Relations with Non Member Countries

GLOBAL FORUM ON TRADE: TRADE AND STRUCTURAL ADJUSTMENT

RAPPORTEUR’S REPORT

Bangkok, Thailand, 3-4 November 2004

This report is being issued as part of the follow up to the Global Forum on Trade conference. It was prepared by Mr. Craig VanGrasstek, consultant to the OECD Trade Directorate.

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I. Introduction and Overview

1. The Global Forum on Trade met in Bangkok, Thailand during 3-4 November 2004 to examine the topic of “Trade and Structural Adjustment,” with special emphasis on the challenges faced by the motor vehicles and textile/apparel sectors. Convened by the Organisation for Economic Cooperation and Development (OECD) in cooperation with the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) and with the support of the Government of Thailand and the World Bank, the conference met at the United Nations Conference Center. Participants represented 28 economies on six continents, as well as the European Commission and a dozen international organisations, non-governmental organisations, and private firms, in a meeting that brought together a diverse group of experts from the fields of government, business, and academia.

2. The purpose of the meeting was to examine the challenges that structural adjustment poses for firms, industries, and governments, and the ways that different countries and industries have responded to these challenges. No formal communiqués were issued, nor were decisions taken; the objective was instead to engage in an exchange of information and analysis to assist in the advancement of ideas in this field. The conference provided a platform for the dissemination of experience and the examination of best practices, and heard opinions that converged on some points of common agreement while also airing divergent views on others.

3. The subject of trade and structural adjustment is not a new issue. To the contrary, it has been a point of discussion from the inception of the multilateral trading system in the middle of the twentieth century. The issue has gained greater significance over time, due in part to the greater openness of the global economy. It was recalled that in 1978 the OECD issued a communiqué calling for “adjustment to new conditions, relying as much as possible on market forces to encourage mobility of labour and capital to their most productive uses.” Since that time, many of the conditions in the world have changed: New players such as China are active, the structure and jurisdiction of the multilateral trading system has changed, and regional trade arrangements (RTAs) have become much more numerous and significant. Several participants stated that the issue is given greater currency by the Doha Round in the World Trade Organisation (WTO). With that round expected to achieve even more progress in opening markets, policymakers need to consider the future challenges that may be faced and contemplate actions that might be taken to ease the burden of structural adjustment.

4. Participants generally agreed on two underlying points. The first of these is that the pace of change in the global economy has accelerated in recent decades. This may be attributed to two causes: the speed with which technological advances are developed and disseminated, and liberalisation in the movement of goods and services.

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1 The views expressed are those of the rapporteur and do not necessarily reflect those of the OECD or its Member countries.
goods, people, and capital. The view was expressed that the first of these causes may be the more significant, with technological advances generally being irreversible.

5. A second point on which there was general agreement concerned the effects of these changes, or at least our perception of them. Whereas earlier work on the subject of structural adjustment had approached this issue from the standpoint of neoclassical economics, with its emphasis on efficiency, today there is at least equal attention devoted to questions of equity. These questions concern the different impacts that change – or responses of change – have on different groups within a country, or between different countries. Does globalisation have a more negative impact on labour than it does on capital, for example? Are its effects more strongly felt by social or economic groups that have lower levels of skills or education? Are some industries better able than others to respond to shifts in competitive advantage? Are some countries more seriously disadvantaged? Several participants made the point that some industries, as well as the workers in them and the countries where they are located, indeed tend to be more seriously affected by structural adjustment than others.

6. Equity also affects issues that go beyond questions of equal opportunity and distributional justice, as they may concern the social, environmental, and political consequences that arise from the challenges of structural adjustment. Globalisation raises a host of political and societal concerns while also increasing the pressure to adjust. It can be a welcome force, but some firms or workers are demonstrably less able to adapt than are others. The adjustment process therefore has a human dimension that cannot be ignored; both efficiency and equity must be addressed by policymakers. Legitimate concerns over adjustment should lead to preparation in advance of proper social and economic policies.

II. Similarities and Differences in the Automotive and Textile/Apparel Sectors

7. The conference focused principally on developments in the automotive and textile/apparel industries. These two sectors differ in numerous ways, but also share some important characteristics in common.

8. The differences between these two sectors are most immediately apparent. The automotive industry is capital-intensive and highly dependent on new technologies and economies of scale. This is quite different from the structure of the textile and apparel industry, which is labour-intensive (though the level of capital-intensity is greater for textiles than apparel) and is centered primarily in developing countries. The differing levels of concentration is especially striking: While just seven groups account for the great majority of world production and trade for automobiles, the textile and apparel industry is spread around the world in relatively small operations.

9. Despite these differences, the two industries share one very important characteristic in common: Trade in both of these sectors used to be limited by quantitative restrictions (QRs), but has been liberalised as a result of the Uruguay Round of multilateral trade negotiations. One of the main accomplishments of that round was the phase-out of most QRs in their various forms. The resulting increase in cross-border competition has obliged firms and governments to deal with structural adjustment.

10. In the case of the automotive industry, trade before and during the Uruguay Round was restricted by infant–industry protection in many developing countries and by the establishment of voluntary export restraints (VERs) in industrialised markets such as the United States and the European Union. The Uruguay Round Agreement on Safeguards outlawed the use of VERs, and required that the existing restrictions be eliminated by the end of 1999. Tariff barriers in most OECD countries are relatively low, but remain high in some developing countries.
11. The Multifiber Arrangement (MFA) and predecessor agreements have restricted trade in textiles and apparel since the early 1960s. The Uruguay Round replaced the MFA with the Agreement on Textiles and Clothing (ATC), which provided *inter alia* for the phased elimination of the MFA quotas. The fourth and final stage of that phase-out will come at the end of 2004. Tariff barriers on textile and apparel products remain relatively high in both industrialised and developing countries, but the end of these QRs is expected to produce a major shake-up in the global industry. It is widely anticipated that China, India, and a small number of other countries will capture large shares of the market, crowding out competition from other countries that have done well under the quota regime.

12. The end of QRs in these two industries has produced similar consequences. In addition to increased trade, they have seen growing pressure on the less competitive producers through lower unit prices and reduced profit margins. This has in turn produced a consolidation in the global automotive industry, a trend that many expect to see repeated in the textile and apparel industry. These consolidations have not been identical – the end of VERs led to mergers and alliances at the firm level, while it is anticipated that the end of the MFA quotas will lead to consolidation at the country level – but the results are similar. Consolidation means the concentration of production and employment in those firms and countries that are most efficient, and losses in those firms and countries that had relied upon market restrictions in order to maintain production; the burden of structural adjustment falls chiefly on the losers in this process.

III. Best Practices: Areas of Agreement and Debate

13. Technology, trade, and competition pose the challenge of structural adjustment. How might this challenge be best met? What is the optimal mix of government policies and industry responses? The discussion in the conference produced a real diversity of opinions, with many participants expressing agreement on some broadly stated principles while also disagreeing on how those principles might best be applied.

14. The points on which there was general agreement, or at least on which the declarations of one or more participants were not explicitly challenged by others, concerned the general nature of the challenges and the respective roles of government and industry. Participants generally agreed that the private and public sectors must work closely together in order to meet adjustment challenges, but the main burden falls on firms. In a system of private enterprise, it is the firms – foreign and domestic – that must ultimately decide what, where, and how to produce goods. While it is not appropriate for governments to make these decisions, they can play a critical role in facilitating them. Governments must provide an effective regulatory framework and adjustment programmes to facilitate the adjustments of firms. As one participant put it, successful countries are not necessarily characterised by stable patterns of production but instead by their capacity to manage structural change. That capacity is shaped in part by the institutions of government. More specifically, participants seemed to be in general agreement on the following points:

- Countries need to have attractive investment environments in order to retain domestic capital and attract foreign capital;
- Countries should have business-friendly regulatory systems, while also meeting social needs;
- The institutions, laws, and procedures in countries should be transparent and free from corruption; and
- The institutions in a country should have the capacity and resources needed in order to identify challenges and respond to them effectively. The Productivity Commission in Australia, for example, was cited as such an institution.
15. Participants also expressed general agreement on the need to identify challenges in advance, especially in the midst of trade negotiations, and on the need to involve non-governmental actors in the process. One participant nevertheless stressed that there is no single, optimal set of institutions, and that there are instead many ways of achieving the same objectives. A country’s institutions might be adopted from abroad or evolve locally through a process of trial and error.

16. While these rather general points appeared to be widely supported, their actual application to specific circumstances was in dispute. Participants had differing views on many specific subjects, as reviewed below, as well as on three “big picture” questions.

17. The first of these was whether there are any best practices that are universally applicable, or if policies must necessarily be adapted to the unique circumstances of a given industry and country. Those circumstances may vary according to the levels of economic development, the type of industry involved, geographical factors (e.g. distance from major markets), differences in national culture, or other considerations.

18. Second, participants expressed differing views on the sequencing of trade liberalisation and adjustment. Is it better to conduct a form of _ex-ante_ adjustment in which one anticipates the likely losers from liberalisation and designs programmes to meet their anticipated needs? In the alternative, should adjustment programmes be geared to deal with adjustment problems as they arise? Some participants felt that the sequence might move in either order, depending on the circumstances at hand.

19. Third, there was disagreement as to whether it is better to adopt adjustment policies on an economy-wide or a targeted, industry-specific basis. Examples were given of both approaches, with some participants observing that it is difficult to identify individual sectors that need assistance and others giving examples of cases where it has worked.

20. Beyond the general points, the debate on best practices can be summarised in two broad categories that encompass nine distinct areas for which there were varying degrees of agreement and disagreement. These are grouped below according to whether they fall within the scope of governmental policy (trade-related and other) or are in the jurisdiction of the private sector.²

A. Measures Taken by Governments

1. _Tariff and Non-Tariff Measures, Including Trade-Remedy Laws_

21. As a general rule, participants expressed support for trade liberalisation as a positive force. As summarised by one participant, open markets help to foster competitiveness and innovation, improve access to essential inputs, and stimulate exports. There was nevertheless some disagreement on the applications of this principle to developing countries (as discussed in the point below), and on the specific instruments that countries might employ in this field.

22. Trade facilitation was the least controversial topic. Several participants noted the benefits that accrue from measures to reduce “border hassles” and the like; no one expressed any opposition to this notion. Trade-remedy laws were at the other end of the spectrum. No one expressed support for the use of antidumping and countervailing duty laws, although some ambivalence was expressed with regard to the use of safeguards. That ambivalence might be characterised as qualified support for safeguards in theory, but concerns over their use in actual practice. That theoretical support stems from the general recognition that safeguards can make a positive contribution both by giving negotiators the confidence to make deeper

² Note that these issues are not presented here in presumed order of importance.
commitments, and by providing a means for troubled industries to take measures to restore their competitiveness. Several participants nevertheless expressed the view that, in actual practice, safeguards may be abused as protectionist instruments in support of industries that are unlikely to return to competitiveness. As one participant put it, economies will lose in the long term if the adjustment challenge is used as an alibi for not liberalising.

23. Tariff liberalisation received neither the same level of support as trade facilitation nor the same level of opposition as trade-remedy laws. While many expressed support for the continued reduction of tariffs in multilateral negotiations, several participants noted reasons why tariffs should not be eliminated altogether, or at least should be phased out slowly. These included the continued dependence of some governments on tariff revenues, the perceived need for “infant industry” protection in some developing countries (see point #2 below), and the effect that the elimination of MFN tariffs may have on the margins of preference in RTAs and preferential trade arrangements (see point #3 below).

2. Treatment of Developing Countries

24. Perhaps more than any other single issue, participants returned repeatedly to the special problems faced by developing countries. Some participants directed their comments to issues affecting developing countries in general, while others focused in particular on the needs of the least developed countries (LDCs). Among the problems faced by developing countries are inadequate infrastructure, poor institutional capacities, and insufficient capital. While there was general agreement among participants that it can be more difficult for developing countries to respond to the challenges posed by structural adjustment, opinions differed widely on how they might best position themselves.

25. Some participants stressed that structural adjustment is more difficult in countries where there is less capital available to both the private and public sectors, and where the range of existing and potential industries is generally narrower. This may be especially true in the LDCs. It was noted that although this subset of the developing world accounts for less than one-quarter of one percent of world trade, these countries are home to one-fifth of the world’s poorest people.

26. There was general support for the notion that open markets are needed, but disagreement on the application of this principle to developing countries. On the one hand, some participants contended that liberalisation has not worked for some developing countries. Participants from two large Asian economies, for example, expressed doubts as to whether the liberalisation that these countries have undertaken has produced the desired results. Another participant responded that it is half-hearted liberalisation that does not work, and that the results would be more encouraging if these and other developing countries adopted more far-reaching economic reforms. The Indian experience was criticised, insofar as it is marked by gradualism and a continued high level of protection. By contrast, the experience of the Thai automotive industry was cited as a case in which liberalisation of trade and investment rules has been followed by growth in production and trade. Similarly, the costs of liberalisation have been fairly low in South Africa’s liberalisation of the motor vehicles industry, where export expansion has thus far been successful.

27. Much discussion focused on the question of burden-sharing in the multilateral system. Some participants expressed the hope that the Doha Round would produce universal zero-tariff market access for the LDCs. Two participants expressed concerns that the process of accession to the WTO is onerous for LDCs, and argued that the system should become fairer for the developing countries.

28. Discussion also focused on preferential programmes and RTAs. One presentation argued that barriers to South-South trade need to be eliminated, and that this approach held out more promise for expanded trade than did the reduction of the (generally low) barriers to the markets of industrialised countries. Some of the participants’ enthusiasm for multilateral liberalisation was tempered by concerns
over the erosion of preferences that this would bring, but at least one other participant noted that the limitations built into programmes such as the Generalised System of Preferences (GSP) ensured that there was relatively little scope for such erosion. While other participants acknowledged that there are shortcomings in the GSP, there was disagreement on how they might best be addressed. Should the GSP be improved upon through (for example) expansion in the range of eligible products, or are there other, more efficient means of assisting countries in improving their competitiveness?

29. There was no agreement among participants on proposals to develop financial compensatory mechanisms within RTAs. It was noted that while in the multilateral system there has thus far been a separation between aid and trade initiatives, the trend in some RTAs has been to draw a closer connection between the two instruments. Both the European Union and (more recently) the United States have begun to provide for compensatory or cooperative efforts in the RTAs that they negotiate with developing countries. Participants expressed differing views, however, on the necessity of such linkages.

3. **Multilateral vs. Discriminatory Liberalisation**

30. This topic was second only to the treatment for developing countries in the attention that was devoted to it, with many speakers devoting at least a part of their comments to questions arising from the proliferation of free trade agreements (FTAs) and other forms of RTAs. While there was general agreement on the increasing and important role of RTAs in the system, there was considerable disagreement on whether and why this may be a positive development.

31. Participants expressing support for RTAs pointed to the following, positive aspects of these agreements:

a) One participant stressed that the biggest benefit from an RTA may be in the institutional aspect, insofar as it creates greater certainty in the liberalising policies that a country adopts. The solemn commitments that are made in a treaty are less easily undone than the autonomous actions that a country undertakes in its domestic laws.

b) RTAs are useful means for advancing trade facilitation.

c) At least two participants pointed to RTAs as an instrument by which developing countries can be assisted in their adjustment to the competition brought on by multilateral liberalisation. One participant provided the example of the U.S.-Central America FTA (CAFTA), which will further liberalise Central American countries’ access to the U.S. market for apparel. According to the participant, this agreement will likely slow the rate of decline for Central American market share with the end of the MFA quotas. Another suggested that RTAs, together with preferential programmes, may aid a country like Mongolia, for example, in its efforts to maintain market share in the post-MFA environment.

32. Perhaps the clearest examples of positive benefits from RTAs were those involving the accession of lower-income countries to FTAs or customs unions with higher-income, contiguous partners. Examples of success stories included Mexico’s negotiation of the North American FTA with Canada and the United States and the accession of Poland to the European Union, both of which benefited the automotive industries; and Romania’s prospective accession to the European Union, which is expected to benefit its textile and clothing industry.

33. On the negative side, some participants pointed to the following shortcomings of RTAs:

a) RTAs can lead to trade diversion and promote inefficient patterns of production (when compared to what might be achieved under multilateral liberalisation).
b) One participant referred to the “FTA trap” that countries might fall into, in which they expect that preferences will ensure their access to a large market but find that these preferences diminish in value when – due to a proliferation of agreements – they are more widespread among partners.

a) Several participants pointed to the rules of origin in RTAs as a means by which the distortive aspects of these agreements may be multiplied. Restrictive rules of origin, it was argued, can actually undermine competitiveness by promoting activities that add to the time and costs involved in shipping.

4. **Autonomous Liberalisation**

34. Autonomous liberalisation was discussed as a complement to, or even substitute for, negotiated liberalisation. It was pointed out that for some countries – and especially developing countries where applied tariff rates tend to be much lower than MFN-bound rates – autonomous liberalisation has accounted for more change than negotiated reductions at the multilateral level. Mention was made, for example, of a World Bank study showing that over the past 20 years multilateral liberalisation has accounted for only about one-third of developing countries’ liberalisation in manufactured products; most of the reductions came via unilateral liberalisation and reforms. There was some disagreement, however, on whether it is preferable for countries to maintain the flexibility of autonomous actions or to provide the greater assurance that investors seek from bound commitments.

5. **Labour Market Policies**

35. As was stressed earlier, issues of equity have become a more significant aspect of the debate over structural adjustment. Nowhere is this more evident than in issues affecting labour. Compared to capital, labour is relatively immobile and hence is less able to respond to competitive challenges through partial or total relocation. The burdens of adjustment thus tend to fall more heavily on workers than on their employers. Several participants noted that the adjustment process has a human dimension that cannot be ignored. Efficiency and equity, it was argued, must both be addressed. Legitimate concerns over adjustment should lead to preparation in advance of proper social and economic policies.

36. These concerns were most forcefully expressed by a representative of labour organisations. According to this participant, there is now a sense of panic among labour unions. They feel a sense of broken trust between management and labour, in which the threat of relocation is improperly used by employers as a means of gaining leverage in bargaining.

37. While there was general agreement that adjustment is more difficult for workers, participants expressed varying opinions as to how best to meet these challenges. Some participants noted the conflicts that may arise when seeking on the one hand to safeguard the interests of workers, and on the other hand to avoid rigidities in labour markets. There was some disagreement as to whether the main problem here concerns the footloose character of capital or the imposition of barriers to exit.

38. Several speakers noted that importance of establishing programmes to upgrade the skills of workers. These might variously be designed to improve the productivity of workers within their established fields, or to promote their movement into other industries. As in other areas of public policy, however, it was noted that not all countries are equal in their capacity to fund social safety nets, worker training programmes, and the like. Such undertakings are more easily afforded in industrialised than in developing countries, and even among the industrialised countries there are wide differences in the goals, structure, and funding for labour-adjustment programmes.
B. Measures Taken by Firms and Consumers

1. Recapitalisation and Adoption of New Technology and Methods

39. One response to the challenges of structural adjustment, especially on the part of industrialised countries or relatively high-income developing countries, is to recapitalise an industry. Capital investments can help to overcome disadvantages in wages by creating or adopting new technologies. The Japanese, German, and U.S. auto industries offer one set of examples of how this may be done effectively. The continued dominance of the “triad” producers in the motor vehicles industry demonstrates that low wages alone are not the key determinant of competitiveness.

40. This approach is not confined to capital-intensive industries. In the case of textiles and apparel, one participant summarised the argument to be presented in a forthcoming book on structural adjustment in this industry. The thesis of the book is that countries aspiring to maintain an export-led strategy in this industry must complement their industrial expertise by developing their ability to compete in the higher value-added segments of the supply chain. Among other things, this requires training in new skills and the development of collaborative innovation processes. Other participants pointed to Canada and Sweden as examples of countries that have been able to survive in the apparel industry through such means as making major new investments in technology, receiving government assistance in the areas of credit and labour market grants, export-promotion, and support to education.

2. Firm Size and Supply Chains

41. Very different views were expressed regarding the economically or socially optimal size of firms. On the one hand, some participants said that small and medium enterprises should be encouraged for social reasons and because of their appropriate size in smaller countries. On the other hand, a representative of the private sector noted objections that “mom and pop” operations are more difficult to deal with and do not enjoy economies of scale.

42. The discussions relating to the automotive and textile/apparel sectors also revealed different preferences with respect to the structure of supply chains. A few participants noted that an integrated supply chain is more efficient in the apparel industry, in which most or all of the operations by which fibers are transformed into fabric, and fabric into apparel, are located in a single country. This integration increases efficiency by reducing the time and money devoted to the transportation of goods. By contrast, in the automotive industry it was observed that components offer opportunities to developing country producers. The production of components in multiple countries, and the resulting fragmentation of the supply chain, does not appear to be as much of an inhibiting factor in this industry as it is in the fiber-fabric-apparel chain.

3. Geography and Shipping Costs

43. Geography matters, especially by affecting the time – and hence the costs – required to ship goods. The problem is even more acute for land-locked or highly remote countries. This is a problem that cannot be solved, but only managed; countries are not free to relocate. There are nevertheless steps that can be taken, such as shifting from ocean to air freight for some types of products.

44. One private sector representative stressed that in the textile and apparel business, speed to market and control of the logistics and supply chain are critical elements of competitiveness and efficiency. Even so, the experiences of South Africa and Mongolia demonstrate the difficulties and options for countries that are geographically remote from major markets.
45. Some participants stressed that geographic distance is not the same as economic distance, however, and that total costs must be taken into account. These costs can preclude some countries from engaging in efficient outward processing operations. While these operations may be a good means for nearby partners to engage in production sharing, the approach is not efficient when pursued among economically distant partners.

4. **Ethical Purchasing**

46. Both for labour and environmental issues, ethical purchasing gives consumers an opportunity to reward or punish firms on the basis of their practices. This is a more significant consideration in the field of textiles and apparel than it is in motor vehicles, due both to the nature of the products and the types of countries in which they are produced.

47. Several participants addressed the issue of ethical purchasing for textile and apparel products. There was general agreement that such campaigns can have an effect on the actual conduct of firms with regard to their labour practices and other matters, but some disagreement as to just how effective they have been in changing those practices. One industry representative stressed that firms place a high value on their image with the public, and do not want to be seen as exploiting workers or otherwise acting in socially irresponsible ways. That same representative noted that there is no conflict between efficiency and ethics; to the contrary, plants tend to be more productive in countries where workers’ rights are recognised. Private codes of conduct and consumer action can indeed be effective. Other participants noted nevertheless that multinational corporations continue to practice lowest-cost sourcing, a fact that tends to encourage the “race to the bottom” among developing countries.