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Towards a More General Approach to Trade Liberalization

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Despite the frequency with which they have been promoted as a model of development, East Asian trade policies have had little influence on the normative economics of trade reform. In contrast to directly dismantling protection, developing countries have often provided concessional import rights which override existing protection. These instruments include EPZs and duty remission. This paper accommodates these instruments of 'new trade liberalization' within a more general understanding of trade liberalization illustrating their similarities and their differences. Both old and new trade liberalization can, on their own, bring about complete free trade. Needless to say, so far, neither has!

[P]olicymakers have *something* on their side. Recall that deficit spending as an instrument to create employment preceded the General Theory. Economists should be a little more cautious in assuming that policy wisdom is necessarily on *their* side. In the area of trade policy I... doubt whether we are immensely smarter than the policy-makers.
Jagdish Bhagwati commenting on the success of North East Asian trade and industry policies, 1973 (1975, p. 513).

I Introduction

Economists and economic theory have traditionally conceived of trade liberalization as the dismantling of existing trade restrictions. This is indeed the way in which most trade liberalization in the developed countries has been achieved. It might seem obvious that the simplest and most direct way to liberalize trade is to remove existing trade barriers. But, usually, if not universally, trade liberalization must be gradual. In such circumstances, simply dismantling existing trade barriers can foreclose potentially valuable liberalization options which have intuitive appeal and which have had considerable practical success.

Certainly the success of some Asian developing countries including the influential examples of Korea and Taiwan in industrial goods suggests that trade can be very successfully liberalized using quite different instruments: the instruments of what I will call 'new' or 'concessional' trade liberalization. Rather than directly dismantling trade barriers, these instruments undermine the effects of trade barriers by providing importers with concessional access to domestic markets which overrides existing trade barriers. Such instruments include export processing zones and duty remission schemes such as duty drawback on physical inputs to export and what I will call 'extended duty drawback'. With extended duty drawback, exports from an industry earn 'credits' for concessional imports. However in contrast to the situation with duty drawback for inputs to export, there is no requirement that concessional imports be incorporated into exports.[1] One reason

* The views expressed here are those of the author and not of any institution with which he is associated. Steve Dowrick and Fred Gruen and an anonymous referee made helpful comments on earlier drafts.

[1] Thus, for instance, under the Australian 'extended

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for the lack of attention to the instruments of new trade liberalization in multilateral trade negotiation has been that the developed countries which have driven much of the GATT trade liberalization agenda have made relatively little use of them.

This paper provides a framework within which the old and the new instruments of trade liberalization can be appreciated for their similarities and their differences. The focus of the article is particularly on the liberalization of trade in industrial products. Section II argues that recent developments in economic theory suggest a case for a more pluralistic approach to trade liberalization than has traditionally been accepted within the economic *corpus*. Section III suggests that practical experience points in the same direction. Sections IV and V present a series of propositions and a taxonomic table which constitute the essential analytical contribution of the paper. Section VI explores some of the implications of what precedes it whilst Section VII briefly concludes.

II Trade Theory and Trade Liberalization

In the past three decades, economists have gained a greater understanding of the complexity and diversity of the forces driving trade. The traditional Hecksher-Ohlin-Samuelson (HOS) 'factor proportions' model of international trade illustrates the gains from exchanging products which embody different factor proportions. For the sake of shorthand these may be called the gains from 'inter-industry' trade. Since the sixties, economists have also focused on alternative 'engines' of trade driven by indivisibilities in production, imperfectly transferable technology and/or diversity of demand. This kind of trade has often been referred to as 'intra-industry trade'.[2]

In a factor proportions model which does not allow for multi-stage production, a tariff to an import replacing industry has the same effect on production in that industry as does a subsidy at the same effective rate. Thus, ignoring consumption, the strategy of trade liberalization is reasonably unproblematic and involves the removal of trade restrictions at a greater or lesser rate. There are two gradual reform rules sanctioned within the HOS literature which I will call 'orthodox trade reform rules'. They involve reducing the highest tariffs first—'tops down' tariff cuts—and equiproportional reductions in tariffs—'across the board' tariff cuts.[3]

The 'theories' of product cycle and intra-industry trade point to important issues which the HOS picture captures, if at all, inadequately. Taken together they point to the potential complexity of the production process and the need for specialization and trade, not only between industries with outputs of different factor proportions, but also within industries. Accordingly they highlight the possibility that, by artificially raising the cost of imports, trade barriers may involve losses not just to consumers, but also to producers who must purchase protected inputs.

Where the HOS framework is extended to multi-stage production it becomes possible to envisage a situation in which removing trade barriers to *inputs* to production—against the orthodox trade reform rules—would expand trade beneficially. Of course in many circumstances, improved access to inputs for protected activities may reduce rather than increase welfare. Nevertheless, an important element of many development success stories has been protected domestic industries' access to finance, intermediate and capital goods on the world market.

An intuition schooled in the HOS framework is likely to underplay the importance of these phenomena. Because of its construction around perfectly competitive markets and the 'law of one price' which they imply, the HOS framework cannot capture trade in products with similar factor proportions resulting from demand for variety in the presence of economies of scale. Accordingly, however comparatively advantaged an industry might be, in the presence of economies of scale and a demand for product variety, it is likely to be cost effective for it to engage in some degree of intra-industry trade which tradi-

duty drawback' arrangements for the automotive industry—Export Facilitation—exported components and vehicles earned credits for the duty free importation of components and vehicles with credit holders allowed to use the imports as they wished, or indeed to sell their credits to third parties.

[2] It should be taken as read that these terms are used as a form of shorthand. Some intra-industry trade is undoubtedly driven by differences in factor proportions. The classic example of HOS intra-industry trade is trading leather bicycle seats for steel bicycle spokes. Likewise trade between industries may also be driven by the kinds of relative technological differences associated with intra-industry trade.

[3] These rules are sanctioned in textbooks such as Corden, 1974 and Vousden 1990, an orientation which has been carried through to policy advice. See Industries Assistance Commission 1982.

tional protection will impede. The focus which both product cycle and intra-industry trade 'theories' place on indivisibilities in production also suggests that, at the firm and individual product level, a 'critical mass' of production may be important—that supply may be very elastic at the margin of viability. Because product cycle trade, much of it intra-industry, occurs around the evolution of comparative advantage and technological 'catching up' it is likely to embody gains through technology transfer and 'learning by doing' which are not driven by factor endowments.

What conclusions can be drawn from all this? Considerable attention has been focused on the implications of intra-industry trade for the old debate between free trade and mercantilism (Grubel and Lloyd 1975, pp. 150–1; Lancaster 1991). Because economies of scale complicate the analysis of the normative economics of trade greatly, they add to the exceptions to the case for free trade. But there were a litany of exceptions to the doctrine of free trade long before economists renewed their interest in economies of scale (McCullock 1993). With regard to the recent interest in the 'strategic' implications of scale economies, as Ronald Wonnacott has commented, after a decade of intense activity, strategic trade theory

> may not yet have even scratched the surface. To identify one of the large number of possible new cases, all that is required is the combining of one of the many causes of market failure with one of the many mercantilist instruments that could then be used to increase welfare (1993, 18).

The exceptions to free trade generated by the new trade literature have been neither sufficiently surprising nor sufficiently robust to dislodge most economists' presumption in favour of free trade in the absence of good reasons to the contrary. Today's consensus is that economies of scale tend to *strengthen* the general case for trade liberalization even if they complicate it (*cf.* Krugman 1988, p. 9). Quantitative general equilibrium modelling suggests that economies of scale can substantially increase the gains from trade (Harris 1984).

But there is a range of issues which the ubiquity of intra-industry trade raises for trade policy which are less fundamental but, on account of that, perhaps of greater immediate significance. For the existence of intra-industry trade has implications for the costs of protection. The conclusion which emerges most robustly from all the approaches to trade which have been mentioned emerges from each of them. For HOS, product cycle and intra-industry trade 'theories' all suggest that industry assistance by way of traditional protection involves avoidable costs. All perspectives support the argument of the 'new development consensus' that, should it be provided, industry assistance should, as far as possible be trade neutral: it should 'promote not protect' (Little, Scitovsky and Scott 1970, Balassa 1971, Krueger 1978 and Bhagwati 1978). Should policy seek to expand output of a designated type, then a simple HOS model highlights the fact that traditional protection—tariffs and/or quotas—involve avoidable losses in consumption. More sophisticated models suggest that there will also be losses in production which may have dynamic qualities.

Second, where it is not desirable or possible to replace protection with promotion—through, for instance, the replacement of tariffs with subsidies—concessional import instruments such as those outlined in Section I should be considered to alleviate the intra-industry trade suppressing effects of traditional protection. Accordingly one might call such instruments 'intra-industry trade facilitation policy'. Intra-industry trade facilitation policy has the objective of facilitating intra-industry trade in the presence of traditional protection.

Third and by the same token, where the focus is on trade liberalization, an important aspect of gains from liberalization is likely to involve improving access to inputs to production as well as permitting other kinds of intra-industry trade and specialization. There are several possible reasons for designing a trade liberalization path which seeks to facilitate intra-industry trade as a priority in a gradual trade liberalization program. Intra-industry trade expansion is likely to lower the costs of protected industries by allowing them to specialize more. It may be important in accessing the dynamic gains from trade early in the trade liberalization program. Also it seems likely that the adjustment costs of intra-industry trade expansion will generally be lower than the adjustment costs of inter-industry expansion (Grubel and Lloyd 1975 pp. 127–9; Krugman 1978).

The case for pursuing trade liberalization by means other than simple tariff dismantling can probably best be made with an example. Assume that at free trade, a particular low wage country would be a major exporter of clothing,

and that it currently has significant trade barriers on various inputs into clothing production, including textiles and capital equipment which provide apparel manufacture with negative assistance. Assume further, and not implausibly in a highly competitive international market, that supply becomes progressively more elastic as free trade is approached. An orthodox unilateral reform path would require partial trade reform episodes to reduce trade barriers from the 'top down' or equiproportionally across the board (Corden 1974, p. 366ff). Notwithstanding its acceptability to economic orthodoxy, such reforms would forego much beneficial trade expansion until they had taken the country relatively close to free trade. This is not necessary. The hypothetical country just discussed is styled from the experience of Mauritius, where trade liberalization and some other measures to reassure investors unleashed a torrent of beneficial trade expansion. Yet the extent of trade liberalization was only moderate (Levy 1993, p. 256). And it conformed with neither the top down nor the across-the-board tariff cutting rules. Mauritius established an export processing zone (EPZ) and apparel exports boomed (Romer 1993).

III 'Lessons' from Developing Countries

In fact, in a way which Bhagwati foreshadowed in the passage extracted at the head of this paper, it seems that policy has anticipated theory with regard to these issues. Many developing countries keen to participate in intra-industry trade, particularly product cycle trade, pioneered the development of a variety of 'intra-industry trade facilitation policies' long before they received much attention from economists and indeed before the extent of their benefits could be expected (Li 1988, p. 135). The core of the arguments presented in the previous section is contained in the new development literature of the 1970s. This literature showed that policy to facilitate intra-industry trade in the presence of trade barriers was widespread in developing countries. Little *et al.* noted the dramatic expansion of Taiwanese exports 'based largely on imported materials' and the accompanying system of rebating import duties on inputs to export (1970, pp. 254–5). Balassa *et al.* documented export drawback systems in Chile, Mexico, Pakistan and the Philippines (1971, see index). And a 1978 study directed by Bhagwati and Krueger noted that import concessions under quantitative restriction regimes were frequently linked to export performance in a variety of ways. To the above list of countries the 1978 study added India, South Korea, and Columbia (Bhagwati 1978, p. 24). Intra-industry trade did not figure prominently in the case for 'promotion not protection', but the relevant economic driving force behind intra-industry trade did—economies of scale in the presence of diverse demand (Balassa 1971, p. 76–9; Krueger 1978, p. 284).

Despite their prevalence and apparent success, these instruments have received relatively little attention from economists. One might attempt an explanation of this by reference to the trade literature's tendency to be oriented around the 'free trade' versus 'protection' dichotomy. Since the mid-1970s, new directions in trade policy research have often been strongly oriented around this dichotomy. Thus considerable effort has gone into exploring the implications of 'new' kinds of protectionism, from the defensive protectionism of voluntary export restraints (VERs) to the more aggressive protectionism motivating 'strategic' trade interventions. The instruments of concessional trade liberalization are much more ambiguously located on the 'free trade' versus 'protection' spectrum. They have received much less attention.[4]

Indeed, a good deal of the attention which has been given to concessional import schemes has been provided in the context of the 'free trade versus protection' debate. Those putting forward the new development consensus have invoked the widespread existence of concessional trade liberalization to argue that the protectionism associated with development success in countries such as

[4] The 'ECONLIT' database at March 1996 contained 40 references to 'voluntary export restraint' and 149 to 'strategic trade'. By contrast it had 11 references to 'export processing zone', one each to 'duty drawback', 'export drawback' and 'export linkage'. The database does not seem to carry any reference to what I have called extended duty drawback. One article on extended duty drawback not cited in the ECONLIT database is Gruen 1991. An anonymous referee has commented that the 'complexity and variety of the new trade liberalization instruments has also discouraged their incorporation into a theoretical literature that places a high premium on simplicity'. There may be something in this, but the examples of 'protectionist' innovations in the empirical world such as VERs and strategic subsidies etc, or indeed for that matter tariffs, is not noticeably simpler than the examples of new trade liberalization instruments.

Korea and Taiwan was nevertheless a very liberal protectionism which applied a 'free trade regime' to exporters (Balassa 1989, p. 2. *Cf.* Krueger 1985, p.195). This interpretation has found its way into policy prescription. For instance Krueger has argued that one of the 'lessons' of East Asian success is that:

> exporters must have ready access to the international market for whatever purchases they may require, including raw materials, spare parts, technical services, marketing skills, freight, insurance and transport. It should be noted in particular that a duty drawback system is probably too cumbersome administratively and otherwise to provide the required access (1985, p. 208).

Surprisingly however, this interpretation of development success and its concomitant policy implications has had very little impact on the normative theory of trade liberalization. Thus, for instance, Vousden's 1990 textbook offering a 'comprehensive overview of the theory of protection', provides elaborate treatment of the traditional economic analysis of protection, strategic trade policy and VERs. It also provides an orthodox discussion of the normative economics of piecemeal or gradual trade liberalization including analysis of the two orthodox rules of unilateral tariff reform—'equi-proportional across the board' and 'top down' tariff reform. But the book provides no mention of EPZs, or duty remission schemes (1990: xii and *passim*).

Likewise, and perhaps even more surprisingly, the body of 'intra-industry trade' literature which has sprung up in the wake of Grubel and Lloyd's 1975 book on the subject does not appear to have considered 'intra-industry trade facilitation policy'. Intra-industry trade theory is similar to its disciplinary cousin—strategic trade theory—in its orientation around the free trade versus 'intervention' dichotomy and its ultimate ambivalence about policy. Greenaway's mid-1980s survey of the normative implications of the new sub-discipline is representative. Commenting that some models of intra-industry trade suggest that tariffs can increase welfare, Greenaway does add that generally in these instances the tariff is actually correcting a domestic distortion. He comments that if so, other policies, particularly subsidies, could usually correct the domestic distortion at lower cost (1985, pp. 87–8, 90). This invocation to offer any assistance as 'promotion not protection' is the essential insight of the new development consensus of the 1970s and, as I have argued in Section II, seems particularly apposite where intra-industry trade is present. Nevertheless, having made this observation, Greenaway proceeds to retreat back into ambivalence. He warns against *any* generalizations, including the conclusion that (intra-industry trade neutral) subsidies are generally superior to (intra-industry trade suppressing) tariffs (1985, p. 96).

The neglect of concessional trade instruments has often led to an instinctive hostility towards them. For instance in the early 1980s the Australian government introduced an extended duty drawback scheme for the Australian automotive industry. The scheme was opposed by economists in the Industries Assistance Commission who focused much more on its potential to subsidize relatively low cost exports, than its concomitant potential to substantially expand imports and, for that reason substantially undermine the very high assistance the Australian local content scheme then provided to component suppliers (Industries Assistance Commission 1981).[5] The Commission also recommended the abolition of duty drawback (Industries Assistance Commission 1987).

Concessional instruments are also often tarred with the 'second best' brush. For instance Peter Warr argues that EPZs can deflect attention from and so displace more thoroughgoing trade liberalization. Yet until it arrives at free trade, all trade liberalization is partial and so in some sense 'second best'. Given that the countries which have implemented EPZs have *ipso facto* demonstrated their unpreparedness to wholly liberalize their trade, it seems arbitrary for Warr to imply that more orthodox liberalization, via tariffication and tariff reduction, is better than less orthodox liberalization. The relevant question is: what welfare effects and what risks attend these 'non-traditional' approaches to trade liberalization compared with the alternative more traditional approaches. Certainly the very examples which Warr cites suggest a much more optimistic scenario: that the instruments of 'new trade liberalization' can help establish momentum for further liberalization. The concessions provided in export processing zones in the Philippines, Malaysia and Korea, were extended to exporters outside those zones. And as these countries became more developed, the momentum of liberalization

[5] The Commission subsequently embraced extended duty drawback for the Australian car industry. (Industry Commission, 1990).

continued to grow as more far reaching reforms took centre stage (Warr 1989, p. 85).

IV The Economics of Import Entitlements

This and the subsequent section sketch a canvass which incorporates the instruments of 'concessional trade liberalization' into orthodox economic thinking on trade liberalization. In a sense the analysis has already begun with the use of the term 'concessional trade liberalization'. One can proceed to define the import concession as an entitlement to import which overrides existing official trade barriers. As will be shown below, it is possible to imagine 'concessional trade liberalization' of a sufficiently 'pure' form that it reduces to one of the two sanctioned reform rules, top down and equiproportional across the board reform. And in more 'selective' forms, import concessions offer means of focusing trade liberalization around particular trade liberalization opportunities and priorities.

One can imagine 'pure' import concessions of at least two kinds. A 'value concession' would entitle the holder to import a certain value of imports. Alternatively what will be called a 'duty paid concession' would stand *in lieu* of a certain quantum of duty paid at customs. Assuming that, once allocated, these concessions are transferable and that those who hold, buy and use them are perfect competitors, then an expansion of concessions to the point at which they are in oversupply will lower their price. This produces the following results:

Proposition 1.1: 'Value concessions' will be used to import those goods which, in the absence of such concessions, would be the most costly to import. Accordingly, a fall in the market price of such concessions has the same effect on resource allocation as top down trade reform.

Proposition 1.2: 'Duty paid concessions' will be used where they reduce the cost of paying duty. A fall in the market price of such concessions has the same effect on resource allocation as across the board tariff reform.

(By contrast, in both cases, the income distribution effects of following concessional trade liberalization are likely to be quite different to the income distribution effects of following traditional trade reform.)

As has been the case with tariff reform generally, actual episodes of reform are 'messier' than any 'ideal type' of reform can generally afford to contemplate. It is possible to characterize the gamut of instruments of 'new trade liberalization' as examples of import concessions which have been constrained in various ways. Such constraints include:

- limitations on the imports to which concessions apply
- limitations on their transferability and/or
- requirements that firms behave in some way, such as invest or export, to 'earn' concessions.

This complicates the analysis of the effects of such instruments. Be that as it may, a mosaic of instruments has been used in developing countries. To many of these instruments it is possible to attach some trade liberalizing 'rationale'. Concessional instruments can provide the policy maker with a menu of options which accelerate the trade liberalization path in given situations in certain ways. Trade barriers discriminate against a wide range of identifiable entities in an economy. They discriminate against certain industries, export activities within industries, and certain firms and regions. Accordingly particular trade expansion cum development opportunities may be evident within firms, industries or regions. Partial import concessions can target the removal of any of these undesired effects as a priority in a trade liberalization and development strategy, in each case with differing and complex effects on trade creation and trade diversion and so welfare.

V A Taxonomy of Trade Liberalization

The table appearing below explores the deep symmetries between traditional tariff dismantling and 'concessional' or 'new trade liberalization'. In the case of each possible path of reform (Column One) it is evident that the following propositions hold:

Proposition 2.1 A partial trade liberalization measure may or may not lead to a net liberalization of trade, depending on the nature of the action and its context.

Proposition 2.2 Where the complexity of actual economies and existing policies is taken into account, there are likely to be both welfare improving and welfare impairing aspects of most if not all available measures in the case of each

type of partial trade liberalization.[6] (These ideas were explored by Viner in the customs union literature by way of the concepts of trade creation and trade diversion. The dilemmas thus explored then provided the original context for Lipsey's and Lancaster's exploration of the theory of the second best).

Proposition 2.3 As has been done with customs unions and direct tariff reduction, 'rules of thumb' can be found to indicate what reforms are likely to promote welfare and in what circumstances. For instance, some rules of thumb which could be applied to export duty drawback (Row Two) are outlined in Gruen (1991).

Proposition 2.4 In the case of each of the partial reform paths, it is possible to envisage further arrangements which would, without recourse to any of the other complementary instruments, take the economy completely to free trade (Column Five).[7]

Proposition 2.5 It follows from proposition 2.4 that the instruments of both 'traditional' and 'concessional' trade liberalization can complement each other, and so, where there is uncertainty, add to the confidence with which a given composite reform path can be expected to lead to net trade liberalization.[8]

Proposition 2.6 In addition to complementing each other, different instruments may also facilitate each other. The instruments will generally lower costs for the industries, regions, firms for which they liberalize trade. If reform cannot proceed faster than is consistent with a certain rate of growth, decline or level of activity within a region, firm or industry, then lowering its costs may increase the rate at which other liberalization measures may be implemented.

The strength of propositions 2.4 and 2.5 in the argument for at least considering non-orthodox approaches to trade liberalization should be apparent. Proposition 2.4 drives home the point that the differences between the different instruments in trade liberalization are differences in the *path* trade liberalization takes. It also shows how misleading it can be to refer to the orthodox reform rules as 'first best' and alternative approaches as 'second best' by contrast. Except for the fact that reform moves do not liberalize trade totally and instantly—something common to moves on all reform *paths* other than the last move—each instrument is 'second best' and reaches free trade according to its own properties.

Each row in the table represents an 'ideal type' for the purposes of taxonomy, although of course the instruments mentioned have usually been used in 'messier' ways and frequently in conjunction with each other, and with other assistance methods. Likewise as the table illustrates, different liberalization instruments will accelerate the achievement of different types of 'economies of integration' at different stages of the reform process. For instance, extended duty drawback will typically accelerate the achievement of economies of intra-industry trade and specialization whereas tariff reduction will accelerate the achievement of inter-industry trade and specialization. The 'integration economies' accelerated by the instruments of 'new trade liberalization'

[6] Thus with top down tariff reform, some of the gains from cutting assistance to the industry receiving the highest level of assistance will be enjoyed by the next most highly assisted industry. The reduced size of the rationalized industry will improve welfare (and create trade) whilst the increased size of the next most assisted industry will reduce welfare (and divert trade). Generally, however, the first effect is concentrated, whilst the second effect is diluted, producing the net gains which are usually associated with top down reform. Given standard neoclassical assumptions, equiproportional tariff reduction will generally produce unambiguous gross welfare gains without any gross losses (Vousden 1990, 209). However the confidence with which one may assume that *either* of the two orthodox reform rules will produce unambiguous welfare gains must wane as the standard neoclassical assumptions are relaxed (Vousden 1990, 210).

[7] Note that the 'free trade' spoken of here is different for different rows. The path to free trade referred to in Rows 1–6 is unilateral free trade, whilst the path to free trade referred to in Row 7 is global free trade. Note also that in the case of extended duty drawback arrangements, expanding the categories to which they apply (as set out in Column Five of the table) will produce freedom of trade where trade is balanced or in surplus. If trade is in deficit it is possible there may be fewer export credits than demand for them—from importers. To complete the transition to free trade using extended duty drawback in such circumstances one could allow exports to qualify for more than their own value in imports.

[8] Proof: Assume that a country has trade barriers. Take any of the instruments of unilateral trade liberalization (Rows One to Six) and move sufficiently far towards free trade that, whatever trade barriers remain, trade creation outweighs trade diversion and so there is net trade liberalization. Now repeat this step for any other instrument of unilateral trade liberalization. The two instruments chosen now complement each other in liberalizing trade.

TABLE 1

A Taxonomy of Trade Liberalization

1 Type of Trade Liberalization	2 Liberalization Instrument(s)	3 Integration Economies	4 Examples	5 Path to Free Trade
1 Inter-industry trade liberalization	Quota Expansion, tariffication, tariff reduction	Inter-industry specialization	Australia New Zealand Chile	Tariff and quota removal
2 Intra-industry trade liberalization	Extended duty drawback	Intra-industry specialization	Canada Korea Australia[a]	Expand import/export links across industries
3 Sub-national trade liberalization	Export processing zones (EPZs)	Accelerated factor (usually wage) price equalization	Wide range of LDCs[b]	Expand EPZ to cover all domestic firms
4 Firm specific trade liberalization I	'Brand to brand' complementation	Economies of common governance	ASEAN countries[c]	Expand eligibility for import permits
5 Firm specific trade liberalization II	Negotiating import rights with individual firms	Product cycle trade, Technology transfer and foreign direct investment	Japan, Korea, Taiwan, and a range of other Countries[d]	Expand concessions to all firms
6 Regional trade liberalization	Regional free trade areas	Regional trade expansion	Countries of • NAFTA • CER • EC & EFTA	Expand trade blocks

Sources:
[a] Korea (Luedde-Neurath 1986, 61–2), Taiwan (Wade 1990, 129).
[b] See Warr 1989. In a sense both Singapore's and Hong Kong's status as entrepôt ports meant that they identified their whole economies as 'export processing zones'.
[c] The Economist Intelligence Unit 1985, 71 and see Chapter Four above. Note also that this empirical example in fact operates in a regional context. 'Brand to Brand Complementation' is generally available only within the ASEAN block.
[d] Rodrik 1993, 18–9.

frequently comprehend some or all of those in Column Three from Rows Two to Five.

VI Implications

This article has suggested reasons for embracing a greater pluralism in approaches to trade liberalization than has yet become fashionable. We should recognize the empirical importance of the non-traditional trade liberalization already implemented. And we should appreciate its potential significance in trade liberalization in the future at the unilateral, bi/plurilateral and multilateral levels. The instruments of new trade liberalization not only enable the trade liberalization path to be specified in a whole range of ways which would not be possible using traditional tariff dismantling. By doing so they enable trade liberalization to be related to other reforms in new ways. Where it might be impossible to reform the markets for trade, capital and labour throughout a country in one 'big bang', instruments such as EPZs raise the prospect of small localized 'big bangs' which then have their own domestic demonstration and incentive effects (*cf.* Warr 1989, p. 85). Of course, as with the direct dismantling of trade barriers, for instance reducing tariffs on inputs to highly assisted industries, the new instruments can also be used badly (see for instance the Economist Intelligence Unit 1985, 71). The advantages of the new instruments do not mean that they are better than the old. Only that they are different and so offer new and additional possibilities which should not be ignored.

New Trade Liberalization and the Developed Countries

Where liberalization is already substantial, as in most developed countries, the potential gains available from alternative liberalization measures will probably be relatively small. Potential costs include the possibility of developing new forms of assistance which may create political constituencies which make them difficult to remove later. And until trade liberalization is complete, concessional trade liberalization (other than duty drawback which is generally already in place) will generally involve setting up new administrative procedures and/or institutions. These risks and costs may outweigh the gains. Extended duty drawback may nevertheless be capable of playing a useful role in stimulating trade within sectors of developed country economies where intra-industry trade and specialization are important and protection remains high. This description fits the automotive industries of many, if not all developed countries. Extended duty drawback arrangements have been successful in both the Australian and Canadian automotive industries in accelerating intra-industry trade and specialization (IC, 1990 Fuss and Waverman 1987, 1992) where a similar degree of trade creation would have been politically impossible on an *inter*-industry basis.

Developing and Newly Industrializing Countries

Although new trade liberalization instruments have made a relatively marginal contribution in developed industrial countries, their contribution has been central to the trade liberalization of many developing and newly industrializing countries. Most of those countries still maintain relatively high traditional tariff and non-tariff barriers on industrial products. If new trade liberalization instruments have been central to expanding trade in these countries, it seems likely that they have had attractions to their host countries which were not offered by traditional tariff dismantling policies. It seems likely that the instruments of new trade liberalization have had a mercantilist appeal to the countries which have introduced them. As Taiwanese Minister Li has commented, these instruments were developed as national planners sought to improvise methods of helping their exporters to earn foreign exchange so as to make those countries less dependent upon foreign military and financial aid (Li 1988, p. 135; *cf.* Krueger 1985, p. 208). To a significant extent the new instruments were not implemented on behalf of anything so abstract as *economic reform*. They were implemented on behalf of *exporters*.

For some, the mercantilistic appeal of these instruments may be alarming. For this author it is encouraging. For it is exceedingly difficult to make progress on liberalization without strong domestic pressure for such a course. Where countries have already adopted the instruments of new trade liberalization and where substantial progress remains to be achieved, it seems sensible to encourage the logic of what trade liberalization has hitherto been achieved to play itself out as far as possible. And where there are anxieties about co-opting mercantilist pressures to fuel the fires of liberalization, traditional liberalization can be pursued as well, both for its own sake, and because, as proposition 2.5 reassures us, it can act as a safeguard against the misuse of other forms of liberalization. Where tariffs and quantitative restrictions are liberalized in beneficial ways, the extent to which concessional instruments can distort trade will generally be reduced.[9]

New Trade Liberalization and Trade Negotiation

The institutions of international trade diplomacy are frequently blind and sometimes strongly hostile to the instruments of new trade liberalization. When countries negotiate bilaterally, plurilaterally or multilaterally, it is typical for the mutual 'concession' seeking to focus on the traditional dismantling of tariff and non-tariff trade barriers, rather than the erosion of such barriers by import concessions. It may well be appropriate that trade negotiation emphasizes the direct dismantling of trade barriers. But it seems unwise for the new instruments to be neglected quite so thoroughly.

Similar comments apply to the multilateral trading system which tends to be either blind to or actively hostile towards the instruments of new trade liberalization. The WTO specifically exempts duty drawback from its general prohibition on export subsidies. Also, in its silence, the WTO does not appear to impede the introduction of EPZs. But the 'concessions' which are traded in multilateral rounds in which member countries provide each other with mutually improved access

[9] As the assistance provided by tariffs or quantitative restrictions falls, so too does any subsidy implicit in concessional duty free access to the domestic market. This point has been appreciated in Australia with regard to the extended duty drawback arrangements for motor vehicles. As tariffs fall, the export subsidy implicit in the arrangements falls with them.

to each others' markets relate principally to the direct reduction of trade barriers. This reduces the extent to which multilateral forums might help facilitate and accelerate trade liberalization through the new instruments.

One reason for the lack of attention to the instruments of new trade liberalization in multilateral trade negotiation has been that developed countries have driven much of the GATT trade liberalization agenda. The WTO has been highly successful in the industrial products markets of most OECD countries where non-tariff barriers are relatively few, and tariff rates are often now down to single digits. A focus on tariffication of remaining non-tariff barriers and the reduction of tariff rates seems appropriate to the circumstances of these countries. But can this agenda make the most of reform opportunities in newly industrializing and developing countries? When the international community is seeking 'concessions' from Mauritius for instance, might it not be worth considering receiving some concessions in the form of expanding access to its EPZ as well as the direct reduction of its existing trade barriers?

The United States' recent aggressive moves to secure import expansion targets from certain trading partners they see as recalcitrant provides one, albeit highly flawed, model of trade diplomacy which does not discriminate between the various institutional means of liberalizing trade. Countries subject to import expansion undertakings can presumably meet them by whatever institutional means they wish. So far, such trade diplomacy has justifiably received a bad reception from economists. Import expansion targets 'manage' the *extent* of import expansion in a way which can obviously distort. Often this will not be a major problem because import expansion will actually take the host economy closer to its free trade position. (This will be particularly true of countries with high levels of protection.) Unfortunately however the emphasis of this kind of diplomacy has been to extract sector specific *bilateral* commitments to import expansion from trading partners. The sector specificity clearly has some potential to distort, although traditional trade negotiation frequently focuses on sector specific liberalization undertakings. The bilateral trade discrimination implicit in import expansions to date, however, raises the twin risks that import expansions will divert more trade than they create at the same time as undermining the cornerstone of the multilateral trading system, the Most Favoured Nation rule.

Multilateral import expansion concessions may have some merit however. In addition to any traditional concessions countries make or seek, they might consider making or seeking from other countries, commitments to multilateral increases in import volumes or market shares. Currently developing countries are often exempted from progressively tightening WTO disciplines for quite lengthy periods of time. Commitments to import expansions might provide a useful interim measure and some discipline on the countries in the period during which they lose their exemptions from other disciplines. Of course countries can expand imports in ways which will divert rather than create trade, but the suggestion here is offered in respect of countries with very illiberal regimes which would probably have to behave quite perversely in order to expand imports in a welfare impairing way. (The same kinds of perversities are also possible by agreeing to trade traditional concessions in such a way as to advantage highly assisted sectors—Carmichael 1986).

And where the WTO permits, but does little to promote concessional trade liberalization using duty drawback and EPZs, it actively impedes the use of extended duty drawback. For the WTO's illustrative list of export subsidies in the subsidies and countervailing duties code clearly includes measures which take duty drawback further than the remission of duty on imports physically incorporated into exports (GATT 1986, pp. 78–9). Again, subject to the reservations expressed above, this prohibition may be a sensible discipline on developed countries who are already close to free trade. On the other hand as newly industrializing and developing countries become more fully subject to the disciplines of the WTO, they will face pressure to eliminate those instruments which offend the letter of the WTO. Yet, for developing countries currently allowing exporters extended duty drawback from existing trade barriers, the effect of meeting the letter of the WTO without fully freeing trade may be to move once again towards inward orientation. A more balanced and contemporary approach would seek progressively to reduce trade-distorting assistance irrespective of its inward or outward orientation. For these reasons it seems appropriate to accommodate policies such as extended duty drawback within the WTO providing host countries meet conditions which ensure that these

measures are compatible with other liberalization objectives.

VII Conclusion

Many would think it is unfortunate that instruments of 'new trade liberalization' like EPZs and extended duty drawback do not liberalize trade more than they do. Perhaps it is. But every form of trade liberalization known to humanity has, so far, been partial. And in almost all circumstances, the relative merits of alternative trade liberalization possibilities can only be determined empirically having regard to individual circumstances rather than 'in principle'. This is as true of the choice between multilateral and bilateral trade negotiation as it is of the choice of instruments in unilateral trade liberalization—the choice between directly dismantling existing trade barriers and the instruments of new trade liberalization and any combination of the two approaches.

That having been said it is of course important to ensure that liberalization via one route is compatible with liberalization via others. Regional initiatives should not be incompatible with multilateral initiatives and intra-industry trade liberalization should not be incompatible with inter-industry trade liberalization. But as Michael Mussa has put it:

> The notion that global, multilateral negotiations are the only safe and legitimate way to go about further liberalising world trade is ... nonsense. Instead the right approach to seeking a more liberal ... trading system is summarised by the observation in another context, of that long-time Chicago alderman, the late Paddy Bauler, 'I seen my opportunities, and I took 'em' [1993, p. 375].

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