U.S. Policy Towards Trade Co-operation

Among Developing Countries

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I. Introduction

Questions relating to trade policy have become central to U.S. relations with the developing world. Developing countries are increasingly preoccupied with the critical role exports can play in economic development and are seeking new ways to improve their export performance.

Developed country and U.S. policies have a greater bearing on developing countries' efforts to expand exports to developed country markets than on developing countries' efforts to expand trade among each other. Expansion of trade among developing countries is primarily determined by the developing countries' own initiatives and trade policies. However, it is apparent that the U.S. as an important trader in the world scene and an aid donor with a great stake in the development efforts of developing countries has a strong interest in, and can have an impact on, the direction of their efforts to increase trade among each other.

The purpose of the present paper is to discuss U.S. policy towards developing countries' efforts to promote expansion of trade among each other. I will be concerned primarily with U.S. policy issues that have been raised by specific developing country cooperative efforts in the recent past. I will not deal with the perhaps far more important question of U.S. policy towards developing country efforts to expand exports to the U.S. market. I will discuss that question only insofar as it has a bearing on the U.S. attitude on trade arrangements among developing countries. Finally, I will make an effort to discuss U.S. policy in the context of recent efforts to promote intra-regional trade among Asian countries.

II. Trade Expansion, Economic Co-operation and Regional Integration: A Summary View.

Efforts by developing countries to increase trade among themselves must be viewed against the general framework of attempts at economic co-operation. Economic co-operation has commonly involved co-operation on trade matters, on a regional or subregional basis with one important exception to be noted below. Trade co-operation in turn has generally meant the granting of preferential treatment on imports. This has led to efforts to establish free trade areas or customs unions in Africa, Central and South America and the Caribbean with the ultimate objective of economic integration. In fact in almost all cases reduction of trade barriers did not cover the full range of traded items.

Some of the groupings where preferences covered substantially all the intra-group trade, such as the Central American Common Market and the East African Common Market, have been shaken recently by political disputes among their members which have had the effect of loosening significantly the ties between members and the re-imposition of restrictions on intra-group trade.

Others such as the LAFTA have encountered difficulties which have forced them to postpone efforts to create a region wide free trade in the immediate future. A number of LAFTA members (the Andean Group) are pushing ahead with plans for a limited free trade area while the remainder are exchanging preferences on a number of commodities.[1/]

In most instances co-operation in trade matters has been buttressed by efforts to develop a co-ordinated investment policy and the establishment of regional development banks. The rationale for these efforts has been:

(a) the belief that the benefits of economic integration to developing countries do not arise so much from the expansion of trade based on existing productive structures. Rather that the main benefit would result from the planned expansion of trade based on new production units which are subject to economies of scale and hence cannot operate efficiently within the limits posed by individual country markets;

(b) that tradé is impeded by the paucity of regional infrastructure.

This attitude has led to the establishment of development banks associated with specific free trade areas or common markets such as the Caribbean Development Bank, the Central American Bank for Economic Integration (CABEI) or the East African Development Bank for the

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1/ Although negotiations to arrive at a common LAFTA list of trade concessions are scheduled for 1974.

purpose of financing of projects of area-wide interest. Similarly all three regional development banks have committed considerable funds for the undertaking of projects related to economic integration efforts in Latin America, Africa and Asia.[1/]

Unlike other regions, in Asia up to now most of the cooperative efforts have eschewed extensive cooperation on trade matters. In the Regional Cooperation for Development group (RCD) the most important progress has been made in setting up joint purpose enterprises designed to eventually supply all the member countries. In South East Asia the prevalent view had been, and may still be, that because of the existing low degree of regional economic interdependence, integration will be hard to achieve unless some degree of coordination of economic policies is first agreed to. Specifically, it has long been argued that national investment plans must first be harmonized so as to insure a future distribution of industry within the region which will be conducive to an efficient division of labor and intraregional trading patterns.[2/] It is interesting to note in this context that of the recent ECAFE proposals the ones on direct trade cooperation have apparently received more limited support than the ones on a clearing union whose effect on expanding intraregional trade is likely to be quite small.

1/ The IDB in 1969 committed $400 million to such projects.

2/ The very recent progress on trade cooperation in the ASEAN is probably the most significant break with this tradition.

Finally, I would like to note two major cooperative efforts involving countries not in the same region. The first is the Tripartite agreement among India, UAR and Yugoslavia to reduce tariff rates by 50% on an extensive list of commodities of trading interest in the three countries.

The second is the recently signed protocol for a more extensive agreement on simple trade preferences involving close to half a billion dollars in trade among sixteen developing countries and apparently patterned on the Tripartite.1/ At the time of this writing the details of the latter agreement had not yet been made public.

These agreements are unique not only in that they involve countries in different regions, but, perhaps for that very reason, they have no provisions for significant economic cooperation beyond that involved in the exchange of tariff preferences for the participating countries.

III. U.S. Policy on Economic Cooperation Among Developing Countries

A. Objectives

To understand fully the U.S. attitude on economic cooperation among developing countries it is necessary to clarify as much as possible the multiple objectives which the U.S. Government is pursuing explicitly or implicitly through its policy. In the discussion to follow no effort is made to attach weight to any of the objectives enumerated. X

1/ The countries involved are Brazil, Chile, Egypt, Greece, India, Israel, Korea, Mexico, Pakistan, Peru, Philippines, Spain, Tunisia, Turkey, Uruguay and Yugoslavia.

1. Economic Development

Acceleration of economic development is undoubtedly x a major consideration of all U.S. policy towards developing x countries. It is most tangibly expressed by the considerable volume of U.S. Government assistance provided through bilateral and multilateral programs. In the context of economic co-operation efforts it implies a concern about the effect of these efforts on the economic development of both participating and nonparticipating developing countries.

2. Safeguarding of U.S. Economic Interests

In the context of economic cooperation this involves consideration of the effect of the arrangement on U.S. trade and/or investment in the participating countries and elsewhere.

3. Honoring of U.S. International Commitments and Obligations

This involves an examination of the implications of a given cooperative arrangement among developing countries in light of U.S. international commitments.

4. Political Objectives

This often undefined and elusive catchall phrase can be thought to include all considerations other than the ones mentioned in (1-3) above which play a role in formulating U.S.

policy towards an agreement involving economic cooperation among developing countries.

B. Past Policy

In light of these objectives, the United States in the past has found it easy to support most economic cooperation efforts of developing countries. In particular the U.S. has supported (a) various regional cooperative efforts which do not involve cooperation in trade, (b) cooperation involving trade when such cooperation has been cast in the context of regional integration through the creation of customs unions or free trade areas.

Examples of U.S. support for the first type of cooperative effort abound. The U.S. has contributed $952 million to the IDB, and has participated actively in the work of other cooperative efforts such as the Asian Development Bank, the African Development Bank and CABEI.[1/]

U.S. support for such efforts is easy to explain: The institutions finance activities that transcend national boundaries and constitute an effective means of channeling resources to individual countries in the region. As such they

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1/ The U.S. has made loans to CABEI amounting to more than $100 million for projects with a regional focus.

assist in the development efforts of the participating developing countries and contribute to the U.S. policy objective of promoting economic development.

At the same time these cooperative efforts have no adverse effects on nonparticipating developing countries and limited effect on U.S. economic interests. Their activities do not conflict with other U.S. international commitments and have posed no political problems that could weaken U.S. support.

When cooperation among developing countries involves trade, the considerations that guide U.S. policy become far more complex. The complications arise from the fact that trade cooperation among developing countries fundamentally involves the extension of preferential treatment to commodities traded among the participating countries. Trade preferences among a group of developing countries in turn raise the possibility that (a) trade of other developing countries and of the

U.S. would be adversely affected, (b) that the preferences may not be in the best economic interest of the countries themselves, (c) that they would be incompatible with existing international commitments of both the U.S. and the developing countries.

The current U.S. attitude towards trade arrangements among developing countries can be summarized as follows:

(a) The U.S. considers that increased trade among developing countries can contribute to their development efforts.

(b) Increased intra-developing countries' trade should be achieved by non-discriminatory reduction in overall barriers to trade, consistent with the MFN principle.

(c) Deviations from the MFN principle must be consistent with GATT provisions under Article XXIV which calls for the creation of customs unions or free trade areas. Such arrangements are considered to be the most effective means for the undertaking of economic co-operation and integration for groups of developing countries.

(d) The U.S. supports efforts of economic integration consistent with Article XXIV of the GATT. However, it has serious doubts about the usefulness and effectiveness of regional or nonregional preferential arrangements among developing countries which fall short of the commitments required under Article XXIV.

The rationale of the present U.S. position is fairly simple: The U.S. supports economic integration involving the creation of a customs union or a free trade area over limited preferential arrangements because the former are more likely than the latter to lead to a net increase in world trade and economic welfare.

Customs union and free trade areas are also thought to be better than limited preferential arrangements because they are more likely to increase economic growth of the participants. This will lead to increased imports from all countries, thereby compensating for any trade diversion effects, both with respect to the U.S. and other developing countries.

Current U.S. policy also considers that regional efforts offer the best chance for developing countries' cooperation. This view is based on the belief that the solidarity necessary for political commitments required in successful integration can best be built on a regional foundation.

From the legal standpoint, the MFN principle has been and remains the cornerstone of U.S. trade policy. Deviations from this principle, in theory, are acceptable only in carefully defined situations such as under Article XXIV of the GATT which permits preferential arrangements when they involve the formation of customs unions or free trade areas, or in special cases when after detailed scrutiny a waiver under GATT Article XXV is provided. While undoubtedly the U.S., in practice, for balance of payments reasons or under pressure from domestic industry interests may have deviated from GATT principles, it is undeniable that adherence to the MFN clause has had a pervasive influence on shaping U.S. commercial policy over time.

In pursuit of this policy the U.S. has supported regional integration efforts among developing countries in South and Central America and Africa. With respect to trade little has been done in direct support of the developing country arrangements. Rather the emphasis has been in bolstering institutions such as CABEI, whose activities are designed to promote regional industrialization with increased trade resulting from the preferences granted under the integration agreement. At the same time, of course, the U.S. has supported such agreements in the context of GATT.

However, the U.S. has generally objected to preferential agreements which fall short of meeting GATT Article XXIV criteria. This has been done not on strict legalistic justifications but rather in the belief that the GATT stipulations embody sound economic criteria. This was manifested in the U.S. position towards the Tripartite agreement. In GATT the U.S. voiced its opposition to the arrangement on the grounds that it did not envisage the creation of a customs union or free trade area. In the end it went along with GATT approval of the agreement stating that the GATT decision in its view was intended to meet the requirements of Article XXV:5 of GATT calling for a general waiver to the MFN under special circumstances. In many respects the reluctant acceptance by the U.S. was dictated by political considerations and specifically a desire not be oppose an agreement which was felt to have little economic merit but reflected a strong expression of political solidarity among a small but important group of developing countries.

IV. Issues Raised by the U.S. Position

The existing U.S. position on economic co-operation efforts of developing countries has made it possible for the U.S. to extend considerable support to these efforts. Yet, there is reason to believe that this quite simple policy outlined above cannot adequately cope with the complex issues raised by economic co-operation efforts of developing countries, particularly in the field of trade.

The basic problem is raised by the fact that conditions in developing countries today make it difficult to reach agreements which are truly consistent with the establishment of a customs union or free trade areas. The second problem is related to the first and has to do with the relevance to developing countries of the simple trade criteria of judging preferential agreements implicit in the rules of GATT. Finally, the principle of regional co-operation is being severely tested by the existence of large differences in the economic development of countries within the same geographic region. This section will analyze these issues and the bearing they have on existing U.S. policy towards economic co-operation which involves preferential trade arrangements.

A. Industrialization and Integration

Few would argue that economic development involves industrialization. 117
With few exceptions developing countries have pursued industrialization primarily by means of import substitution. Import substitution industrialization, in turn, implies the establishment

of trade controls. While economists have consistently argued that trade controls are the most efficient means of promoting industrialization only in a very narrow and well defined set of circumstances, current practice in developing countries usually involves indiscriminate protection at high levels for indefinite time periods often by means of quotas and absolute bans on imports.

These practices have been well documented in recent literature [2, 7]. The conclusions from these analyses point to several developments inimical to the objectives of developing countries:

(a) Industries have been established which operate at less than optimum scale and/or at low levels of capacity utilization.

(b) The shielding from foreign competition has reduced, if not eliminated, incentives to increase productivity.

(c) The provision of sheltered markets and the structure of domestic protection has generated a serious bias against exports.

Preferential agreements among developing countries can be used to open up each other's markets, to increase the scale of operations used, and the degree to which existing capacity is utilized. More efficient scale of operations and increased capacity utilization will tend to reduce costs and make industries in developing countries more viable in international competition. Obviously, the degree of competition also increases if industrialization cum protection is undertaken in a larger market composed of many developing countries than if each one pursues its own nationally oriented industrialization effort behind trade barriers. Thus, preferential agreements offer the opportunity for developing countries to pursue a more rational industrialization policy in the context of a larger market, a policy which would inhibit the phenomenon common to many developing countries of attempting to establish a full range of industrial activities irrespective of relative cost.

In addition, developing countries' efforts to expand exports to foreign markets are often stymied by their lack of experience in selling abroad, inadequate marketing techniques, and general ineffectiveness resulting from operating for a long time solely in a protected market. Preferential arrangements with other developing countries can prove useful to exporters who may be able to gain the experience necessary to compete internationally. They can reorient themselves towards foreign markets, develop techniques of marketing and market penetration while not exposed, for a period, to the full rigor of head-on competition from developed country producers. Such arrangements can thus be viewed as providing an opportunity for developing countries to expand their export base, and to bring their hitherto sheltered economies in contact with at least some international competition.

Yet, it is ironic that while preferential agreements offer an opportunity for developing countries to industrialize more rationally, the objective of national industrialization poses often insuperable problems towards establishment of customs unions or free trade areas consistent with GATT Article XXIV. The problems stem fundamentally from an inability to undertake the commitments necessary to liberalize trade fully. They are compounded by differences in the level of development and the level of protection of various developing countries.

A commitment completely to liberalize trade among developing countries depends on the undertaking of commitments to coordinate policy in a large number of other areas: "If, for instance, no firm commitments of harmonization are entered into regarding matters such as the tariff and trade policy toward third countries, there might be a reluctance to accept the elimination of internal trade barriers. Yet, as long as the developing countries concerned trade overwhelmingly with third countries and as long as the possibilities of supply from each other are inadequate, the negotiation of harmonization commitments will run into great resistance, even more in cases where the countries concerned have different preferential trade links with different third countries." [12 p.13]

Also, problems will be encountered because of the differing relative emphasis on import substitution as a means of promoting industrialization. Some countries such as Korea and Taiwan have had a much more outward looking industrialization policy than others in the Asian region. Agreements designed to create common trade barriers among countries with widely different existing trade control structures require the kind of internal adjustments which developing countries cannot easily make.

"Similarly, co-ordination of tariff policies towards third country imports requires that developing countries also co-ordinate their incentive measures involving the promotion of industrial development through the provision of tariff rebates towards imports of other fiscal incentives. In general, as long as the countries concerned have not agreed upon a regional investment policy they might hesitate to abandon trade barriers between them because of a fear that new investments would preferably go to the partner country. Yet, if there are doubts about the partner's willingness to face squarely the prospect of a unified economic area, the elaboration of a joint investment policy might be so slow that the current investments would actually be made with little regard for the regional prospects; as a consequence vested interests would be created that would constitute further obstacles to the trade liberalization effort." [12 p. 13]

The ease of undertaking these commitments depends a great deal on the degree of economic interdependence already existing among the group of countries prospective members in preferential trade agreement. In Europe, where the degree of economic interdependence prior to the creation of the EEC was substantial, significant problems were and are still faced regarding the important commitments necessary to implement a customs union. In most developing countries there is at present little economic interdependence, the existing trade channels run overwhelmingly towards developed countries, and to start trading with business partners in other developing countries means dealing with numerous unknown factors.

The Central American Common Market is probably the most ambitious integration effort to date among developing countries. Until recently internal tariffs among all five developing countries had been removed and most steps had been taken to establish a common external tariff in all items. Yet the inability of the countries to agree to a common investment policy and the provision of differential fiscal incentives are important reasons for the difficulties currently experienced by CACM and the break-off of Honduras.

Full trade liberalization among developing countries which are at different stages of development raises the problem of equity in the distribution of the benefits among the participating members. Experience has shown that trade liberalization among countries at different stages of development leads to polarization particularly of the benefits accruing to industry. Given the political realities in developing countries today it is difficult to expect that there is enough political solidarity among developing countries for some to enter into an agreement whereby on the grounds of efficiency of resource allocation from the standpoint of the group of the participating countries on a whole, one or more obtain little or no stimulus to national industrialization.

To assure that industrialization continues roughly at the equal pace in a group of developing countries at different stages of development, it is necessary that special treatment be given to the industries of the least developed in the group. While this special attention can be given without the provision of trade controls, given the past inability and/or reluctance of developing countries to use fiscal measures to promote industry, it is likely that certain industries in some countries would have to be sheltered from competition both from developed and developing countries participating in the agreement. This implies that the agreement cannot involve complete commodity coverage and/or complete elimination of trade barriers in commodities covered. Therefore, such agreements would apparently be inconsistent with U.S. policy, unless they involve commitments for the progressive elimination of all trade barriers at some time in the future.

In fact, it is not surprising that in light of these difficulties in establishing customs unions or free trade areas, existing arrangements among developing countries at present amount to little more than limited preferential agreements whether in name committed to integration or not. A good example of this is LAFTA. The countries involved were committed originally to elimination of all trade restraints according to an agreed timetable. The timetable at present has been pushed back indefinitely. The tariff concessions already granted under the agreements cover a considerable number of products, but the value of trade involved is quite small relative to the total trade of Latin American countries.

B. Limited Preferential Arrangements

Given that developing country agreements in the immediate future are not likely to involve the creation of free trade areas or customs unions, the U.S., it seems to me, is faced with a choice: if it can be demonstrated that no limited preferential arrangements (LPAs) can be supported on economic grounds, the U.S. should continue its opposition. The U.S. could condone LPAs, whether ostensibly aiming at integration or not, only in specific situations when overriding political considerations warrant it. Alternatively, if LPAs in general can be shown to further development objectives, the U.S. should support the concept. Finally, if on economic grounds, some LPAs are desirable and some not, it would seem that one ought to use a selective approach and decide on a position not by reference to general propositions but on a case-by-case basis. Such an approach, of course, would require the development of criteria on which to judge LPAs different from those on which present policy is based. Let us then turn our attention to the implication of LPAs for the attainment of development objectives.

1. Economic Development

If judged on the basis of the simple trade diversion/ trade creation criteria implicit in GATT provisions, LPAs are not deemed beneficial to the economic development of participating countries. This is because they are expected to result in considerable trade diversion with detrimental effects on the participating countries' resource allocation.

However, the relevance of the criteria imbedded in GATT Article XXIV to trade arrangements among developing countries has come under extensive criticism during the last decade [1, 8, 13]. This is not the place to review this criticism. Suffice to say that there is ample support for the view that the simple customs union theory criteria of trade creation/trade diversion as codified in Article XXIV need to be supplemented by an examination of a host of other factors pertaining to the growth effects of preferential agreements among developing countries. "Preferential agreements among developing countries may score rather badly looking at trade alone with a predominance of trade diversion, but this may be consistent with promoting much desired industrialization in the developing countries involved" [1 p. 4].

The main benefits of preferential arrangements for a group of developing countries would seem to derive from the opportunity that such arrangements offer for a more rational pattern of import substitution for the group as a whole [6]. If that is the case, preferential agreements ought to be judged by use of criteria which incorporate both considerations of static resource reallocation and dynamic effects pertaining to the pattern of industrialization that evolves over time in the participating nations.

However, whether the criteria used are the simple trade diversion/trade creation ones or a more extensive set which involves growth considerations, it is clear that trade agreements which cover the whole range of tradeable commodities are preferable to ones that are limited to a few items.

Since under circumstances likely to prevail in developing countries, LPAs are the most realistic alternative, can it be argued that any and all preferential agreements make a positive contribution to the participants' development? I believe not. Agreements limited to the exchange of preferences on a few items instead of rationalizing the pattern of import substitution might simply make it possible for inefficiency to spill over national boundaries. Preferences may be exchanged on items which none of the partners have any prospects of producing efficiently. The preferential agreement may thus enable inefficient industries to spread to other partners in the agreement, perpetuating and exacerbating regional resource misallocation and reducing growth potential.

The conclusion that emerges from this discussion seems to be as follows: it cannot be asserted that any and all LPAs make a positive contribution to the participants' development. At the same time LPAs may make a positive contribution to development despite the fact that they look bad on trade criteria and are inconsistent with GATT provisions. The problem then is to devise criteria against which agreements that fall short of a full customs union or free trade area can be judged in terms of their development effects on participants. In the past, all too often, there has been a tendency for supporters of preferential arrangements among developing countries to assert that the agreements will make large contributions to the growth of the participants [13]. However, these claims have not been supported by quantitative evidence of the effects of such agreements on the growth of the participants.

I believe there are several problems with such findings:

First, although the quantitative effects of LPAs on growth might well be uncertain or insignificant, it is possible that they will make a positive contribution to development indirectly by becoming instruments whereby tighter economic links among developing countries are forged. Limited selective trade concessions preceded the creation of both the Central American Common Market and the Central African Customs Union.

Second, the economic models that have been employed have not been adequate to assess the growth implications of preferential arrangement, primarily because they are too closely linked to conventional customs union theory [2,9]. While the criticism levied against simple application of customs union theory has been extensive, the evolution of alternative criteria which can be used to evaluate the impact of preferential arrangements has been slow.

At the same time, recent academic efforts to design models capable of assessing the growth effects of trading arrangements suggest that it is very difficult to make a priori judgments of the effects of a preferential arrangement on the growth of participants [1,9]. While empirical analysis under traditional customs union theory is limited to calculation of the charges in trade attendant upon the re-arrangement of tariffs as a customs union or free trade area is formed, the estimation of growth implications of a trade arrangement requires, among other data, estimates of the effective rather than nominal rates of protection, the degree of capacity utilization in various industries, and the presence or absence of an over-all foreign exchange constraint. This implies that to make a reasoned judgment on the effects of an LPA growth, the policy maker would have to rely on complex analyses using data often not available in developing countries.

2. Third Country Implications

a. For other developing countries

The growth implications of limited preferential arrangements on third countries are uncertain. An agreement limited to the exchange of preferences on a few items might well make a minimal contribution to the participants' growth. The traditional defense of preferential arrangements in terms of their effect on third countries has been that the resulting income growth will generate increased demand for third country imports. But if the income growth generated is small, the increase in import demand for non-participating developing countries might well be inconsequential. Yet the preferences may adversely affect existing trade of non-participating developing countries, primarily in manufactures hitherto imported from some of the more industrially developed countries left outside the group.

It could be argued that since trade among LDCs is at present quite limited, the impact of preferential arrangements on existing trade would also be limited. However, there are still several important risks with respect to non-participant developing countries. First, the future trading possibilities with non-participant developing countries might be impaired by preferences among a limited number of developing countries. Second, preferential arrangements might freeze trading patterns by establishing vested interests in the participating countries which would inhibit the general freeing of trade vis-a-vis all developing countries in the future.

Since the U.S. interests in development are wider than development objectives of a specific group of developing countries, its concern over the implications of limited preferential arrangement for other developing countries is natural. Its attitude towards such agreements would thus have to take into account the safeguards that limited agreements provide against damage to third developing country interests.

b. For the U.S.

There is reason to believe that over-all U.S. trade will not be adversely affected by LPAs among developing countries. Developing countries spend a large portion of their increments in foreign exchange earnings on imports, and a vast pent-up demand for imports from developed countries, which is not satisfied because of foreign exchange shortage in developing countries, seems to be present. As an OECD study concluded, the faster growth in trade among developing countries resulting from preferential agreements would generate a further rise in the demand for manufactures from the outside world [6].

What is likely to happen with respect to U.S. exporters is that as a result of trade diversion there will be shifts in the composition of, rather than absolute declines in, exports to developing countries. It should also be pointed out that existing integration schemes in developing countries -- with few exceptions -- are not much different from limited preferential arrangements. It would be very unlikely that the effects of additional preferential arrangements among developing countries would be any different from the impact of past integration schemes, which from the limited evidence available have had no adverse effects on over-all U.S. exports [5]. Thus, U.S. opposition to limited preferential arrangements has not stemmed primarily from concern about the effect of such arrangements on U.S. trade, and it is not likely to be guided by such consideration in the future.

3. Implications for General U.S. Commercial Policy

In the past the U.S. opposition to limited preferential arrangements has been influenced by the over-all U.S. attitude toward special preferential agreements. In particular, the U S. has been opposed to the special preferential arrangements concluded between developed country groups, and particularly the EEC, and groups of developing countries. Objections to such arrangements have been based primarily on the detrimental effects of these arrangements on other developing countries and particularly Latin America. Similarly, the U.S. has opposed the granting of so-called reverse preferences by developing country groups to developed countries. The grounds for opposing the latter have been: (a) that these preferences are detrimental to the interests of the developing countries involved because they make them forego the opportunity to purchase from least cost developed country sources; (b) that the U.S., which does not enjoy such preferences (except in the Philippines) sustains trade losses. The latter reason has not been very important because U.S. trade losses from reverse preferences have in fact been minimal. However, it has been felt that if the U.S. condoned limited arrangements among developing countries, it would undermine its opposition to limited preferential arrangements between groups of developing and developed countries or between developed countries.

The establishment of a generalized system of preferences for developing countries is likely to have profound effects on U.S. thinking about the principles that guide trading relations betwen developed and less developed countries. It will also have a bearing on the attitude of the U.S. on limited preferential arrangements among developing countries.

The adoption by the U.S. of a program of generalized preferences[1/] would imply the recognition that compelling reasons of development may justify a temporary deviation from the operation of the MFN principle in trade relations between developed and less developed countries.

1/ At the time of this writing the U.S. proposal had not been submitted for legislative approval. The delay in most part has been caused by the prevailing uncertainty about the future of the U.S. balance of payments and the evolution of the international monetary system.

Preferential treatment granted by the developing countries in each other's markets is simply the other side of the generalized preferences system. Acceptance of this proposition might well lead to the establishment in principle of a two-tier MFN system providing preferences to developing countries in all rather than only in developed country markets.

Assuming that generalized preferences are established, the extension of the system to developing countries markets may well encounter less opposition from developed countries as a whole including the U.S., because it may be felt that it entails less potential danger to developed country producers than preferences in developed country markets. At the same time it might appear that expansion of trade among developing countries could relieve the pressure for further opening up of developed country markets to goods from developing countries.

It must be stressed however, that potential U.S. support for limited preferential arrangements among developing countries on the basis of such considerations would be tempered considerably by the requirement that the preferential treatment be extended by developing countries to all developing countries rather than to a select few. This is because if limited agreements are concluded among only a few developing countries the specter of adverse repercussions on other developing countries is again raised.

C. Regional vs. Non-regional Arrangements

A final problem of current U.S. policy stems from the view that regional efforts offer the best chance of successful intra-developing country cooperation. This view is based on the belief that the solidarity necessary for the political commitments required in successful integration can best be built on a regional foundation. While this view is based on the well known examples of the Benelux, the EEC and even the U.S. itself, there is enough experience to the contrary to indicate that it would be a mistake to insist upon close geographic propinquity as a condition of support of all agreements for economic co-operation. There have been numerous cases where the political will was lacking, precisely from the conflicting interests generated by geographic contiguity. Examples of this abound: In Central America, the problems of Honduras and El Salvador, in Africa the problems between Uganda, Tanzania and Kenya, India and Pakistan, Turkey and Greece not to mention the past problems between Thailand and Cambodia, Philippines, Malaysia, and Indonesia.

On economic grounds prospects for economic cooperation among developing countries in the same region may often be better than among developing countries in different regions, provided that the developing countries concerned are at similar stages of development, since intra-regional trade links are usually closer than extra-regional to start with. However, it should be recognized that the proviso that the countries in question be at similar stages of development, is an important qualification to this generalization. The formation of the Andean group in LAFTA and the experience of the East African countries illustrate the potential or actual disruptive effects of trade dis-equilibria originating in an economic union which is composed of members at different stages of development even though they are all members of the same region.

Trade preferences between countries at approximately the same stage of development, whether within the same region or not, are likely to be more productive in terms of promoting efficiency in production and trade increases than strictly regional schemes. Although such arrangements are less likely to lead to full economic integration, they might be the only form of cooperation possible among the countries concerned. The alternative may well be no cooperation at all.

One danger that such arrangements entail is that as a result of preferences the opportunity for more extensive intra-regional cooperation is foregone. However, if recent experience can be used as a guideline, this danger could be exaggerated. India is a member of the Tripartite Agreement involving extra-regional preferential treatment for a limited range of products and of the proposed protocol involving widespread exchange of preferences among 16 developing countries. This has not stopped India from being a prime supporter of trade cooperation within the ECAFE region. On the contrary, one of the main stumbling blocks in ECAFE wide cooperation on trade has been the fear by some of the less industrialized countries in Asia that India might derive an unduly large share of the benefits from any regional trade arrangements because of its relative industrial advancement.

V. U.S. Policy on Trade Arrangements among Developing Countries - A Summary View and Prospects

A. Summary

(a) The U.S. has exhibited a strong preference for developing country agreements which ultimately lead to regional integration through the creation of customs unions or free trade areas. Existing conditions in developing countries make it very difficult to reach the kind of agreements which are consistent in letter and in fact with the demands of economic integration.

(b) The emphasis on creation of customs unions or free trade areas has largely been based on the belief that these arrangements are preferable to alternative agreements because their over-all trade effects are more beneficial to the participating developing countries and to the rest of the world. Yet it has been argued that trade criteria should not be the main basis of judging the effects of trade arrangements among developing countries.

(c) To the extent that the U.S. has exerted any influence on developing countries' policy: (1) The emphasis on trade criteria may have inhibited economic cooperation among developing countries which looked bad on trade grounds, but could have made positive contributions to the participants' development efforts; (2) The emphasis on a regional approach may have resulted in giving up opportunities for fruitful cooperation across regions.

In defense of U.S. policy it must be stated that the growth implications of trade arrangements whether they involve full integration or be limited to exchange of preferences on a few items, cannot be easily evaluated, particularly on an a priori basis. This is in part due to the paucity of tools of analysis and the economic data necessary to make an adequate analysis. For the policy makers who have to make decisions often under considerable pressure, it is far easier to rely on the simple trade rules codified in GATT, than to attempt to quantify the growth effects of a proposed trade arrangement on the basis of analyses which may have not obtained a wide degree of acceptance even among members of the academic community.

Also, in the absence of well established and easily quantifiable criteria on which the growth implications of limited preferential arrangements can be assessed, U.S. policy makers have feared that support of the general principle that limited preferential agreements can make a positive contribution to the growth of the participants would lead to the proliferation of trade arrangements which would be undesirable because: (a) they make limited or no contribution to the participants own development, (b) they have adverse repercussions on third countries and particularly other developing countries, (c) they undermine other U.S. efforts designed to reduce discriminatory practices in world trade.

Finally, in partial recognition of the problems developing countries are facing in forging strong economic links, the U.S. has not rigidly opposed arrangements among developing countries which have been consistent in name only but not in fact with the criteria the U.S. has said it would apply in judging trade arrangements among developing countries.

B. Prospects

The initiative for economic co-operation among developing countries in the field of trade must rest with the developing countries themselves. The U.S. can only respond to such initiatives. The U.S. response consists of two broad components: (a) the U.S. posture towards trade agreements among developing countries as expressed in the various international bodies dealing with the issues such as UNCTAD and GATT and in the bilateral U.S. relations with the participating countries; (b) The material support that the U.S. can offer to promote the expansion of trade among developing countries within the context of specific trade agreements.

With respect to the overall posture there is a need for a shift of emphasis in the following respects: (a) greater weight should be given to the development implications of trade agreements, as opposed to conventional customs union considerations; (b) recognition should be given to the fact that agreements falling short of full integration can make positive contributions to economic growth and to the forging of economic links on which further co-operation can flourish; (c) U.S. policy should be determined on a case-by-case basis relying increasingly on detailed economic analyses of preferential arrangements rather than on the compatibility of such arrangements with general rules derived from conventional customs union theory.

I believe that the U.S. attitude should be more favorable if the agreements incorporate the following features:

(a) There is a strong expectation that they will make a positive contribution to developing countries' growth. In the past the positive growth effects of trade arrangements have often been trumpeted but little empirical evidence has been offered in support. Such evidence could consist, for example, of indications as to the effective rate of protection required for the industries to survive within the preferential market, the existence of unutilized capacity, and the importance of economies of scale.

(b) There is no increase in trade barriers to third countries, and hence preferences are offered only by reduction in intra-developing country tariff and non-tariff barriers. It would be difficult to accept on growth grounds intra-developing country trade arrangements which serve as a means for increasing the overall levels of effective protection.

(c) Safeguards exist designed to minimize adverse repercussions on third countries and particularly other developing countries' trade, and accession of new members is facilitated. Where other developing countries are threatened with injury it would appear necessary that procedures be devised to provide an opportunity to check abuses and to find ways of accommodating third country interests, e.g., where non-tariff barriers are involved, third country suppliers should be gauranteed the quotas they obtained prior to the preferential agreement.

(d) Unilateral trade liberalization via MFN reduction in tariff and non-tariff barriers would not be precluded. While preferences might be a powerful instrument to increasing trade among developing countries, agreements should not contain clauses which will impede the further liberalization of participating countries' trade along MFN lines.

(e) Machinery to analyze effects of the agreement on third countries and particularly developing countries is established. Where the members are GATT Contracting Parties, the agreement should be submitted to the GATT for examination and sanction.

A good test of the U.S. posture will occur soon in the context of the sixteen-country preferential agreement reached within GATT noted earlier. At the time of this writing neither the details of the proposed agreement nor the U.S. position were known. While the U.S. may not oppose the over-all agreement, it is likely that it would insist on safeguards to protect third-country interests and object to the exchange of preferences that are not extended to all other developing countries.

In the last analysis, the U.S. over-all posture on economic cooperation among developing countries is less important than what the U.S. can do in support of such cooperation. Trade agreements between developing countries have been, and will continue to be, concluded despite U.S. opposition. In addition, individual agreements may not affect U.S. commercial interests to the point where retaliatory action might be proposed.

In general there is very little opportunity for the U.S. to do something positive in response to an agreement which involves the simple exchange of trade preferences among a group of developing countries. The opportunities and the likelihood of U.S. support increase, the closer the economic cooperation envisaged.

There are various types of support that the U.S. can provide to the economic cooperation efforts of developing countries which could be of some significance to the attainment of the development objectives of such cooperation. First, the U.S. can provide assistance in the form of loans on soft terms to institutions entrusted with promoting investment in the group of cooperating countries as a whole. This implies that the cooperation effort should involve a minimum degree of agreement on a common investment policy, and the allocation of investment projects among the participating countries with a view to maximizing the efficiency of resource allocation and trade for the group as a whole. Such assistance has been extended by the U.S. before, as noted above, to regional institutions created in support of trade arrangements in Central America and the Caribbean, and could be expected in the future.

Second, the U.S. could extend technical assistance in export promotion and development. The needs of developing countries in this area are well known. In the past the U.S. has extended technical assistance on export promotion on a bilateral basis to 24 countries. Just recently the U.S. Agency for International Development established a central office designed to respond to technical assistance requests of developing countries in this area. Furthermore, A.I.D.

has also made a capital assistance loan to CABEI of $30 million for the purpose of developing export industries and tourism in South America.

U.S. efforts have generally been directed toward expanding developing countries' exports in developed country markets. While developed country markets are likely to continue to be of primary importance to developing countries, technical assistance efforts to promote intragroup trade should not be neglected. It would appear logical that the function of promoting intragroup trade should be entrusted to an institution with group-wide mandates. Such an institution would have responsibility for export promotion activities in the cooperating countries. At the same time it might become the focus of cooperation on export development of the group as a whole to the rest of the world, so that members of the group do not duplicate efforts to penetrate third markets or attempt to promote the products of the same industries in the same market, i.e., encourage specialization of members of the group in the international market.[1/]

Instead of the U.S. and international institutions spreading their technical assistance efforts through numerous bilateral programs in a group of developing countries, expansion of intragroup trade, as well as coordination of expansion of extra-group exports, could be assisted by U.S. technical assistance programs to the group as a whole.

Finally, I believe that an urgent need exists for additional research both in theoretical questions pertaining to the effects of

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1/ In Central America, PROMECA, a regional institution with such responsibilities, has already been established.

LPAs on growth and in the identification of specific commodities and sectors where trade cooperation among developing countries would contribute to their development objectives. The U.S. has sponsored such research in the past and especially in Asia, and could support such research in the future.

VI. U.S. Policy Towards Economic Cooperation in Asia

I will focus my remarks on U.S. policy towards Asian economic cooperation by discussing considerations that have a bearing on the U.S. attitude towards the recent ECAFE proposals for Asian co-operation on trade and payments.

A. Trade

There is little that can be said about the U.S. attitude towards Asian cooperation in the trade area. The countries involved have made less progress in this area by comparison to cooperation in other fields and by comparison to the progress made in other regions. The problems involved, I believe, are well known. I wish to emphasize, however, two features of the Asian economies which inhibit region-wide cooperation on trade: First, countries in the region exhibit wide differences in their levels of industrial development, and, second, they have developed widely divergent orientations towards international trade [10]. Some have pursued development objectives by import substitution using extensive exchange and trade controls. Others have adopted far more liberal trade policies with a strong orientation toward expanding exports.

Trade cooperation among countries with widely divergent industrialization and trade policies is very difficult. Thus it would appear that in the immediate future trade cooperation can realistically be expected to take two forms, not mutually exclusive: (a) Subregional efforts at extensive cooperation among countries at similar levels of development and with a similar orientation with respect to trade policy, (b) the exchange of limited trade preferences on a regional-wide scale. It might be noted that the principles on trade drafted at the ECAFE ministerial meeting in December 1970 are sufficiently broad as to allow for most any form of international cooperation on trade.

Of the two approaches mentioned above, the item-by-item approach of extending preferences on individual commodities appears the least attractive. In addition to the hazards associated with this approach mentioned earlier, there is the additional complication of the preferential agreement recently concluded by sixteen developing countries, including some from Asia. It does not appear desirable to have a proliferation of trade groups in developing countries, each covering only a small portion of their trade and with uncertain effects on third-country trade. It might well be that when the agreement of the sixteen is put into effect other Asian nations should consider joining it, rather than to form a separate group limited only to the exchange of preferences on a small number of commodities.

As to the evolution of closer trading ties with subregional groups, such as ASEAN, there is little doubt that the U.S. would support such efforts. However, in the absence of a concrete agreement, it would be difficult to ascertain *a priori* the type of support that the U.S. could provide except by referring to the programs mentioned above with respect to worldwide U.S. response to cooperation among developing countries.

B. Clearing

In contrast to the situation surrounding cooperation in trade, there are well-defined proposals for the establishment of an Asian Clearing Union. The main effects of this arrangement, should it be agreed to, can be summarized as follows:

(1) The direct benefits to increasing intraregional trade can be expected to be minimal. Trade within the region is not hampered by the existence of bilateralism and inconvertibility, hence the direct stimulus multilateral clearing is likely to impart is going to be small.

(2) An agreement with the characteristics of the one proposed will undoubtedly strengthen the economic ties within the region, particularly for the banking system. This strengthening can be used as a basis for further cooperation in other areas, including negotiations to liberalize intraregional trade.

(3) The proposed agreement will result in facilitating payments and yield modest savings in transaction costs and foreign exchange.

From the U.S. standpoint, I am hopeful that the agreement, if concluded, will not be opposed. At the same time, because of the specific features of the agreement, there is little that the United States can do to actively support it.

Specifically, the only serious argument that has been used to justify opposition to the agreement can be easily rebutted. It has been argued that the agreement, by interposing the clearing mechanism, reduces the cost of foreign transactions to the private sector and hence involves an implicit subsidy to such transactions. Of course, there is no _a priori_ reason why conversion costs for foreign exchange must exist. On the contrary, it could be argued that their very existence is an impediment to the free international flow of goods. Their reduction or elimination, rather than constituting a subsidy, involves the dismantling of a minor barrier to trade.1/

At the same time if the agreement involves provision of only interim credit with short settlement periods, as apparently currently envisaged, it can operate without the assistance of third countries. Hence, there would be no need for U.S. or any other developed country assistance. If, however, a clearing arrangement is established which provides for more than interim short-term credit, the scope for outside assistance increases. This is because medium-term credit - involved in what might be then called a payments rather than strictly clearing

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1/ A less serious argument is that the agreement might reduce the income of international banks, including some U.S. banks, whose commissions from conversions are likely to decline. Since the over-all intraregional trade is a small portion of the total Asian trade finance, and that, in turn, is only a fraction of the over-all business of the banks in the area, the over-all effect would be quite miniscule. Obviously, the expected benefits in terms of the boost the agreement would give to intraregional cooperation far outweigh these costs.

union - would require that participating countries which are in surplus position on intra-regional account extend credit to those in deficit positions. The overall foreign exchange position in most countries in the area is such that they can ill afford to extend such credit. The operation of clearing with medium term credit would be facilitated by the establishment of a fund to which participants as well as third countries could contribute so that the extension of credit does not fall exclusively on the countries with regional surplus.1/

The U.S. has in the past supported payments arrangements related to clearing in Europe and in Central America. In both instances, however, the arrangements were not supported primarily for their own sake. Rather they were supported as a means of attaining trade liberalization objectives in the countries in the region. In both instances the arrangements were intimately connected with programs calling for extensive trade liberalization commitments by the participating countries. In the case of Europe in particular, the U.S. support was also affected by the feeling that balance of payments reasons and impediments to trade created by inconvertibility were at the root of the existing exchange and trade restrictions. In the case of developing countries at present, however, there is some feeling that trade restrictions result just as much from the industrialization objectives of developing

1/ There are various other considerations which would affect the feasibility of setting up payments arrangements of this nature. These have been explored elsewhere [11]. It might be noted that the chances of their being concluded increase if (a) they involve only increments in intra-regional trade, (b) the expected surplus and deficit positions among the participating countries are small and reversible.

countries as from balance of payments problems. Consequently, payments arrangements alone might well prove ineffectual in providing a stimulus to reduction of trade barriers. In order that they be effective they ought to be intimately related to extensive trade liberalization commitments.

C. Asian Reserve Bank

The proposal to create a reserve bank to meet the needs of the region and serve as what appears to be a mini-IMF is quite unique and intriguing. In light of the apparent limited support that the proposal commands at present among countries in the region, I doubt the usefulness of even speculating at what the U.S. position towards this form of regional co-operation might be. However, in light of the over-all interests guiding U.S. policy towards economic co-operation among developing countries, I might hazard a guess as to the kinds of questions that are likely to be asked about such an arrangement.

The first concern would be with standards or criteria that would be applied in determining the extension of balance of payments assistance by the proposed institution. It would be felt that the standards to be employed should not be any less exacting than those demanded by the IMF. The second concern will be with how would the institution fits into the international monetary system. The latter is going through a period of considerable strain with a good deal of uncertainty about its future evolution. Little can be said about how an idea such as the

Asian Reserve Bank would fit into what evolves in the years ahead.

Yet perhaps precisely because we are now passing through a period of considerable change, when the very foundations of conventional institutions are being questioned, the time is opportune to examine new concepts and new institutional forms of co-operation among developing countries both in finance as well as in the fields of investment and trade. Though the initiative for such co-operation should come from the developing countries themselves, I am hopeful that the U.S. Government is going to give sympathetic consideration to all constructive initiatives.

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