facing stiff competition from newly industrializing countries. Steel is an industry with a large employment base with strong political representation. This means that governments have a great stake in controlling trade flows and have often bypassed agreed upon rules for fair and unfair trade in order to maintain or expand market share. Importing countries have increasingly adopted trade remedies to deal with industrial problems that have domestic origins.

The United States is an active and significant participant in this trend. The Presidential decision to negotiate a series of bilateral, "voluntary" restraint agreements as a remedy to injury caused by both fairly and unfairly traded carbon steel imports joins like U.S. agreements on specialty steel, textiles, and autos, among others. These actions do not auger well for U.S. support of a safeguards code based on non-discrimination, transparency, temporary time limits, and payment of compensation.

However, the U.S. government has recognized that the problems of its steel industry are not caused solely by imports. If domestic adjustment for the industry as called for in the Trade and Tariff Act of 1984 is carried out, it may prove as beneficial to resolving the problems of the steel industry as any trade solution. EC import restrictions are open to charges of discriminatory treatment similar to those that have been lodged against the United States. EC import protection is an integral part of a formal domestic program with government-dictated restructuring goals.

GATT AND MULTILATERALISM

It is within a framework of government intervention in domestic economies that the GATT is being called upon to provide guidelines and settle disputes over countries' trading behavior. Not surprisingly, the GATT has not been able to control government actions or settle all disputes between trading partners. But to judge the GATT on its ability to force governments to change their behavior is to judge it for failing to achieve objectives it was never intended nor given the wherewithall to achieve. The GATT does provide an external forum and force for change if national governments are willing to participate. However, trading disputes are often manifestations of domestic problems. Without attention on a national level to these problems, no solution can be found between trading partners, GATT or no GATT.

Most countries continue to espouse strong support for the principle of non-discrimination, the primary underpinning of the multilateral trade system. Despite this stated support, many countries are participating in bilateral discussions and taking unilateral actions that can violate the non-discrimination principle. In steel, we have noted the proliferation of numerous discriminatory bilateral arrangements to control the flow of steel products. The United States and the European Community have been major participants in this process.

Bilateral agreements could undermine the multilateral trade system created by the GATT because of their discriminatory nature. However, such agreements do not inherently violate the MFN principle. For example, benefits derived from an agreement negotiated between the United States and Japan have been applied

multilaterally. If genuine attempts are made to expand the application of bilateral agreements, such agreements could serve as useful tools in bridging the gap between a lack of international consensus in a given area (e.g., safeguards code) and conclusion of a full-fledged multilateral agreement. It is nevertheless important to recognize that bilateral solutions to disputes may be limited. For example, no agreement on greater discipline over the use of export subsidies will work without the participation of the United States and the European Community. Neither is it likely that an agreement in this area between the United States and the European Community alone could work without the constructive participation of other major exporters. Thus, if bilateral agreements are to be negotiated, the challenge before the United States and other contracting parties is to make every effort to negotiate these in accordance with GATT principles and work to bring these into GATT's multilateral framework and discipline.

Multilateralism and the principles contained in the GATT serve the United States well. Our work leads us to believe that there remains a harmony between U.S. policy and interests and the underlying principles of the trading system. The benefits extend beyond the significant reductions negotiated in tariffs over the last three decades. Today, with the growing number of participants in the world trading system, particularly developing countries, the GATT provides the United States with a framework of standards in which to conduct its trade relations.

U.S. actions have been a compromise between international trade principles and domestic political realities, with political realities gaining more weight. It is in this context that GATT as an institution is in the interest of the United States. Given the increasing tensions arising out of trade disputes, GATT, as the sole forum providing a broad-based membership and dispute settlement procedures, is important to the reduction of these tensions. With 90 contracting parties, the GATT as an institution brings together developed and developing countries, and those with centrally-planned economies to discuss a broad range of issues. Moreover, its dispute settlement procedures foster the consultations and dialogue necessary to even begin resolving differences.

Both of these functions are important not only to the reduction of tensions between nations but also to the evolution of the GATT. To be relevant, the GATT must evolve to meet demands of the current trading environment, many of which were not envisioned by the original authors. Thus, multilateral efforts, such as successive rounds of multilateral trade negotiations, have attempted to better define and establish some discipline for a host of domestic policy actions which heretofore were not of paramount importance because of high tariffs. Creation of the GATT Committee on Trade in Agriculture reflects

the desire of contracting parties to see an evolution of the GATT. It is in the U.S. interest to support and push for the successful conclusion of such endeavors.

The United States has initiated and supported calls for a new round of multilateral trade negotiations. Based on the numerous trade disagreements that exist, the necessary preparation for formal negotiations has been substantial. There appears to be some consensus that work in the agriculture and safeguard areas has progressed as far as it can go without commencing formal negotiations in a new round. A new round of trade talks should include agricultural and manufactured goods and service trade to allow maximum latitude for exchanging concessions and thus provide greater likelihood of success. Limiting the negotiations to one group or the other assures that some nations will have little interest in participating in talks in which they have much to lose and little to gain. Including all sectors gives every country, not just limited interest groups, something to bargain for and it likewise gives every country something to offer in return for concessions.

The disintegration of the GATT system would not result in any apparent gains for the United States, which like any other country, should expect retaliation for protective measures taken outside of or inconsistent with agreed upon trading rules. When that occurs, efficient export industries are penalized in order to benefit less efficient industries receiving protection. The United States can and should pursue agreements in the GATT which lay out general principles and objectives to buttress the development of competitive industries and increased trade.

Frustration with the seeming inability of the multilateral trading system to solve problems has led to case-by-case resolution among like-minded parties. This may solve problems in the short run, but at the cost of weakening the multilateral system. With the strongest nations "calling the shots" and given overriding domestic concerns, especially in steel and agriculture, the long-run consequences of this trend for the United States and the trading community as a whole are unclear. Even if unilateral protectionist U.S. actions are perceived to be in the best interest of the United States, similar actions taken by other countries in response may result in economic loss for everyone in the end.

AGENCY COMMENTS AND OUR EVALUATION

Commerce officials noted their disagreement with what they perceived as generally pessimistic conclusions about what the GATT can do to resolve problems in steel, services and agricultural trade. They further stated that these areas are "at the heart of U.S. proposals for improving the GATT under the

aegis of a new round." We do not disagree with the latter point and, in fact, throughout the report we support the idea that it is in the U.S. interest to continue to push for the evolution of the GATT to meet the changing demands of the current trading system. We view our assessments as realistic rather than pessimistic. We conclude that U.S. interests are served by continued support of the GATT, but we wish to avoid false expectations that revolutionary changes can be made in the GATT which would quickly or easily solve the problems discussed in this report.

APPENDIX I

United States Senate

COMMITTEE ON FOREIGN RELATIONS

WASHINGTON, D.C. 20510

July 25, 1983

Mr. Charles A. Bowsher
Comptroller General
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Bowsher:

I am writing to request that the GAO undertake a study of the comparative trading practices of the United States and its major trading partners.

American trade policy has become not only a central issue in the national debate about the state of the domestic economy but is a subject of growing contention with our European and Japanese allies. Despite evidence of economic recovery, unemployment will remain high for several years, thus insuring that trade policy will remain a bone in America's throat. With 1984 an election year, the intensity of the arguments regarding all aspects of foreign trade will intensify.

Few who participate in the frequently heated discussion about trade policy openly advocate protectionism. A different case is advanced. Organized labor in general, as well as numerous spokesmen for business and some representatives of the academic community, insist that the open trading system, exemplified by the General Agreement on Tariffs and Trade, served the world well over the last 30 years and while the GATT principles and objectives remain laudable, they are today no longer relevant or achievable. A recurrent theme of these critics is that while they basically favor "fair trade," as the GATT system presupposes, infractions and invasions of the principles and rules by other nations are at the root of America's trade problems. Industries have suffered; and the ranks of the unemployed have steadily grown due to the unfair practices of our trading partners. They make a further point. The GATT system has become so riddled with exceptions that it no longer can be described as an open trading system based on agreed and enforceable rules. Indeed, there has emerged a new charge that the GATT machinery, designed to carry out investigations, judge and settle disputes, is itself ineffective and unfair.

I would like to have for the use of the Subcommittee on International Economic Policy an analysis by GAO of the "fairness" contention as outlined above. This study should examine the practices of both our major trading partners and of the United States. The GAO should investigate as well the related charge that the GATT system is so riddled by exceptions and so skewed against liberal principles that it no longer can be reasonably expected to serve

the purposes for which it was originally designed. The study should also consider trade in services, although recognizing that in general no agreed rules cover this area. Nonetheless, because of the reiterated charge of "unfair" discrimination against United States services, an appraisal of this specific issue would be an appropriate part of the inquiry.

I would like to receive an early preliminary report to be followed by a more complete study. I assume that the GATT secretariat will have available considerable pertinent data, and that the GAO will also wish to draw on the work of various American research centers and consult with trade experts in the academic community.

Casimir Yost, Staff Director for the International Economic Policy Subcommittee of the Senate Foreign Relations Committee, is prepared to discuss further the scope of this effort with whomever you designate. He can be reached at 224-4192.

With best wishes,

Sincerely,

Charles McC. Mathias, Jr.
Chairman, International Economic
Policy Subcommittee

CMM:cay

RELATED GAO REPORTS

"Emerging Issues in Export Competition: The Case of the Brazilian Market," forthcoming.

"The Difficulty of Quantifying Non-Tariff Measures Affecting Trade," forthcoming.

"The International Agreement on Government Procurement: An Assessment of its Commercial Value and U.S. Government Implementation," GAO/NSIAD-84-117, July 16, 1984.

"Assessment of Bilateral Telecommunications Agreements with Japan," GAO/NSIAD-84-2, October 7, 1983.

"Implementation of Trade Restrictions for Textiles and Apparel," GAO/NSIAD-84-18, November 4, 1983.

"Benefits of International Agreement on Trade Distorting Subsidies Not Yet Realized," NSIAD/GAO-83-10, August 15, 1983.

"International Insurance Trade--U.S. Market Open: Impact of Foreign Barriers Unknown," ID-82-39, August 23, 1982.

OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

June 7, 1985

Mr. Frank C. Conahan
Director
National Security and International
Affairs Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

Thank you for your letter to Mr. Brock of April 18, affording USTR the opportunity to comment on your draft report "United States Participation in the Multilateral Trading System: The Value of the General Agreement on Tariffs and Trade." We were grateful for the opportunity to provide and discuss detailed or technical comments and suggestions, and will therefore provide in this letter only more general comments and points of emphasis.

Those responsible within USTR for the various issues discussed in the report have shared the view that the report is in general well done, offering a number of useful insights. As you yourselves note, the specifc problems discussed are among the areas which highlight deficiencies, rather than virtues, of the GATT. Nevertheless, at a time of considerable frustration and sensitivity with the shortcomings of the trading system, your effort to analyze the reasons for the problems provides useful balance to those who would simply blame or dismiss the GATT. While we do not agree with all of your judgements or fully share your perspective, we believe you have adopted a valid analytical approach in distinguishing among problems with the rules of the GATT in the areas addressed, and problems of compliance. Your analysis of obstacles to securing improved rules and improved compliance is also timely, though in certain respects we see improvements as both more necessary and more feasible than does the draft report.

The following are our principal reservations regarding specific issues addressed.

Agriculture

In the agricultural section, we believe that some of the commentary is unbalanced, particularly in the comparative assessment of U.S. and EC policies and actions. For example, we think it should be noted that subsidized U.S. export credits were introduced largely as a reaction to an institutionalized and far

more massive EC program of export subsidies and food aid programs should not be considered comparable to subsidized commercial exports. The draft report also seems to understate the trade distortions of large national subsidies in the EC, while appearing to give undue weight to lesser "miscellaneous" U.S. subsidies.

As we noted in oral discussions, we have a similar concern that the report equates the U.S. position on the wheat flour case with that of the EC in the Pasta dispute. The Wheat Flour panel report left no country happy, since it found as a factual matter that the EC had used export subsidies to become overwhelmingly the world's largest exporter, but as a legal matter the panel reached no conclusion on the central issue. There was no significant support for adoption of that report. The Pasta report was blocked by the EC and certain other countries because they could not accept the panel report's clear legal conclusions regarding practices they had maintained for an extended period.

Services

With regard to services, we believe that your analysis of the ongoing work on services in GATT and the OECD is a useful contribution to that exercise. It has assisted in sharpening the questions on some of the more complicated issues, such as national treatment and the legal problems of amending GATT Articles to extend to these sectors. Its discussion of the telecommunications sector, with its structure and historical developments and areas of geographic restriction has assisted in focusing this issue.

However, we would disagree with several important observations on services, the most significant of which is that trade in services has flourished in the absence of any international rules. While statistics on services are poor, our information is that U.S. exports of services have grown by only 1% in the last ten years. A reason for this stagnation is the large number of restrictions imposed by foreign governments, and this has been evidenced by widespread complaints we have received from service industries.

On the general question of tactics, you have suggested that the contentiousness of this issue, particularly with the LDC's, might involve too great a political cost in other trade areas; and, as an alternative to a GATT understanding, a "statement of intent" would be a substitute. While as you have pointed out, a services understanding may require less conventional means, we see little practical value to the statement of intent. We view our future export opportunities in services as simply too vital to accept a non-binding political statement by countries. The current discussions launched in the GATT in January of this year

should sharpen and clarify the complicated issues affecting services. Reservations and sensitivities exist, but a consensus is building and we have greater confidence than is expressed in your report that countries will accept the inevitability of services in GATT.

To summarize, your analysis points to a number of pitfalls we must deal with in negotiating a GATT understanding on services. Where we seem to differ is on the importance of this issue to international trade and the ability to achieve tangible results as a consequence of such an understanding.

Safeguards and Steel

We agree with the view that strengthened international safeguard rules are needed. We believe it would be desirable to reach an international understanding on safeguards on an accelerated basis, even before other elements of a new round of negotiations may be achieved.

We have a different perspective than that taken in the report, however, on the recent U.S. actions on steel. The President's program has neither the purpose nor the effect of cartelizing steel trade. The program is temporary, of a finite duration, and was brought about by unprecedented surges in unfairly traded imports and diversion because of closed foreign markets. Given the widespread evidence of dumping and subsidization of steel in our markets, we question that any broad assumption of greater efficiency among foreign suppliers is warranted. We would add that the U.S. program does not cover steel imports from all countries.

The program is enforceable only upon the condition that the President annually determine that the major U.S. steel companies, taken as a whole, have reinvested substantially all of their net cash flow from steel operations competitive, including the retraining of workers, and have taken sufficient action to maintain their international competitiveness. In addition those companies will normally be required to commit 1% of their net cash flow to worker retraining.

As was discussed orally in more detail, the tone of some of the commentary in the draft seems to suggest that the EC's more restrictive import program adopted in the 1970's is somehow preferable to the U.S. program because of the greater degree of government intervention in EC restructuring decisions. We doubt such a proposition. Structural adjustment is clearly desireable, and that objective is part of our program. However, we believe that it is preferable that the decisions on investment and restructuring be left to the private sector to the maximum extent possible, rather than having the government dictate such decisions as which capacity should be cut, which plant revitalized or which closed.

APPENDIX III

I hope that these comments and those provided orally will be helpful to you in preparing your final report. We would be pleased to answer any questions you may have.

Sincerely,

CLAUD L. GINGRICH
General Counsel

CLG:rcc

APPENDIX IV

United States Department of Agriculture
Foreign Agricultural Service
Washington, D.C. 20250

MAY 20 1985

Mr. J. Dexter Peach
Director
Resources, Community and
Economic Development Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

The following are the comments of the Department of Agriculture on the draft report of the General Accounting Office, "United States Participation in the Multilateral Trading System: The Value of the General Agreement on Tariffs and Trade" (Code 483391).

This is an unusually thoughtful report on the ability of the General Agreement on Tariffs and Trade (GATT) to moderate trade problems and settle disputes. We agree completely with the central conclusion of this report:

> It is within a framework of government intervention in domestic economies that the GATT is being called upon to provide guidelines and settle disputes over countries' trade behavior. Not surprisingly, the GATT has not been able to control government actions nor settle all disputes between trading partners. But to judge the GATT on its ability to force governments to change their behavior is to judge it for failing to achieve objectives it was never intended nor given the wherewithal to achieve.

We further agree that the basic objectives of the GATT, which are to foster freer trade and settlement of disputes, are in harmony with U.S. national interests. As the report says, "The disintegration of the GATT system would not result in any apparent gains for the United States....The United States can and should pursue agreements in the GATT which lay out general principles and objectives to buttress the development of competitive industries and increased trade."

In short, the report acknowledges the weaknesses of the GATT and states the answer is to strengthen the system, not to abandon it.

While largely consistent with Administration policy, the report is on weaker grounds in stating "The challenge before the United States and other contracting parties, then, is to make every effort to negotiate bilateral arrangements in accordance with GATT principles and work to bring these into GATT's multilateral framework and discipline." Further on, the report is rightly more cautious: "Frustration with the seeming inability of the multilateral trading system to solve problems has lead to case-by-case

resolution among like-minded parties. This may solve problems in the short run, but at the cost of weakening multilateralism. With the strongest nations 'calling the shots' and given overriding domestic concerns, especially in steel and agriculture, the long-run consequences of this trend for the United States and the trading community as a whole are unclear." The report would also do well to acknowledge the fact that there are limits to the bilateral approach. For example, no agreement on greater discipline over the use of export subsidies will work unless both the United States and the European Community are a party to it. Neither is it likely that an agreement in this area between the United States and the European Community alone could work without the constructive participation of other major exporters.

The report is particularly useful in pointing out that the GATT is ill-equipped to deal with the kinds of problems which face industries like steel and agriculture. It may be possible, and we should try, to design more effective safeguard rules -- rules for the imposition of temporary import relief -- and more effective ways of dealing with agricultural problems. But international trading rules cannot be expected to solve problems of long-term structural adjustment in basic economic sectors, nor even to help speed up the adjustment process unless the countries concerned believe such accelerated adjustment is in their national interest. Reasons given for fostering a non-competitive steel industry are very similar to the reasons given for fostering a non-competitive agriculture. The most that can be expected of the GATT in this context is that it help to reduce the most blatantly unfair trade practices by which the consequences of uneconomic policies -- usually excessive production capacity -- are passed to the international market.

Comments on other specific points are:

(Now pp. iii, 12 and 26) Pages V, 19 and 42. The report correctly notes that virtually all governments intervene in agricultural markets. The report misses the point that the degree of intervention may be a significant factor in the ability of a country to meet its agricultural income and adjustment objectives without disrupting trade, and hence in the ability of the country to accept stricter GATT obligations. U.S. and EC policies contrast sharply in this regard.

(Now p. 8) Page 14. We do not regard the GATT Committee on Trade in Agriculture as "permanent". Its current work program was set out in November 1984 to be continued on a year to year basis if the situation warrants it.

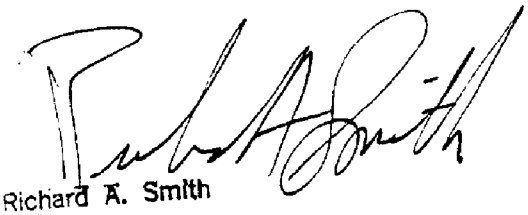
(Now p. 13) Pages 20 and 21. Market position is not really a determinant of government policy. Exporting countries clearly work to establish and keep customers. However, export programs are designed more to dispose of available supplies than to gain a predetermined share of the world market.

(Now p. 18) Page 30. The paragraph on Section 22, while accurate, is not relevant to the discussion on wheat.

(Now p. 19) Page 31. The discussion of EC wheat policies makes a comparison with EC policies for wine and dairy products. It would be better to delete this comparison. It is not necessary to the discussion and is misleading since the same comparison can also be made with a number of other products.

(Now p. 36) Page 60. While it is true that United States agricultural exports have been hindered not only by the trade practices of other countries but also by exchange rate changes, foreign indebtedness, and our own farm programs, the impact of each of these factors differs significantly from product to product and the existence of these other factors does not change the need to make the GATT more effective in dealing with subsidies and restrictive trade practices. Moreover, it is arguable whether U.S. use of subsidies and restrictive trade practices undercuts our efforts to obtain stronger GATT rules. The critical question is whether U.S. producers can compete if restrictions and subsidies are negotiated away in exchange for the removal of the unfair trade practices of other countries.

Sincerely,



Richard A. Smith
Administrator

APPENDIX V

UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Administration
Washington, D.C. 20230

MAY 30 1985

Mr. J. Dexter Peach
Director, Resources, Community, and
Economic Development Division
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

This is in reply to GAO's letter of April 18, 1985, requesting comments on the draft report entitled "United States Participation in the Multilateral Trading System: The Value of the General Agreement on Tariffs and Trade."

We have reviewed the enclosed comments of the Under Secretary for International Trade and believe they are responsive to the matters discussed in the report.

Sincerely,

Kay Bulow

Kay Bulow
Assistant Secretary
for Administration

Enclosure

APPENDIX V

UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for International Trade
Washington, D.C. 20230

MAY 23 1985

Mr. J. Dexter Peach
Director
United States General
Accounting Office
Washington, DC 20548

Dear Mr. Peach:

I have read your draft report entitled "United States Participation in the Multilateral Trading System: The Value of the General Agreement on Tariffs and Trade" with interest and offer the following comments.

The draft report provides a valid assessment of the GATT's performance in those areas it chose to address. In the case of agriculture, for example, we share the view that the GATT has been generally ineffective for the reasons cited. At the same time, however, the overall report suffers from the limitations imposed on its coverage. It is somewhat difficult to generalize about the GATT's effectiveness based solely on the material contained in the report. Had time and resources permitted a broader view of the GATT's operations, including those areas, like tariffs, where the GATT has traditionally worked well, the report's general conclusions would probably have been more optimistic. In retrospect, a sacrifice of some detail in the extensive treatment of steel and wheat, for example, for broader product and issue coverage would have afforded a more complete assessment of the workings of the GATT system.

The report correctly points out that, despite certain recognized successes, there are important areas of international trade not addressed by the GATT, such as services; there are areas which are insufficiently regulated by the GATT, such as agriculture; and there are areas where the GATT has not been able to prevent the erection of industry protection outside the GATT safeguard provisions, such as steel and footwear.

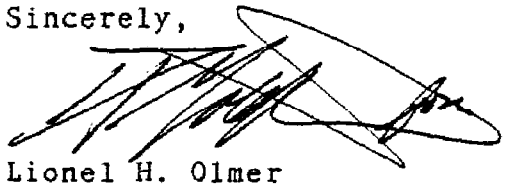
We differ, however, with the report's conclusions about what can be done about these problems. While the study correctly points out that many of the perceived shortcomings of the GATT derive from the fact that the system was not designed to deal with some of the problems we face in the 1980s, we believe the logical extension of

this point is to seek to make the GATT relevant to these problems. It is precisely for these reasons that the Administration is pressing for a new round of multilateral trade negotiations aimed at broadening and strengthening the rules of the GATT system. A number of the areas targeted in your paper, including how the GATT treats problems in agriculture, services and basic industries, are at the heart of U.S. proposals for improving the GATT under the aegis of a new round. Further, we believe the GATT can be expanded to address trade problems in areas not contemplated by the system's framers, including counterfeiting, high technology, and trade-related investment as well.

Going beyond the specific GATT discussion, the draft report's treatment of the effectiveness of existing antidumping and countervailing duty laws concludes, on the basis of examining one industry (steel), that they are "generally considered inadequate." We disagree with this conclusion. U.S. industry antidumping and countervailing duty petitions filed each year with the Department of Commerce have more than doubled over the past five years. Similar substantial filing increases covering a wide variety of industries have been experienced by other GATT signatories to the Antidumping and Countervailing Duty codes. While these laws, by themselves, cannot solve the larger problem of structural adjustment, many industries nevertheless consider them a worthwhile avenue to pursue to achieve elimination of unfair competition.

In addition to these general remarks, I have attached some more specific, technical comments on the report which elaborate on a number of these themes. Thank you for the opportunity to review it.

Sincerely,



Lionel H. Olmer

GAO note: Commerce's technical comments are not included in this appendix; however they were considered and incorporated in the report where appropriate.

APPENDIX VI

United States Department of State

Comptroller

Washington, D.C. 20520

May 22, 1985

Dear Frank:

I am replying to your letter of April 18, 1985 to the Secretary which forwarded copies of the draft report: "United States Participation in the Multilateral Trading System: the Value of the General Agreement on Tariffs and Trade".

The enclosed comments on this report were prepared in the Bureau of Economic and Business Affairs.

We appreciate having had the opportunity to review and comment on the draft report. If I may be of further assistance, I trust you will let me know.

Sincerely,

Roger

Roger B. Feldman

Enclosure:
As stated.

Mr. Frank C. Conahan,
Director,
National Security and
International Affairs Division,
U.S. General Accounting Office,
Washington, D.C. 20548

United States Participation in the Multilateral Trading System: The Value of the General Agreement on Tariffs and Trade

(Now p. 94) This is a good report; we agree with the GAO's conclusion on page 150 that "multilateralism and the principles contained in the GATT serve the United States well," and that "there remains a harmony between U.S. national self-interests and the underlying principles of the trading system." The key test in the near term will be the success or failure of the next round of trade negotiations.

We have a few specific suggestions for improvement of the draft report:

(Now p. 44) Page 70, end of the second paragraph: the recently concluded U.S.-Israel Free Trade Area has a declaration on liberalizing services trade; talks with Canada in the services area are still at a very early stage.

(Now p. 46) Page 75: the discussion of "conditional application of MFN" coupled with the notion of preferential treatment is confusing. Perhaps the paragraph could be dropped after moving its opening sentence to the end of the preceding paragraph. Please note that the U.S. does not subscribe to the UNCTAD Liner Code.

(Now p. 69) Page 112, the checklist of government assistance programs: The list should be cross-checked with Federal Register notices of actual Commerce findings involving steel. Upon filing cases, petitioners often allege every government assistance program available in a country, whereas Commerce often determines that a given industry only benefits from some of the available programs.

(Now p. 73) Page 118: Mention might also be made of the special treatment for environmental expenses of steel producers set out in the 1981 Tax Reform Act.

(Now p. 74) Page 120: The importance of the closed nature of the Japanese market seems understated. It is misleading to state that U.S. and EC restrictions are "the most important determinants" of trade flows; Japanese purchasing practices are very important determinants.

(Now Table 7, p. 76) Table 8 on page 121: the entry describing a VRA 1982-85 between the U.S. and the EC confuses two separate arrangements. The carbon steel arrangement runs from 1982 to 1985, the pipe and tube arrangement from 1985 to 1986.

(Now p. 77) Page 123: the statement in the middle of the page that "other exporters...feel pressured to participate in this market allocation process or run the risk of losing access...entirely," describes a very secondary motivation. The smaller exporters that have approached the U.S. to negotiate restraint agreements have all done so in reaction to antidumping and countervailing duty cases.

Our European Bureau has provided us with the following observations:

This is a fine report. We agree with the positive conclusion on the importance of the GATT to the U.S. We also picked up a few relatively minor points that could be improved:

(Now p. v) Page VII of Digest - as noted in the text, problem for steel industry is also drop in demand. If demand continued to grow LDCs would be less of a problem in short run.

(Now p. vi) Page VIII - GATT safeguard code always intended to address temporary relief. GATT does not sanction permanent relief. Must be an exception or a special agreement like MFA.

(Now p. 4) Page 6 - Sentence in middle of page beginning with "Likewise" is misleading. The only issue is whether competition is unfair to domestic producers. GATT, in this case, is not concerned about advantage to consumers of obtaining subsidized steel.

(Now p. 12) Page 19 - Last sentence in paragraph 19 should read "element of the EC's Common Agricultural Policy (CAP) which adversely affect U.S. trade."

(Now p. 26) Page 43 - The first sentence of the middle paragraph should begin "The EC's "

(Now p. 28) Page 47 - The last sentence in the first full paragraph is not clear.

(Now p. 35) Page 59 - The following words should be deleted from paragraph 1: "present...because."

Denis Lamb
Deputy Assistant Secretary
for Trade and Commercial Affairs
Economic and Business Bureau

(483391)

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