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INTERNATIONAL
MONETARY FUND

Trade Policies of IMF
Borrowers



June 22, 1999

Congressional Committees:

To facilitate congressional oversight of U.S. policy concerning the International Monetary Fund (IMF),¹ the Omnibus Appropriations Act for 1999 (P.L. 105-277) required us to report on the degree to which IMF borrowers² restrict free and open trade and whether their export policies may adversely affect, or result in unfair trade practices against, U.S. companies.³ The 98 current IMF borrowers include a number of countries that have received large-scale IMF financial assistance since the Asian financial crisis began in 1997.

The specific objectives of this report are to (1) identify the extent to which current IMF borrower countries restrict international trade and the borrowers whose trade has the potential to affect the United States; (2) describe the reported trade barriers and export policies⁴ of four IMF borrowers that are among those with the greatest capacity to affect the United States—Brazil, Indonesia, the Republic of Korea (hereafter referred to as Korea), and Thailand—and recent actions reported to have been taken to reduce those barriers or modify policies; (3) identify actions, in the context of their recent IMF financing arrangements, the four countries have taken or are committed to take to liberalize their trading systems; and (4) determine the extent to which the impact of the four countries' export

¹ The IMF is an organization of 182 member countries that was established to promote international monetary cooperation and exchange rate stability and to provide short-term lending to member countries that experience balance-of-payments difficulties.

² With the exception of some financing for low-income countries, the IMF does not loan funds to a country, per se. Rather, the country "purchases" the currency it needs from the IMF with an equal amount of its own currency and then later "repurchases" its own currency on terms established by the IMF. For the purposes of this report, we will use the terms "financial arrangement," "disbursement," and "loan" to refer to "purchases," and "repayments" to refer to "repurchases."

³ The Omnibus Appropriations Act for fiscal year 1999 (P.L. 105-277, Oct. 21, 1998) appropriated about \$18 billion for the IMF and required us to report on a seven-point mandate for reviews of the IMF. We have divided this mandate into three reports—this report on the trade policies of countries that borrow from IMF, one on the terms and conditions of IMF financial assistance ([International Monetary Fund: Approach Used to Establish and Monitor Conditions for Financial Assistance](#) GAO/GGD/NSIAD-99-168, June 22, 1999); and a third that addresses the IMF's financial condition, to be issued by September 30, 1999.

⁴ For purposes of this report, "trade barriers" are broadly defined as government laws, regulations, policies, or practices that protect domestic products from foreign competition. Trade barriers include tariffs and other import charges; and nontariff import barriers such as quantitative restrictions, state trade monopolies, restrictive foreign exchange practices that affect a country's trade system, and quality controls and customs procedures that act as trade restrictions. Export policies include export-related subsidies; export restrictions, such as export taxes; and performance requirements, such as the requirement that companies export a certain percentage of their production.

policies on the United States can be predicted and measured and which U.S. industry sectors might be affected by recent changes in trade from these countries. We selected Brazil, Indonesia, Korea, and Thailand because, in addition to being significant U.S. trading partners, they are among the top 10 top current IMF borrowers and have current IMF financing arrangements. Unless otherwise noted, data in this report are current as of April 30, 1999.

Results in Brief

Although the 98 current IMF borrowers all restrict trade to some extent, only a few are large enough traders to affect individual sectors of the U.S. economy. According to IMF and other measures of trade restrictiveness, borrowers have generally reduced their tariff and nontariff barriers since 1990. However, according to the IMF measure, about one-half still maintain moderate to restrictive barriers. Borrowers' levels of trade restrictiveness are similar to nonborrowers'. Few borrowers are large enough traders to significantly affect even individual U.S. industry sectors—90 borrowers accounted for 5 percent of U.S. trade in 1998 while the 8 other borrowers accounted for 21 percent. However, a few borrowers are significant U.S. trading partners and important competitors to U.S. producers in world markets. We studied four of the eight countries—Brazil, Indonesia, Korea, and Thailand. Average tariff rates in all four countries have fallen over the past decade. According to the Office of the U.S. Trade Representative (USTR) and other sources, in 1998 Thailand had an average tariff rate of about 18 percent, Korea had an average tariff rate of about 8 percent, and Brazil's and Indonesia's rates fell in between. In comparison, 1998 average tariff rates for the United States, Japan, and European Union (EU)⁵ countries were between 3 percent and 7 percent.⁶ Also, each of the four countries maintained nontariff import barriers that the IMF considers to be significant. Like about two-thirds of current IMF borrowers, Brazil, Indonesia, Korea, and Thailand are all members of the World Trade Organization (WTO), which establishes rules for international trade and provides a forum for resolving trade disputes. In recent years, the United States and other countries have used WTO dispute procedures to challenge restrictive trade policies in the four nations.

⁵ The European Union is a treaty-based, institutional framework that defines and manages economic and political cooperation among its 15 European member states: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

⁶ As the IMF pointed out in commenting on a draft of this report, these average tariff rates are only for those products with tariffs that are a percentage of the value of the product (known as "ad valorem" tariffs). Other tariffs are per unit ("specific") or a combination of ad valorem and specific tariffs. When these other types of tariffs are taken into account, a country's average tariff rate increases.

Brazil, Indonesia, Korea, and Thailand have experienced either rising trade surpluses or falling trade deficits with the United States and other countries since their recent financial crises began. The changes in the countries' U.S. trade balances were due primarily to a large decline in U.S. exports to them. U.S. exports to these countries declined because the countries' currency devaluations made U.S. and other countries' exports to them more expensive and because recessions in the four countries lowered their demand for imported products, including those from the United States. Even before the crises, the U.S. government was particularly concerned about certain trade practices in these countries, especially in Korea. The United States continues to press such issues even as it gives priority to restoring the overall health of crisis countries for their own and the U.S.' benefit. Korean trade policies of concern have included barriers to imports and distribution of beef, automobiles, and distilled spirits; discriminatory airport procurement practices; and possible subsidies that support steel exports. Policies of U.S. concern in the other three countries have included possible Brazilian subsidies to its steel industry, restrictions on automobile imports in Thailand, and inadequate protection of intellectual property rights, especially in Indonesia. The U.S. government and others have reported some progress in the last 3 years in eliminating or modifying some of these trade policies as part of the countries' commitments to the WTO and other multilateral forums, and bilaterally, through trade agreements with the United States.

Countries in an IMF financing arrangement sometimes have liberalized their trade systems within the context of their arrangements, although in many cases the liberalization has not been a condition of receiving disbursements of IMF funds. As part of their recent arrangements, Brazil, Indonesia, and Korea have made changes to trade policies.⁷ For example, under its IMF program, Korea has eliminated four subsidies. Indonesia has reduced or eliminated some import tariffs and export restrictions that encouraged local processing; it also has committed to phase out most remaining nontariff import barriers and export restrictions by the time its IMF program ends in the year 2000. However, the IMF programs in Brazil, Indonesia, Korea, and Thailand focus primarily on macroeconomic and structural reforms other than trade reform because, according to the Treasury and the IMF, restrictive trade policies were not major causes of

⁷ Thailand's IMF program has no trade liberalization commitments because, according to the Treasury Department, Thailand had fewer distorting trade policies than the other three countries in our review, and because inadequate financial supervision and central banking errors were the root causes of its financial problems, not trade-related policies or practices.

the countries' financial crises.⁸ Further, the trade reforms that Brazil, Indonesia, and Korea have undertaken are not intended to assist the countries' trading partners, though this may result from the reforms, but instead are aimed at helping the countries' economies operate more efficiently. In addition to trade liberalization measures, as part of their IMF programs, Korea, Indonesia, and Thailand have committed to further open their economies to foreign investment and to substantially restructure their financial and corporate sectors. These commitments, if fully implemented, could lead to increased U.S. investment in and trade with these countries.

The policies maintained by Brazil, Indonesia, Korea, and Thailand to encourage exports could potentially distort trade and displace production by U.S. producers, even though they may benefit other U.S. companies or consumers. However, the large macroeconomic changes in these countries caused by their recent financial crises greatly complicate predicting and measuring the policies' impact on the United States because the macroeconomic changes have probably been a more important source of recent changes in trade flows. Our analysis of 1997-98 trade data reveals that overall U.S. imports from Brazil, Indonesia, Korea, and Thailand rose moderately in 1998, but by less than U.S. imports from other trading partners. However, products accounting for about 16 percent of the value of U.S. imports from these four IMF borrowers registered large increases and falling U.S. prices during this period. Some of these product sectors, notably steel, have already been subject to petitions by U.S. industry for relief from "unfairly traded" imports under U.S. trade law,⁹ while the executive branch is monitoring imports of others of these products, including semiconductors, chemicals, and paper and paper products.

⁸ See our report on IMF terms and conditions (International Monetary Fund: Approach Used to Establish and Monitor Conditions for Financial Assistance GAO/GGD/NSIAD-99-168, June 22, 1999) for more detail on the causes of the recent financial crises of Brazil, Indonesia, and Korea as well as Argentina, Russia, and Uganda.

⁹ For purposes of this report, allegations of "unfairly traded" imports refer to petitions for relief by U.S. industry from harm as a result of imports that may be subsidized or dumped (unfairly priced). "Unfairly traded" imports means imports that, after investigations resulting in affirmative determinations by the Commerce Department and the International Trade Commission (ITC), are subject to outstanding countervailing or antidumping duty orders.

Although Still Somewhat Restrictive, IMF Borrowers' Trade Systems Are Liberalizing, and Few Are Large U.S. Trade Partners

Most IMF borrower countries have reduced important barriers to trade over the past decade. Although progress has varied among countries and over time, generally tariff and nontariff barriers have fallen. Despite this progress, many policies remain that restrict free and open trade, and some IMF borrowers still maintain very high restraints. However, borrowers' restrictiveness levels are similar to those of nonborrowers, and about two-thirds are WTO members. Only a few of the 98 IMF borrowers trade enough to have much ability to significantly affect any individual sectors of the U.S. economy.

Borrowers' Trade Restrictiveness Has Fallen

We analyzed the import barriers of IMF borrower countries using several available measures of restrictiveness, including average tariff rates,¹⁰ nontariff barriers; and indexes constructed by the IMF, the Heritage Foundation, and the Fraser Institute.¹¹ Although these indicators do not comprehensively measure all the policies that countries may use to restrict trade, they do reflect important barriers and provide information on the relative restrictiveness of countries among one another and over time. Overall, we found that these measures demonstrated growing trade liberalization. The IMF conducted a study of 27 countries' trade policies during 1990-96, using its own restrictiveness measures. The study found that during this period the number of countries labeled "restrictive"¹² fell from 63 to 41 percent, while the number of "open" countries rose from 11 to 33 percent. Taking the same 27 countries and reviewing their progress through 1998, we found that the number of restrictive countries further fell to 7 percent, and the number of open countries rose to 48 percent.¹³ Other indicators also confirmed this liberalization trend across the full group of 98 IMF borrowers.

About One-half of Borrowers Have Moderate to Restrictive Trade Barriers

Despite the progress made in reducing trade barriers, many restraints remain that inhibit imports into IMF borrower countries. According to the IMF's measure, about one-half of the 98 current borrowers maintain moderate (38 percent of borrowers) or restrictive (14 percent of borrowers) barriers. The Heritage Foundation and Fraser Institute

¹⁰ Average tariff rates are the average of the applied rates across the entire tariff schedule.

¹¹ For more information on the indicators we used, see appendix IV.

¹² The IMF overall index combines information on tariff and nontariff barriers to rank countries on a 10-point scale. From this ranking, it classifies countries as "open" (generally, average tariffs less than 10 percent and limited nontariff barriers); "moderate" (generally, average tariffs between 10 and 25 percent and significant but not pervasive nontariff barriers); and "restrictive" (generally, average tariffs higher than 25 percent and pervasive nontariff barriers). For more information, see appendix IV.

¹³ Specifically, 17 out of the 27 countries studied by the IMF were initially labeled as restrictive. In 1996, 11 countries were, and by 1998, only 2 countries remained in that category.

indicators also show a range of restrictiveness, although the Heritage Foundation's measure reported less openness than either the IMF or Fraser Institute indicator, placing over one-half of borrowers in its most restrictive groupings. The tariff data we reviewed showed that average tariffs for borrowers ranged from as low as 0.1 percent to over 40 percent, but the majority fell between 7 percent and 24 percent. In comparison, the United States, the EU, and Japan maintain average tariffs of approximately 3 to 7 percent.

Thirty of the 98 borrowers are listed in a March 1999 U.S. government report¹⁴ that identifies the most significant foreign trade barriers that affect U.S. exports. Most of the 30 countries listed were cited for having inadequate intellectual property protection or for maintaining restrictive import policies, such as setting investment barriers and creating barriers to foreign participation in government procurement.

Borrowers' Restrictiveness Levels Are Similar to Those of Nonborrowers

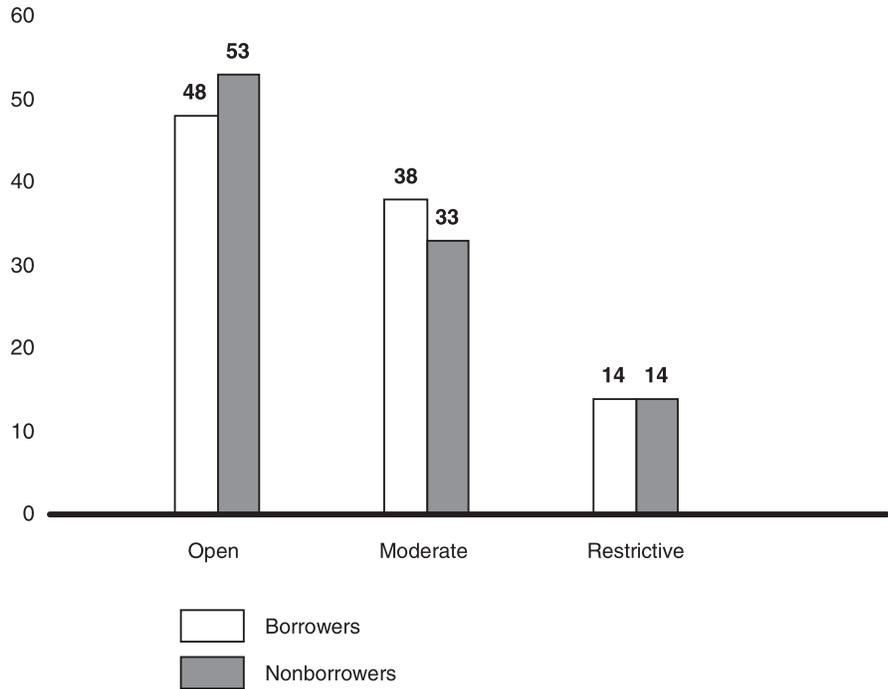
Our analysis shows that the 98 current IMF borrowers restrict trade to about the same extent as the 78 IMF member countries that do not owe funds to the IMF.¹⁵ As figure 1 shows, the IMF trade measure rates 48 percent of borrowers as open, compared with 53 percent of nonborrowers; 38 percent as moderate, compared with 33 percent of nonborrowers; and 14 percent as restrictive, compared with 14 percent of nonborrowers. Also, lesser economically developed borrowers and nonborrowers alike tended to have higher levels of restrictiveness. However, we did find that borrowers and nonborrowers tend to use different types of policies to restrict trade. Borrowers generally use higher tariff barriers, while nonborrowers tend to use higher nontariff barriers such as import quotas.

¹⁴ 1999 National Trade Estimate Report on Foreign Trade Barriers (Washington, D.C.: USTR, Mar. 31, 1999).

¹⁵ The IMF did not calculate its trade restrictiveness indicator for 6 of its 182 members.

Figure 1: Percentage of IMF Borrowers and IMF Nonborrowers in Each IMF Restrictiveness Index Category

Percentage of IMF borrowers and nonborrowers



Source: IMF.

Most Borrowers Are WTO Members, and One-fifth Have Been Involved as Respondents in Trade Disputes

Of the 98 IMF borrowers, about two-thirds are WTO members.¹⁶ WTO membership commits them to following WTO disciplines on their trade policies, providing some degree of market access, and complying with WTO dispute settlement procedures.¹⁷ Many IMF borrowers have also undertaken additional WTO liberalization commitments, as well as made commitments under bilateral agreements with the United States on investment and other matters. For example, 37 IMF borrowers have signed the WTO agreement on basic telecommunications services, and 51 have reached bilateral accords with the United States on such matters as investment and intellectual property.

¹⁶ The WTO was created as a permanent organization to oversee implementation of the Uruguay Round Agreements, to provide a forum for multilateral trade negotiations, and to settle disputes.

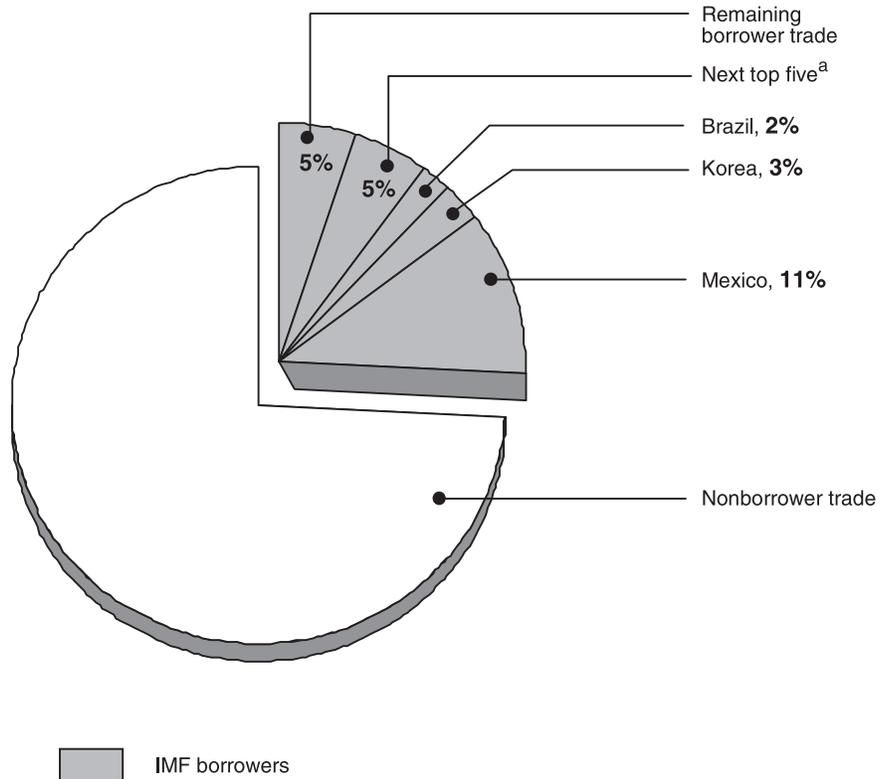
¹⁷ The WTO dispute settlement process has four main stages: (1) consultation and conciliation, (2) establishment and deliberation of panels, (3) appellate body review, and (4) implementation.

Despite greater integration into the world trading system and growing trade, many borrower countries have been involved in trade disputes with the United States. One-fifth (17) of the 98 borrowers have been subject to formal market access complaints under the WTO's dispute settlement procedures.

Few Borrowers Have Much Potential to Affect the U.S. Economy

Only a few of the 98 IMF borrowers are large enough traders to significantly affect any particular sectors of the U.S. economy. Eight borrowers accounted for 21 percent of U.S. trade in 1998, while the other 90 borrowers accounted for 5 percent. As figure 2 shows, of these eight countries, Mexico traded the most with the United States in 1998, accounting for about 11 percent of U.S. trade; followed by Korea with 3 percent; Brazil with 2 percent; and the Philippines, Thailand, Venezuela, India, and Indonesia, with about 1 percent each. One of the other 90 borrowers could significantly affect U.S. companies or workers in certain product sectors, however, if it comprised a large share of U.S. trade of a particular product. For example, flat-rolled iron and nonalloy steel imports from Russia account for approximately 26 percent of U.S. imports of that product.

Figure 2: IMF Countries' Shares of Total U.S. Trade, 1998 (Exports Plus Imports, by Country)



Source: U.S. Department of Commerce.

The eight largest U.S. trade partners generally maintain moderate barriers to trade. According to the tariff and other information we analyzed, most have average tariffs between 10 percent and 20 percent and are rated by various indicators as having significant nontariff barriers. For example, Thailand's average tariff rate in 1998 was 18 percent, Brazil's was 15 percent, and Indonesia's was 10 percent. Exceptions include Korea, which in 1998 had an average tariff rate of 8 percent; and India, with a 23 percent average rate. Mexico's average tariff rate is about 13 percent for all countries outside of the North American Free Trade Agreement (NAFTA), but its average tariff rate on U.S. products is about 2 percent due to NAFTA. All eight of these U.S. trade partners are members of the WTO, and most have bilateral trade agreements with the United States.

Trade Barriers and Export Policies of Brazil, Indonesia, Korea, and Thailand

We evaluated the import barriers and export policies of four of the eight IMF borrowers that accounted for 21 percent of U.S. trade in 1998: Brazil, Indonesia, Korea, and Thailand.¹⁸ These countries accounted for about 7 percent of U.S. trade in 1998.

Financial crises in Brazil, Indonesia, Korea, and Thailand have substantially affected their trade with the United States, even as the U.S. government has remained concerned about various trade policies in the four countries. The four countries have experienced either rising trade surpluses or falling trade deficits with the United States since their financial crises began, due primarily to a large decline in U.S. exports to them. Even before their crises began, however, the U.S. government had been concerned about a number of these countries' trade policies. Prior to the crises, much of the executive branch's attention had been focused on import policies that affected U.S. exports to the four countries, especially in Korea. Import policies of concern in the four countries have included Korean barriers to imports and distribution of beef, automobiles, and distilled spirits, government procurement procedures in airport construction, and import clearance procedures; restrictions on automobile imports in Brazil and Thailand; and inadequate protection of intellectual property rights, especially in Indonesia. Export policies that the executive branch has been concerned about include Korean government support to its steel and semiconductor industries, and Indonesian government subsidies to its automobile industry. The United States continues to press these and other trade issues even as it places priority on restoring the overall health of crisis countries for their own and the U.S.' benefit.

Financial Crises Have Substantially Affected the Four Countries' Trade

Any analysis of import barriers and export policies in Brazil, Indonesia, Korea, and Thailand must acknowledge the effects those countries' recent financial crises have had on their economies and trade. The crises that began in 1997 dramatically reduced incomes and demand for domestic as well as imported goods. The value of these nations' currencies declined, with each of the countries' currencies depreciating by 30-50 percent or more relative to the U.S. dollar in real (inflation-adjusted) terms. The depreciations reduced the purchasing power of local currencies, making it hard for these countries to buy U.S. exports. The depreciations also made the affected nation's exports more competitive on world markets. World

¹⁸ We selected these four countries because, in addition to being significant U.S. trading partners, they are among the 10 top current IMF borrowers and have current IMF financing arrangements. Mexico is the largest U.S. trading partner among these countries. We did not select Mexico because, although Mexico currently owes debts to the IMF, it is not currently in an IMF financing arrangement (that is, it is not eligible to borrow more funds from the IMF), and because a substantial share of U.S.-Mexican trade consists of special arrangements provided for under NAFTA.

prices for key commodities fell, particularly for oil, agricultural goods, and electronic products. Outflows of foreign capital and domestic credit crunches reduced output and stalled commerce, with direct implications for trade accounts.¹⁹

Even without policy changes, such macroeconomic disturbances have a major influence on overall trade levels and balances. Since their crises erupted in 1997, Indonesia and Thailand have widened their trade surpluses with other countries, Korea's trade balance went from a deficit to a surplus, and Brazil's deficit has fallen. Most of the shift was caused by a decline in these nations' imports from abroad, rather than by increases in their exports to other countries. Even though the volume of their exports rose at a double-digit rate, the dollar value of exports from these nations was actually lower in 1998 than it was in 1997 because dollar prices for many of their goods were falling dramatically. The United States, meanwhile, has seen a worsening of its trade deficit with all countries worldwide, not only in absolute terms but also relative to the size of its economy. From 1997 to 1998, the U.S. trade surplus with Brazil fell; for Korea, a U.S. surplus changed to a deficit; and for Indonesia and Thailand, U.S. deficits grew larger.

According to a March 1999 USTR report, U.S. government trade policy in 1999 remains centered on assuring recovery in the nations in financial crisis. Stabilization and growth are necessary before customers in Brazil, Indonesia, Korea, and Thailand can resume buying U.S. exports at levels at or above those in the past. Healthy economies will also absorb more of the output of local producers, easing pressures on U.S. firms competing with these nations' suppliers. Economists also suggest that the U.S. economy will suffer more if crisis countries are unable to export as they recover. For example, a 1998 Brookings Institution paper that analyzed the impact of the Asian financial crisis on trade and capital flows reached this conclusion.²⁰ In essence, a downward spiral of falling production, consumption, and imports would ensue, hurting both these four countries and the United States.

At the same time, U.S. efforts to address trade policies of concern continue. Items being actively pursued with Brazil, Indonesia, Korea, and Thailand include long-standing import market access and export subsidy

¹⁹ Since foreign capital flows must balance the trade deficit, when foreign capital leaves, either the trade deficit must fall or the trade surplus must increase.

²⁰ Warwick J. McGibbin, *The Crisis in Asia: An Empirical Assessment*, Brookings Institution Discussion Papers in International Economics, No. 136 (Washington, D.C.: The Brookings Institution, Apr. 1998).

issues, and the need to improve protection of intellectual property rights. Since the crisis unfolded, two additional types of issues have been added to the U.S. agenda: (1) ensuring that the countries do not reverse the liberalization accomplished in prior years; and (2) more vigorously addressing governmental and industry practices that the U.S. government and industry believe may have contributed to the crisis, such as directed credit and other privileges for industries deemed by these nations' governments to be important for economic development.

U.S. Concerns About Trade Policies Have Focused on the Four Countries' Import Barriers

The U.S. government has focused considerable attention in the last 3 years on eliminating or modifying certain import policies in Brazil, Indonesia, Korea, and Thailand that had restricted U.S. exports to those countries. The United States has invoked WTO dispute settlement procedures over some of these policies and has signed bilateral trade agreements to try to resolve other policies. The United States has had more concerns about Korea's import policies than about the other three countries in our review. The United States has invoked WTO dispute settlement procedures against Korean policies concerning beef, distilled spirits, airport procurement procedures, and import clearance procedures that have delayed or impeded the entry of U.S. products into Korea. Other Korean import policies that have been high priorities for the executive branch include restrictions on imports and distribution of pharmaceutical products, motor vehicles, agricultural and food products, and cosmetics. In Brazil, U.S. concerns have included policies that allegedly discriminated against U.S. automobile exports²¹ and that restrict the availability of import financing.

In Indonesia, the main U.S. concern has been over protection of intellectual property rights. In Thailand, U.S. priorities have included high import duties on certain agricultural and food products, high automobile tariffs, inadequate protection of intellectual property rights, and inefficient customs operations.

Appendix I contains more information on these and other U.S. priority import policies in Brazil, Indonesia, Korea, and Thailand.

U.S. Concerns Over the Four Countries' Export Policies

Since 1996, the United States has formally invoked WTO dispute settlement procedures over a number of Brazilian, Indonesian, and Korean subsidies and has found subsidies in Brazil, Korea, and Thailand to be countervailable under U.S. trade law; that is, that the subsidies both were being provided by their governments and were conferring a benefit to their companies under the meaning of those laws, or were specifically

²¹ In March 1998, the United States and Brazil signed an agreement settling the auto dispute.

prohibited by WTO agreements. In addition, the U.S. government has been concerned about possible export policies, such as Korean government-directed lending and support to its steel industry and the Brazilian government's auto sector policies.

Korea: U.S. Concern About Steel Support and Several Export Policies

Korea is the largest economy of the four countries we reviewed and the world's seventh largest exporter. Korea was the U.S.' ninth largest export market in 1998, dropping from its position of fifth largest in 1997 due to its financial crisis. The United States ran a \$7.4-billion merchandise trade deficit with Korea in 1998, compared to a \$1.9 billion surplus in 1997. The trade deficit resulted from a 34 percent drop in U.S. merchandise exports to Korea, from \$25.1 billion in 1997 to \$16.5 billion in 1998, and a 3.4 percent increase in Korean merchandise exports to the United States, from \$23.2 billion in 1997 to \$23.9 billion in 1998. Major Korean exports to the United States in 1998 included machinery and transport equipment, steel, manufactured goods, and chemicals and related products.

Over the last 30 years, Korea has pursued a strongly export-oriented economic development model with considerable government involvement. Under this model, the Korean government has worked closely with Korean financial institutions and large corporate conglomerates to promote exports in targeted sectors, such as heavy and chemical industries, consumer electronics, and automobiles. The overinvestment in certain sectors and excessive corporate debt that this development strategy eventually produced contributed to Korea's recent financial crisis. Government assistance to exporters has consisted of providing a range of industry-specific subsidies, tax benefits, export financing, export marketing assistance, government-influenced lending, and research and development assistance. In recent years, the United States has been concerned over Korean subsidies and other export policies.

Korean Subsidies and Internal Supports—U.S.-initiated WTO Disputes and Countervailing Duty Cases: In February 1999, the United States invoked WTO dispute settlement procedures against Korean beef industry policies. The United States alleged that Korean regulations discriminated against and constrained opportunities for the sale of imported beef in Korea and that Korea provided domestic support to its cattle industry in amounts that exceeded its WTO tariff reduction schedule. The United States and Korea engaged in formal consultations over this matter in mid-March, and a panel to consider the matter was formed on May 26, 1999. Also, within the last 5 years, the Commerce Department has determined that a number of Korean subsidies to its steel industry were countervailable under U.S.

trade law.²² The three cases have involved stainless steel plate in coils; stainless steel sheet and strip in coils; and certain cut-to-length, carbon-quality steel plate. (App. II provides more details concerning U.S. countervailing duty law, WTO subsidies rules, and these specific cases.)

U.S. Concerns About Other Korean Policies: In addition to policies that the U.S. government has formally raised in the WTO or found to be countervailing under U.S. trade law, the executive branch has been concerned about other Korean export and subsidy policies in the last 3 years. These policies have involved government-directed lending, government involvement in and support to the Korean steel industry, restructuring of corporate conglomerates (particularly in the automobile, steel, shipbuilding, and semiconductor industries), and semiconductors.

Government-directed Lending: The Commerce Department has reported that it is monitoring whether the Korean government may be influencing commercial banks to lend funds at preferential rates to targeted industries—particularly to Korea’s steel and semiconductor industries. The U.S. government has raised this issue with Korean government and industry officials on numerous occasions. In addition, Korea’s IMF and World Bank programs contain reforms to Korea’s financial system and corporate sector that help to curtail the government’s ability to direct bank lending on noncommercial terms. As previously mentioned, Commerce has examined potential subsidies resulting from alleged government-directed lending to the Korean steel industry in three recent countervailing duty investigations of certain Korean steel products.

Steel Industry: The U.S. government and U.S. steel industry have been concerned for some time about Korean government involvement in and support for its steel industry, such as below-market-interest-rate loans extended by government-owned banks to steel producers. Several actions have taken place in addition to the countervailing duty cases previously discussed. In June 1995, the U.S. Committee on Pipe and Tube Imports filed a Section 301 petition²³ alleging that Korea restricted exports of

²² Countervailing duties are only imposed if the Commerce Department determines that a countervailing subsidy is being provided and if the International Trade Commission determines that an industry in the United States is materially injured or threatened with material injury, or that the establishment of an industry in the United States is materially retarded, by reason of the subject imports.

²³ Section 301 of the Trade Act of 1974 (19 U.S.C. 2411), as amended, provides the U.S. Trade Representative with the authority to enforce U.S. rights under bilateral and multilateral trade agreements and to respond to unjustifiable or discriminatory foreign government practices that burden or restrict U.S. commerce. Section 301 investigations can be initiated by USTR or pursued by USTR in response to a petition filed by a person, firm, or association.

domestically produced steel sheet, controlled domestic prices below world prices, and diverted exports of pipe and tube products from the EU to the U.S. market. The Committee withdrew its petition in July 1995 when Korea agreed to establish a consultative mechanism with the United States to provide information about Korea's steel sheet, pipe, and tube production and exports. The Korean government also agreed to notify the United States of any measure to control steel production, pricing, or exports, and to not interfere in steel pricing or production. Although the consultative mechanism was extended for another year, and bilateral consultations were held in 1996 and 1997, the United States continued to raise concerns about Korean government influence over private-sector decisions concerning steel. In 1997 and 1998, for example, the United States asked the Korean government to respond to specific questions concerning Hanbo (Korea's second largest steel producer), which collapsed financially and is now being sold. The United States was concerned that the Korean government may have provided subsidies to Hanbo and directed Korean banks to extend credit to the company—actions that may have contributed to prices that undercut competitors and displaced U.S. steel exports to Korea and other countries.

As a result of a 30 percent surge in steel imports into the United States during the first 10 months of 1998 compared to the same period in 1997, of which about 6 percentage points came from Korea (Japan and Russia were other important suppliers), the United States initiated an extensive dialogue with the Korean government to ensure that its steel sector would operate on a market-driven basis rather than with Korean government help. In 1998, the Korean government provided written assurances that it would not support, or direct others to support, Hanbo and that the sale of the company would be market based and managed by a reputable international financial company. In addition, Hanbo temporarily shut down production at one of its plants that was of particular concern to the U.S. steel industry.

The Korean government also announced its intention to privatize Korea's largest and the world's second largest steel producer, Pohang Iron and Steel Company (POSCO). Since December 1998, the Korean government has reduced its 33 percent stake in POSCO to 20.8 percent. The full privatization of POSCO would serve to remove the Korean government's influence from the company's pricing, production, and other business decisions. In addition to monitoring POSCO's privatization, the U.S. government is continuing to monitor steel import trends and any potential Korean government support to other steel companies. In addition, the U.S. government believes that, if faithfully implemented, Korea's financial and

corporate restructuring efforts—particularly those involving bank oversight and lending limits—should help guarantee that Korea’s steel corporations operate on a market-oriented basis.

Restructuring of Corporate Conglomerates: As part of Korea’s financial arrangements with the IMF, the Korean government is trying to restructure the five largest Korean industrial conglomerates, or “chaebol,” to make them more commercially oriented and to reduce their debt levels. These chaebol are swapping certain assets and subsidiaries, as part of the so-called “Big Deal.” The World Bank is taking the lead in assisting Korea with its corporate sector restructuring. The U.S. government has flagged corporate restructuring as a systemic change that could not only help the Korean economy regain and sustain its stability but also enhance market access. The U.S. government has submitted questions to the Korean government on the specifics of certain restructuring efforts, including in the semiconductor sector, and emphasized that as a whole the restructuring should (1) yield more efficient, market-driven Korean firms without uneconomic business lines that contribute to excess capacity; and (2) be carried out in a manner that is consistent with Korea’s international obligations, particularly under the WTO Agreement on Subsidies and Countervailing Measures. The Commerce Department has reported that it is monitoring whether the Korean government might provide certain subsidies—such as tax breaks or drastic debt relief—as incentives to the companies to participate in the restructuring.

In addition to these practices, the U.S. government in 1998 reported that Korea uses various tax-related measures that benefit Korean exporters or foreign investors in Korea. These include tax reserves for export losses and overseas market development, exemptions or reductions in duties on imported capital equipment to be used in exports, reductions in duties for imported aircraft and vessel parts, tax concessions to encourage foreign investment, tax concessions for overseas business losses, tax exemptions for overseas business development, and tax credits for investment in facilities. The Commerce Department also reported on Korean subsidy practices that benefit specific industry sectors. These sectoral practices include incentives to sustain steel companies; tax exemptions or credits for firms in designated manufacturing industries (machinery, electronics, aviation, defense, fine chemicals, genetic engineering, new basic materials, and antipollution technologies); tax incentives for multinational corporations in computer software and telecommunications; expense deductions for firms in traditional industries; support to miners when mines are closed; incentives to the stone industry; and assistance to small and medium-sized enterprises.

Brazil: U.S. Focus Has Been on Three Subsidies

Brazil was the U.S.' 11th largest export market in 1998. In 1998, the United States ran a \$5-billion trade surplus with Brazil. Brazilian merchandise exports to the United States totaled about \$10 billion that year and consisted primarily of machinery and other manufactured goods. The Brazilian government does not provide many direct subsidies to exporters; however, the United States has been concerned about several that it does provide.

WTO Disputes and Countervailing Duty Cases: Since 1996, the United States has participated in WTO cases involving two Brazilian subsidies. The United States invoked WTO dispute settlement procedures and held consultations with Brazil regarding various aspects of its automotive regime in August 1996, including provisions in its WTO-notified subsidy program for automobiles. In March 1998, the United States and Brazil signed an agreement settling the dispute. (See app. I for more details on this case.) The other WTO dispute was brought by Canada and involved PROEX, a Brazilian government export financing program. The United States reserved its rights as a third party in the dispute. In April 1999, a WTO dispute resolution panel found that PROEX's interest equalization program was a prohibited export subsidy²⁴ and that, because Brazil did not meet the conditions that allow developing countries more time than developed countries to remove prohibited export subsidies, the program must be withdrawn immediately. In addition to these WTO cases, in the last 3 years the U.S. government has found one Brazilian subsidy to manufacturers of certain hot-rolled flat-rolled carbon-quality steel products to be countervailable. (See app. II for more information about the PROEX dispute and the steel case.)

Other Brazilian Subsidies of U.S. Concern: The U.S. government has been concerned about other Brazilian export programs. These programs include tax and tariff exemptions for equipment and materials imported for the production of goods for export, excise and sales tax exemptions on exported products, and rebates on materials used in the manufacture of exported products. Exporters enjoy exemptions from withholding tax for remittances sent overseas for loan payments and marketing, as well as from the financial operations tax for deposit receipts on export products. Exporters are also eligible for a rebate on social contribution taxes paid on locally acquired production inputs.²⁵ According to the Commerce

²⁴ The interest equalization program subsidizes Brazilian exports so as to equalize domestic and international interest rates for export financing.

²⁵ In commenting on a draft of this report, the IMF stated that the subsidies described in this paragraph include practices that any country with sales taxes based on the destination principle would follow. In particular, the IMF said, the EU's sales taxes rebate the entire value of the value-added tax levied on

Department, tariff concessions Brazil introduced under its auto regime in December 1995 raised questions about the regime's consistency with the WTO's Agreement on Subsidies and Countervailing Measures.

Indonesia: Concern About Automotive Subsidies

In 1998, Indonesia was the seventh largest U.S. trading partner among IMF borrowers but accounted for less than 1 percent of U.S. imports and exports. In 1998, the United States ran a \$7.6-billion merchandise trade deficit with Indonesia, an increase of \$2.5 billion from 1997. The increase in the merchandise trade deficit was mainly the result of a fall in U.S. exports to Indonesia in 1998 of \$2.2 billion. Indonesia is a significant U.S. trading partner in some sectors, such as in U.S. imports of wood and rubber products. Indonesia has notified the WTO that it maintains a small number of subsidies.

In October 1996, the United States and the EU initiated WTO dispute settlement procedures against two Indonesian subsidies to its automotive industry. One subsidy granted import duty relief to certain automotive parts and accessories for use in assembling or manufacturing motor vehicles based on the percentage of local content in the finished vehicles. The other subsidy permitted an Indonesian firm that was designated as a "pioneer" company to import tariff-free finished automobiles designated as "national cars" and to sell the national cars luxury tax-free for 3 years.²⁶ Indonesia eliminated the subsidy to the pioneer company in January 1998 as a commitment to the IMF and, based on a June 1998 WTO appellate body ruling, Indonesia has until July 1999 to eliminate the local content subsidy. In addition to these automotive industry subsidies, in March 1999 the U.S. Commerce Department found that the Bank of Indonesia's rediscount export financing program was an export subsidy; however, Commerce did not find it to be countervailable due to its small size. (See app. II for more details.)

Thailand: United States Has Found Several Subsidies to Be Countervailable

Thailand was the 26th largest export market for U.S. goods and 13th largest supplier of goods to the United States in 1998. That year, the U.S. trade deficit with Thailand increased by about \$5 billion, reaching an all-time high of \$8.2 billion; the value of U.S. merchandise exports decreased by about \$2 billion, while Thai merchandise exports increased by about \$840 million. Thailand maintains a number of programs aimed at

exports as they cross the border, and a similar mechanism functions in the case of interstate trade in the United States for certain products. Sales tax rates are considerably higher in Brazil than they are in U.S. states, according to the IMF, and the burden that would be imposed on exporters in the absence of such a rebate mechanism could be considerable.

²⁶ Japan joined the United States and the EU in disputing this second Indonesian subsidy.

promoting exports in global markets, encouraging investment, and establishing or expanding industrial development zones. These programs include subsidies in the form of credits and tax exemptions on certain exports, and reduced tariffs on raw materials for products intended for reexport.

In the past, the U.S. government has found a number of Thai subsidies to be countervailable, although in some cases no countervailing duty order was issued because the ITC did not find material injury to the competing U.S. industry. The countervailable Thai subsidies have included export packing credits (short-term, preshipment export loans); tax and duty exemptions that allow exporting companies to import machinery and equipment free of import duties and business and local taxes; import duty exemptions for raw materials that allow companies to import raw and “essential “ materials used in the production, mixing, and assembly of exports, free of import duties; and assistance for trading companies, which provides certain incentives to eligible trading companies. (See app. II for more details.)

In addition to programs found to be countervailable, the U.S. government has identified several other Thai government export programs that are of potential concern. These programs include subsidized credit on some government-to-government sales of Thai rice, which benefit certain processed agricultural products and manufactured goods.

Trade Liberalization in Brazil's, Indonesia's, Korea's, and Thailand's Recent IMF Financing Arrangements

Countries in an IMF financing arrangement sometimes have liberalized their trade systems within the context of their arrangements, although in many cases the liberalization has not been a condition of receiving disbursements of IMF funds. As part of their recent arrangements, Brazil, Indonesia, and Korea have liberalized their trade regimes to some degree. Brazil has modified one subsidy program and pledged not to introduce any new trade restrictions that hinder regional integration or are inconsistent with the WTO. Indonesia has reduced or eliminated some import tariffs and export restrictions and has committed to phase out most remaining nontariff import barriers and export restrictions by the year 2000. Korea has eliminated four subsidies and plans to make the operation of its subsidy programs more transparent. Korea is also making several changes to its import certification procedures. Thailand's IMF program has no direct trade policy commitments. One reason for this, according to the U.S. Treasury, is that Thailand had fewer distorting trade policies than the other three countries.

Although Brazil, Indonesia, and Korea are undertaking some trade reform, their IMF financing arrangements focus primarily on macroeconomic and other structural reforms rather than trade reform. According to the Treasury and the IMF, restrictive trade policies were not major causes of the countries' financial crises. Further, while several of the trade policies to be eliminated or modified under the three countries' IMF programs have been of concern to the United States and other countries, the stated purpose of these measures is not to assist the four countries' trading partners but instead it is to make their economies operate more efficiently. That said, measures taken in an effort to restore economic stability should also contribute to market opening. In addition, as part of their IMF programs, Indonesia, Korea, and Thailand plan to further open their economies to foreign investment and to substantially restructure their financial and corporate sectors. For example, Korea has committed to end government-directed lending, which USTR views as a very significant trade-related commitment. These commitments, if fully implemented, could lead to increased U.S. investment in and trade with these countries.

Purpose of Trade Liberalization in IMF Financing Arrangements

A fundamental objective of the IMF's mission, as embodied in article I of its Articles of Agreement, is to facilitate the expansion and balanced growth of international trade. According to the IMF, trade liberalization, at both the national and global levels, is thus an integral part of structural adjustment policies incorporated in IMF programs and surveillance activities. As such, countries that have borrowed from the IMF sometimes have liberalized their trade systems within the context of their financing arrangements. Borrowers have eliminated or reduced tariffs or nontariff

barriers to imports, such as import quotas, licensing, or other restrictions. They also have ended or altered export policies, such as subsidies and export restrictions. In some cases, trade liberalization measures have been IMF “performance criteria,” which are conditions that a borrower generally must meet in order to qualify for future disbursements. In many cases, however, borrowers’ trade liberalization measures were not performance criteria, although this does not mean that the IMF or the borrower considered the measures to be unimportant to achieving the objectives of the financial arrangements. According to the IMF, for some borrowers trade reform can be a critical element of structural reforms. In addition, IMF financing arrangements typically require that countries pledge not to impose or intensify import restrictions for balance-of-payments reasons.

Brazil, Indonesia, and Korea have undertaken some trade liberalization within the context of their recent IMF financing arrangements. Nevertheless, their overall IMF arrangements focus on macroeconomic and structural reforms other than trade reform because restrictive trade policies were not major causes of their financial crises, according to U.S. Treasury and IMF officials. Reflecting this reality, only one of the trade liberalization measures is a performance criterion—the requirement that Indonesia reduce export taxes on logs and sawn timber. Further, although several of the import and export policies to be eliminated or modified under their IMF programs have been of concern to the United States and other countries, the stated purpose of these reforms is not to assist the four countries’ trading partners but instead it is to make their economies operate more efficiently and thus help achieve the IMF program objectives of resolving the countries’ balance-of-payments problems and preventing their recurrence.

Brazil Is to Modify Two Export Programs and Not Impose Additional Trade Restrictions

Since December 1998, Brazil made several trade commitments within the context of its IMF financing arrangements. As table 1 shows, Brazil has committed to limit the scope of its interest equalization export subsidy program to capital goods, and, according to the IMF, Brazil has kept its pledge not to impose any new trade restrictions that hinder regional integration, are inconsistent with the WTO, or that are for balance-of-payments purposes.

Table 1: Trade Liberalization in Brazil's Recent IMF Financing Arrangements, December 2, 1998, through April 30, 1999

Measure	Description	Status
I. Import-related measures		
General	Continue promoting economic integration with MERCOSUL ^a and other regional trading partners. Increase trade with countries outside the region. Do not impose trade restrictions that are either WTO inconsistent or for balance-of-payments reasons.	Tariffs were reduced on 98 products. No new trade restrictions have been imposed that either hinder regional integration, are inconsistent with the WTO, or that are for balance-of-payments reasons.
II. Export-related measures		
Subsidies	a. Limit the scope of interest equalization export financing program to goods with a long production cycle (capital goods). b. Suspend, for 1999, exporters' rebates on social contribution taxes	a. Measure was submitted to Brazil's Congress in December 1998 but has not been approved. However, measure is in force (Brazilian law allows president to enact provisional measures before congressional ratification). Measure was submitted as part of a major tax reform proposal that called for a national value-added tax. b. Rebate was suspended for 1999.

^aMERCOSUL is the largest preferential trade arrangement in Latin America and consists of Argentina, Brazil, Paraguay, and Uruguay. Bolivia and Chile are associate members.

Sources: Brazil's letters of intent, IMF, U.S. Treasury Department.

Indonesia Is to Remove Unjustifiable Trade Restrictions

Since November 1997, Indonesia has made many changes to its trade policies in the context of its IMF financing arrangements. As table 2 shows, Indonesia has reduced tariffs on a range of mainly agricultural products and eliminated the government's monopoly on importation and distribution of agricultural products. Also, Indonesia has pledged to eliminate all other import and export restrictions by the end of its IMF program in the year 2000, except for those necessary for health, safety, environment, or security reasons. In March 1999 testimony, a Commerce Department official stated that the U.S. government has been satisfied with Indonesia's efforts to date in reforming its trade system.²⁷ However, the official also said that the true test of these reforms will come when increased trade flows resume.

²⁷ Testimony of the Honorable Patrick A. Mulloy, Assistant Secretary of Commerce for Market Access and Compliance, Before the House of Representatives, Committee on Banking, Housing, and Urban Affairs (Mar. 9, 1999).

Table 2: Trade Liberalization in Indonesia's Recent IMF Financing Arrangements, November 5, 1997, through April 30, 1999

Measure	Description	Status
I. Import-related measures		
Tariffs	a. Reduce tariffs on all items currently subject to tariffs of 15% to 25% by 5 percentage points by March 31, 1998.	a. Completed by deadline.
	b. Reduce tariffs on all nonfood agricultural products to a maximum of 10% by 2003.	b. A cut of 5 percentage points was made on February 1, 1998.
	c. Reduce tariffs on all food products to a maximum of 5%.	c. Completed on February 1, 1998.
	d. Reduce tariffs on chemical, steel/metal, and fishery products to 5%-10% by 2003.	d. Chemical tariffs were reduced by 5 percentage points on January 1, 1998.
Nontariff barriers	a. Abolish import restrictions on new and used ships.	a. Completed in February 1998.
	b. Eliminate government monopoly on agricultural commodity imports.	b. Completed as scheduled.
	c. Eliminate government monopoly's rice import subsidy.	c. Completed by March 1999.
	d. Abolish local content regulations on dairy products.	d. Completed effective February 1, 1998.
	e. Develop longer-term role for and restructure government agricultural state trading enterprise.	e. To be done with World Bank assistance
	f. Allow private traders to import rice.	f. Completed in September 1998.
	g. Phase out all remaining barriers, including quantitative restrictions, by end-program, except for those necessary for health, safety, environmental, or security reasons.	
II. Export-related measures		
Subsidies	a. Discontinue special tax, customs, and credit privileges to national car project.	a. National car project privileges were discontinued in January 1998.
	b. Phase out local content program by the year 2000.	
Aircraft program	Discontinue budgetary and extrabudgetary support.	Completed in January 1998.
Export restrictions	a. Reduce export taxes on logs, sawn timber, rattan, and minerals to 10% by December 2000 and gradually replace with resource rent taxes.	a. Begun. See (b)
	b. Reduce export taxes on logs and sawn timber to 20% by December 31, 1998. ^a	b. Not completed by deadline. IMF waived performance criteria. Completed in February 1999.
	c. Abolish export taxes on leather, cork, ores, and aluminum waste products.	c. Completed in February 1998.
	d. Lift export bans on food commodities. Replace quantitative restrictions on palm oil, olein, and stearin exports with export tax of 40% by April 22, 1998, and reduce tax to 10% by December 31, 1999.	d. Bans lifted September 1998 – April 1999. Export tax was imposed by April 22, 1998. The tax went up from 40% to 60% in mid-summer 1998, but was reduced to 40% again in February 1999.
	e. Abolish provincial and local government export taxes.	e. Completed in January 1998.
	f. Eliminate all other export restrictions by end-program, except for those deemed necessary for health, safety, security, or environmental reasons.	

^aPerformance criterion.

Sources: Indonesia's letters of intent, IMF, U.S. Treasury Department.

Korea Has Eliminated Some Subsidies and Is Reviewing Certain Import Policies

As part of its recent IMF financing arrangements, among other actions, Korea has reduced some import barriers, eliminated four trade-related subsidies, and made improvements to the transparency of its subsidy programs. Korea has met every deadline for implementing these measures, although deadlines for completing some actions have not yet passed. Table 3 shows the implementation status of trade policy measures that Korea has committed to the IMF to implement since its December 1997 IMF financing program began.

Table 3: Trade Liberalization in Korea's Recent IMF Financing Arrangements, December 4, 1997, through April 30, 1999

Measure	Description	Status
I. Import-related measures		
Tariffs	Reduce number of items subject to adjustment (higher-than-normal) tariffs used to protect domestic producers against import surges.	Number of products covered was reduced from 62 to 38.
Nontariff barriers	a. Eliminate import diversification program, which barred imports of 113 Japanese products and affected U.S. exports to Korea that contained substantial Japanese content.	a. To be phased out by June 1999. Sixteen items remain covered.
	b. Review import certification procedures. By August 15, 1998, present to IMF a plan to streamline and bring procedures in line with international practice.	b. Plan completed by deadline. Some reforms implemented during 1998, and others planned. Reforms involve a wide range of products, government ministries, and laws.
II. Export-related measures		
Subsidies	a. Eliminate four trade-related subsidies: (1) reserves for export losses of exporters, (2) reserves for exporters' overseas market development, (3) program to promote exporters' use of minicomputers, (4) tax incentives for foreign investment.	a. All were eliminated by March 31, 1998.
	b. Review all existing subsidy programs and their economic rationale and, by November 15, 1998, present to IMF a plan for rationalizing programs.	b. Plan completed by deadline. Plan proposed several measures to rationalize programs by enhancing transparency, tightening supervisory control of tax benefits, and introducing in the long term a more systematic and transparent budgeting system for tax expenditures.

Sources: Korea's letters of intent, IMF, U.S. Treasury Department.

Other IMF Conditions Could Significantly Affect the Four Countries' Trade

In addition to trade liberalization measures, as part of their IMF financing arrangements, Korea, Indonesia, and Thailand have committed to further open their economies to foreign investment and to substantially restructure their financial and corporate sectors. These commitments, if

fully implemented, could lead to increased U.S. investment in and trade with these countries. For example, Korea has eliminated the aggregate ceiling on foreign investment in Korean equities, as well as the foreign investment ceiling on domestic bonds. Other measures would facilitate friendly or hostile foreign mergers with, or acquisitions of, Korean companies, while yet others would ease restrictions in corporate foreign borrowing, the establishment of subsidiaries of foreign banks and brokerage houses, foreign direct investment, foreign acquisition of land, and foreign exchange transactions. Similarly, measures related to restructuring the financial sector would liberalize restrictions on the ability of foreign financial institutions to merge with, acquire, or invest in domestic Korean financial institutions and would allow foreigners to become bank managers. According to the IMF, the Korean economy has become much more open to foreign investment since its recent financing arrangements began. Indonesia, among other commitments, has pledged to open more sectors of its economy to foreign investment and to remove restrictions on permitting foreign banks to have branches in Indonesia. Investment liberalization could lead to more U.S. or other foreign direct or portfolio²⁸ investment. This could increase trade, because trade tends to follow investment.

In addition to liberalizing foreign investment, other structural reforms being implemented by Brazil, Indonesia, Korea, and Thailand within the context of their recent IMF financing arrangements could affect their trade. For example, according to the U.S. Treasury Department, under its IMF financing arrangements, Korea has agreed to a fundamental overhaul of its weak and noncompetitive financial system. Korea also has committed to end government-directed lending. Brazil, Indonesia, and Thailand are further privatizing state-owned enterprises. If implemented successfully in conjunction with foreign trade and investment liberalization, these structural reforms could have a significant effect on U.S. and other foreign trade and investment in these economies. Finally, to the extent that their IMF programs as a whole lessen the duration and severity of these countries' economic crises, the prospects for increased foreign trade and investment would improve. The success of these programs depends on many factors, including their macroeconomic and structural policy changes. But success also depends on factors that are in part outside of the borrowers' and the IMF's control, such as investor confidence in the four countries' economies and macroeconomic conditions in other countries.

²⁸ Portfolio investments are assets held in the form of marketable equity or debt securities.

Potential Impact of IMF Borrowers' Export Policies on the United States Is Difficult to Measure

The policies maintained by Brazil, Indonesia, Korea, and Thailand to encourage exports could potentially distort trade and displace production by U.S. producers, even though they may benefit other U.S. companies or consumers. However, the large macroeconomic changes in these countries caused by their recent financial crises greatly complicate predicting and measuring the policies' impact on the United States because the macroeconomic changes are likely a major reason for recent changes in trade flows. Moreover, overall U.S. imports from these nations grew modestly in 1998, and many sectors registered declines. Imports from Brazil, Indonesia, Korea, and Thailand also grew at a slower pace than overall U.S. imports and than they have in previous years. Nevertheless, in certain sectors such as steel and chemicals, the United States faces substantial and growing import competition from suppliers from one or more of the four countries. Products accounting for about 16 percent of the value of U.S. imports from these four IMF borrowers registered large increases in imports and falling prices over the past year. Mechanisms exist to investigate and remedy situations, such as steel import surges, where U.S. industry believes rising imports are attributable to foreign government policy and harm its economic interests.

Export Policies Can Distort Trade, but Assessing Their Impact Is Difficult

Export policies such as subsidies to producers and low-cost financing for exports can harm U.S. companies by displacing U.S. sales in the United States and other world markets. At the same time, they may benefit U.S. consumers and other U.S. industries that use the imported products. Aside from any direct economic impact, U.S. trade law and international trade agreements such as the WTO agreements contain disciplines to limit the use of subsidies and provide remedies for harmful effects of trading partners' export policies in specified circumstances.

In a prior section, we identified export policies maintained by Brazil, Indonesia, Korea, and Thailand. Relatively few of the policies have been major sources of U.S. industry or government concern. But some have been, particularly Korea's policies in the steel, automotive, shipbuilding, and semiconductor sectors and Brazil's policies in the steel and automotive sectors. Brazil and Korea were among the top 10 countries cited in U.S. countervailing duty investigations into complaints over unfairly subsidized imports during 1980-97. Brazil was the top country cited, accounting for about 11 percent of all cases filed.

However, accurately weighing the recent impact of export policies on U.S. industries is difficult. First, as has been seen, the United States can expect to face deteriorating trade balances and heightened competition from key IMF borrowers because of their financial crises and the accompanying

sharp currency devaluations and shrinking demand in these markets. The strong performance of the U.S. economy relative to that of other nations also draws in imports. For now, U.S. output is rising, inflation is low, and unemployment is at its lowest level in 30 years. These trends provide a favorable backdrop for absorbing rising imports. Also, U.S. imports from Brazil, Indonesia, Korea, and Thailand rose at a slower pace than overall U.S. imports in 1998,²⁹ and, for Brazil and Indonesia, rose by less in 1998 than they had in previous years. Indeed, substantial contractions were recorded in U.S. imports from each of the four countries in many sectors.

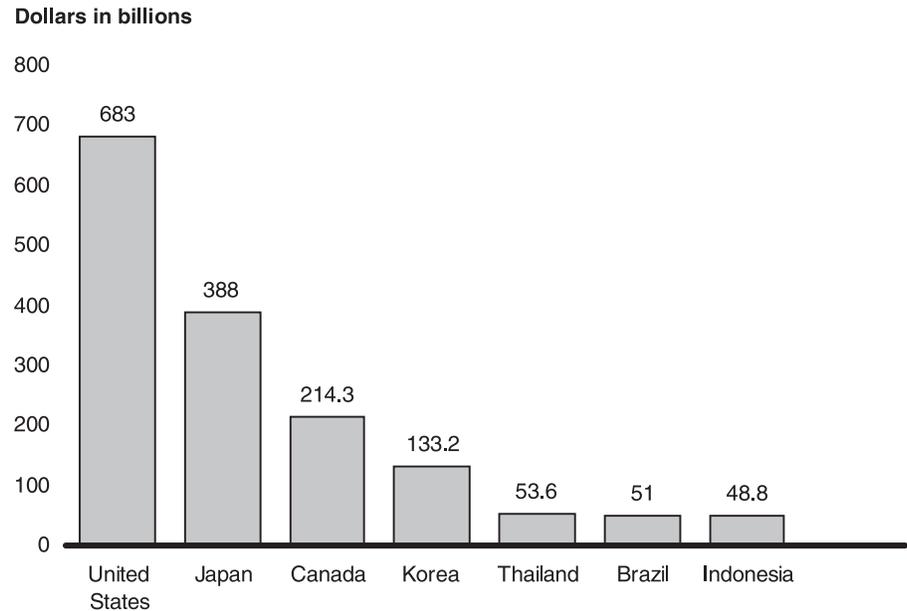
Another factor that makes it difficult to determine the impact of export policies is that such an investigation requires considerable legal, economic, and industry information. Some of this information is readily available, but much of it must be estimated or specially collected and analyzed on a case-by-base basis. For example, the U.S. government agencies responsible for administering U.S. trade law, including the Commerce Department and the ITC, conduct in-depth investigations regarding specific allegations of improper subsidies and injurious effects on domestic industries. Still, as a general rule, the larger the distortion and the greater the trade affected, the more likely the policy could harm the U.S. industry.

The United States Is an Important Market for Brazil, Indonesia, Korea, and Thailand, and Thus Stands to Be Among Those Most Affected by Their Export Policies

Brazil, Indonesia, Korea, and Thailand are leading world exporters. The U.S. market receives a substantial portion of their export shipments. Based on IMF data, the four nations account for 35 percent of the total world exports of current IMF borrowers, with Korea alone accounting for 16 percent of total exports from IMF borrowers. Recent WTO data reveal that the four countries ranked among the world's leading exporters in 1998 and that Korea was the world's 7th largest exporter, while Thailand, Brazil, and Indonesia ranked 15th, 16th, and 17th, respectively. Collectively, the four sold \$287 billion abroad in 1998, which is more than Canada, but less than the United States and Japan. Figure 3 shows 1998 exports of Brazil, Canada, Indonesia, Japan, Korea, Thailand, and the United States.

²⁹ Total U.S. imports from all sources rose by 5.36 percent from 1997 to 1998. U.S. imports from Brazil rose by 4.40 percent; from Indonesia, by 3.04 percent; from Korea, by 4.22 percent; and from Thailand by 6.87 percent.

Figure 3: World Exports, by Selected Nations, 1998



Source: WTO.

The United States is an important market for these four countries, but its importance as a buyer did not increase substantially relative to other nations in 1998. In 1998, the United States accounted for an estimated 19 percent of Brazil's exports, 18 percent of Indonesia's exports, and 16 percent of Korea's exports, according to the U.S. Department of State. All of these shares were similar to those recorded in 1997 and 1996. (Some 20 percent of Thailand's exports were shipped to the United States in 1997, the latest year for which data are available.) In 1998, the four countries together accounted for about 7 percent of both U.S. exports and imports, according to Commerce statistics. Industry analysts report that U.S. suppliers face head-on competition from all four countries in such sectors as steel and chemicals; automobiles (Korea); orange juice (Brazil); wood and paper products (Indonesia and Brazil); and poultry and pork (Thailand and Korea). However, in many product sectors, these nations compete more with each other and other nations than with U.S. suppliers. For example, Brazil competes with China, Italy, Spain, Indonesia, and Korea in footwear. Thailand competes with Mexico and the Philippines in the supply of electric wire and cables. Korea and Japan compete with U.S. producers in the United States and with each other in Asian markets for semiconductor memory devices. In other industries, such as many chemicals from Indonesia and semiconductors from Thailand, the imports

are raw materials or intermediate products used in final U.S. production of higher value-added goods.

Commerce Is Monitoring Policies and Import Surges to Detect Potential Problem Areas

The executive branch has implemented programs to detect and deter potentially harmful effects of export subsidies by these four nations (as well as certain others). These programs were developed by the Commerce Department to respond to concerns by U.S. industries. The industry concerns were twofold: that nations could use subsidies to export their way out of their financial crisis and that the IMF stabilization programs could allow these countries to resume financial practices that had previously benefited strategic industries to the possible detriment of U.S. firms and workers.

Commerce's special efforts involve (1) tracking existing and prospective policies (export or production-related subsidies) by key nations; and (2) monitoring U.S. imports in selected sectors—including steel, semiconductors, autos, paper, and chemicals—that are vulnerable to import penetration and that have faced unfair trade practices in the past. Commerce staff report that they identify import surges by examining the value, quantity, and price of imports; the share of the U.S. market that has been captured by imports (import penetration); and the level of industry concern. The result is an early warning mechanism to flag potential problems for further analysis and action, if appropriate.

Some U.S. Imports From the Four Countries Have Increased Markedly in the Past Year

To shed light on whether the export policies of Brazil, Indonesia, Korea, and Thailand could pose a potential threat to U.S. producers, we supplemented the information on export policies presented in a prior section with an analysis of imports from the four IMF borrowers that showed large increases in U.S. imports in 1998.³⁰ Textiles, apparel, and steel were the product categories that experienced the largest increases in imports from these countries. Other important categories were certain primary or processed agricultural and fishery products, chemicals, rubber products, wood and paper products, and electric and nonelectric machinery.

The results of the multistage analysis revealed that products accounting for \$9.4 billion, or 16 percent, of U.S. imports from Brazil, Indonesia, Korea, and Thailand both increased substantially and registered price declines in 1998. Table 4 shows the 62 product categories that met all of our criteria and, for each product, the percentage increase in imports from

³⁰ Specifically, we identified items that met certain value, import market share, and import increase criteria. We then examined whether prices were falling for these imports. See appendix IV for details.

the four countries. (An additional 300 items at a more disaggregated level also met our criteria and showed substantial import increases and price declines; these items accounted for \$5.3 billion in imports from the four IMF borrowers.) For example, imports of radio transmission apparatus from Korea rose by nearly 90 percent to reach a value of \$788.4 million, while imports of one category of flat-rolled steel from Korea rose by 36 percent, to \$355.8 million. Paper and paperboard imports from Indonesia were up by 284 percent, amounting to \$40.8 million.

Table 4: U.S. Imports from Brazil, Indonesia, Korea, and Thailand That Increased by More Than 15 Percent While Their Prices Fell, 1997-98 (thousands of dollars)

Product class	Product name	Change 1997-98	1998 Imports
Brazil			
Sugars and Sugar Confectionary	Sugars (nesoi ^a) including Lactose, Caramel	913.6%	\$33,077
Inorganic Chemicals; Precious & Rare Earth Metals	Titanium Oxides	648.8	3,204
Misc. Edible Preparations	Extracts of Coffee, Tea or Mate, Roast Chicory	179.5	41,591
Salt, Sulfur, Earth & Stone, Lime & Cement, etc.	Kaolin and other Kaolin Clays (including Calcined)	171.1	7,479
Coffee, Tea, Mate & Spices	Pepper, Genus Piper, Genus Capsicum or Pimenta	68.7	30,353
Edible Preparations of Meat, Fish, Crustaceans, etc.	Prepared Meats, Meat Offal & Blood (nesoi ^a)	63.0	104,753
Leather Art, Saddery, Handbags, etc.	Articles of Gut (nesoi ^a), Goldbeater's Skin, etc.	58.0	6,754
Plastics, etc.	Cellulose and Chemical Derivatives (nesoi ^a)	49.5	9,667
Iron and Steel	Flat-rolled Iron and Steel (600mm wide, cold rolled)	47.0	71,052
Rubber, etc.	Unvulcanized Rubber Forms (nesoi ^a) and Articles	36.2	3,344
Iron and Steel	Pig Iron & Spiegeleisen in Pigs, Blocks, etc.	33.6	366,229
Oreas, Slag & Ash	Aluminum Ores and Concentrates	25.5	66,712
Misc. Chemical Products	Rosin & Resin Acids, Rosin Spirit, Run Gum, etc.	22.4	3,755
Iron and Steel	Flat-rolled Iron and Steel (600mm wide)	22.0	10,555
Salt, Sulfur, Earth & Stone, Lime & Cement, etc.	Natural Graphite	20.2	6,481
Indonesia			
Paper & Paperboard, etc.	Paper, Paperboard, etc.	284.2	40,777
Dairy Products, Birds' Eggs, Honey, etc.	Edible Products of Animal Origin (nesoi ^a)	221.1	2,301
Aluminum, etc.	Household Articles (pot scour, aluminum, etc.)	71.5	45,730
Misc. Chemical Products	Rosin & Resin Acids, Rosin Spirit, Run Gum, etc.	69.7	2,469
Apparel Articles and Accessories (not knit), etc.	Men's or Boys' Undershirts (not knit or crochet), etc.	57.0	25,465
Essensial Oils, Perfumery, Cometics, etc.	Essential Oils Resinoid	50.4	36,057
Electric Machinery, Sound and TV Equipment, etc.	Primary Cells & Batteries, parts	36.5	52,522
Musical Instruments (parts and accessories)	Musical Instruments with Sound Electric Products, etc.	32.8	20,070
Coffee, Tea, Mate & Spices	Pepper, Genus Piper, Genus Capsicum or Pimenta	32.1	95,108
Edible Preparations of Meat, Fish, Crustaceans, etc.	Fish, Caviar and Caviar Substitutes	22.7	35,031
Feathers, Down, Artificial Flowers, Hair Art, etc.	Wigs of Hair and Articles of Human Hair (nesoi ^a)	20.3	38,076
Korea			
Iron and Steel	Angles, Shapes & Sections of Iron and Steel	2980.1	139,776
Articles of Stone, Plaster, Cement, Asbestos, etc.	Millstones for Grinding Various Materials	348.8	6,816
Inorganic Chemicals; Precious & Rare Earth Metals	Cyanides, Cyanide Oxides and Complex Cyanides	266.0	5,073
Iron and Steel	Wire of Alloy Steel (nesoi ^a)	92.0	7,965
Electric Machinery, Sound and TV Equipment, etc.	Transport Appar. for Radio, TV, TV Camera, Recorders	89.9	788,375
Misc. Articles of Base Metal	Wire, Rods for Soldering and Metal Spray, etc.	82.7	12,143
Misc. Edible Preparations	Ice Cream and other Edible Ice, with Cocoa or Not	80.5	1,615
Textile Articles (needlecraft, worn textile), etc.	Blankets and Traveling Rugs	71.4	16,221
Salt, Sulfur, Earth & Stone, Lime & Cement, etc.	Pumice, Emery, Natural Corundum and Garnet, etc.	70.7	951
Beverages, Spirits and Vinegar	Fermented Beverages (nesoi ^a) (Cider, Perry, Mead, etc.)	61.6	1,161
Explosives, Pyrotechnics, Matches, etc.	Ferrocium & other Pyrophoric Alloys, etc.	59.5	1,716
Products of Straw, Basketware and Wickerwork	Plaits and Products of Plaiting Materials, etc.	47.3	1,955
Articles of Iron or Steel	Nails, Tacks, Drawing Pins, etc. of Iron or Steel	37.8	118,946

Product class	Product name	Change 1997-98	1998 Imports
Misc. Articles of Base Metal	Safes, Cash or Deed Boxes of Base Metals	36.3	4,108
Iron and Steel	Flat-rolled Iron and Steel (600mm wide, hot rolled)	36.1	355,824
Plastics, etc.	Polymers of Styrene, in primary forms	35.6	44,316
Rubber, etc.	Soft Vulc. Rubber Plates, Sheets, Profile Shapes, etc.	33.6	5,081
Wadding, Felt, Yarn, Twine, Ropes, etc.	Metal Yarn, Textile Yarn, or Strip w/Metal	32.3	1,947
Mineral Fuel, Oil, Bitumin, Mineral Wax, etc.	Pitch and Pitch Coke from Coal Tar or other Mineral Tars	30.9	16,730
Electric Machinery, Sound and TV Equipment, etc.	Electric Water, Space and Soil Heaters and other Dryers	25.2	502,387
Musical Instruments (parts and accessories)	Pianos, Harpsichords and other Keyboard Stringed Instruments	24.8	68,416
Tools, Cutlery and Parts of Base Metals	Articles of Cutlery (nesoi ^a), Manicure Sets, etc.	24.0	23,042
Photographic or Cinematographic Goods	Motion-Picture Film (exposed and developed)	23.2	23,966
Misc. Manufactured Articles	Molded Resin, etc. and Carving Material (nesoi ^a)	19.8	12,126
Rubber, etc.	Hygienic or Pharmaceutical Articles of Vulcanized Rubber	17.8	1,743
Woven Fabrics, Tufted Fabric, Lace, Tapestries, Etc.	Labels, Badges, etc. of Textiles	17.2	4,676
Pearls, Precious Stones, Precious Metals, Coins, etc.	Imitation Jewelry	15.2	136,031
Thailand			
Ceramic Products	Ceramic Sinks, Washbasins, Water Closet Bowls, etc.	359.4	8,039
Photographic or Cinematographic Goods	Motion-Picture Film (exposed and developed)	238.9	8,374
Rubber, etc.	Hygienic or Pharmaceutical Articles of Vulcanized Rubber	126.6	3,603
Rubber, etc.	Articles of Apparel and Accessories of Vulcanized Rubber	51.9	222,510
Gums, Resins, and Other Vegetable Saps and Extracts	Natural Gums, Resins, Gum-Resins and Balsams	51.1	4,062
Aluminum, etc.	Household Articles (pot scour, aluminum, etc.)	44.5	63,675
Electric Machinery, Sound and TV Equipment, etc.	Electric Water, Space and Soil Heaters and other Dryers	23.4	166,568
Apparel Articles (knit or crochet), etc.	Men's or Boys Shirts (knit or crochet), etc.	17.8	137,651
Musical Instruments (parts and accessories)	Percussion Musical Instruments (drums, etc.)	17.6	6,129
Total			\$4,082,327
Total (all products)^b			\$9,370,226

^anesoi stands for "not elsewhere specified or indicated."

^badditional products at a more detailed level also met the criteria.

Sources: U.S. Department of Commerce statistics and GAO calculations.

Some U.S. Industries Appear to Be Vulnerable to Increased Imports; Others Are Less so

Though we did not separately collect production statistics for these items, our examination of analyses prepared by outside industry experts suggests that the United States produces most of these fast-rising import items, although notable exceptions include certain primary products (for example, rubber) and certain machinery and consumer electronic goods.

We then assessed whether U.S. industries that compete with the surging imports are particularly vulnerable to import competition. For example, we examined the tariff treatment of different import categories, including under the U.S. Generalized System of Preference (GSP) program.³¹ Under the program, certain imported products are not eligible for duty-free treatment because they are import sensitive. Most textiles and apparel, leather goods, and glass have been deemed import sensitive by statute. For other product sectors in which imports are surging, we examined industry reports and discussed the factors contributing to the increases and potential vulnerability of the U.S. industry with staff at the Commerce Department and the ITC. According to these industry sources, some of the import surges we identified are in industries where foreign unfair trade practices do not appear to be an issue, while other import surges are in industries where allegations of foreign unfair trade practices already exist, and still other import surges have a more tenuous relationship to policy or adverse impact.

In some cases, the industry sources we consulted cited factors other than “unfair imports” as the primary cause of surging imports:

- Market factors, such as a slight increase in U.S. coffee consumption and the need for more natural rubber for the larger tires being used in U.S. motor vehicles appear to be the primary factors in increased U.S. imports.
- In the fishery sector, rising imports of shrimp from Indonesia and Thailand appear to be tied to the strong U.S. economy; virtually all shrimp imported into the United States is destined for restaurant consumption, which has risen with U.S. incomes.
- Other increases are explained by resource endowments; for example, the United States is consuming more natural dyes and fragrances that are only available from nations with rain forest conditions, such as Brazil.

Industry reports also suggest that a variety of factors are at play in many sectors that heighten competitive pressures on U.S. firms, including the ongoing globalization of production, the emergence of new competitors in

³¹ The GSP program provides duty-free treatment for specified nations and products as part of an overall effort to help developing nations diversify and increase their exports.

Asia and elsewhere, and the price pressures that ensue from falling demand and excess capacity (some of which preceded the crisis). Some industries are calling for forceful action and strong enforcement of U.S. trade laws. Other industries, such as chemicals and forest products, say the most helpful U.S. government response would be pursuit of lowered trade barriers in these countries to provide new opportunities to U.S. exporters.

Investigations Into Industry Complaints Over Export Policies Are Underway in Some of the Sectors Having Major Increases in Imports

Some investigations into complaints over harm from export policies by Brazil, Indonesia, Korea, and Thailand are currently underway under U.S. trade statutes. In addition, export policies of Brazil and Indonesia have been subject to dispute settlement procedures in the WTO. Steel is the sector with the largest number of cases pending under U.S. trade law. Overall U.S. imports of steel were up by 9 million metric tons in 1998, and imports captured 30 percent of the U.S. market, up from 24 percent in 1997. Various cases involve Brazilian, Indonesian, and Korean suppliers, as well as suppliers in Russia and Japan. Korea's POSCO is the world's second largest steel firm, and Brazil is among the top five U.S. import suppliers of steel. On January 7, 1999, the President outlined a seven-point action plan for responding to the rise in steel imports. Various plastic and rubber goods and textiles are also under investigation. Semiconductors and other microelectronic products have been subject to dumping and intellectual property right infringement in the past; the executive branch continues to monitor imports, and Korea is among the top five U.S. import suppliers of microelectronics (including semiconductors). In addition, Brazil's aircraft subsidies were recently found to be inconsistent with WTO rules. The United States is a major consumer, not a producer, of these regional jets but has had long-standing concerns over Brazil's export financing program, which applies to other sectors.

In some recent countervailing duty cases, the U.S. Commerce Department determined the magnitude of the subsidies provided to be fairly small. Within the past 9 months, Commerce has found subsidies to Indonesian producers of rubber thread to be less than 3 percent of the thread's value, and countervailable subsidies of 6.62-9.45 percent for Brazilian hot-rolled steel. Subsidies for Korean stainless steel and strip were somewhat larger, up to 29 percent. In certain cases, the ITC has determined that imports were not causing injury to U.S. industry. In April 1999, for example, the ITC made a negative injury determination regarding synthetic rubber from Korea, Brazil, and Mexico, and in May 1999 the ITC made a negative injury determination in a case involving stainless steel round wire from Korea and other countries.

The ITC is conducting fact-finding investigations of imports of forest products at the Congress' request.³² ITC analysts suggest that U.S. suppliers face competition from hardwood plywood, and printing and writing paper from Indonesia; our data show paper imports are rising rapidly and prices are down. Commerce analysts report that the forest product industry employs more workers than the steel industry and some mills in the Northwest have recently closed in the face of weak demand and falling prices. Industry has reportedly expressed concern that rising imports from Indonesia may be due to unfair trade practices but has yet to file a formal case. Pulp imports from Brazil are also up but are reportedly from the Brazilian production facilities of U.S. firms.

Concerns Exist in Other Sectors, too, but Rising Imports May Be Primarily Due to Other Factors

Textiles and apparel imports are increasing sharply, even though U.S. limits on the quantity imported (quotas) are in place.³³ A few instances of investigations into "unfair trade" in textiles have occurred, including textile products from Thailand and a recently filed petition alleging dumping of polyester staple fiber from Korea. However, Commerce analysts report that in general the surges that occurred in the past 2 years appear to be caused by market forces and exacerbated by the financial crises that began in mid-1997, rather than government policies. Brazil, Indonesia, Korea, and Thailand are all WTO members and have bilateral quota agreements with the United States that establish comprehensive limits on virtually all categories of their textile and apparel exports to the United States. While these limits apparently had considerable room for growth,³⁴ imports from Indonesia have fallen sharply in recent months as shipments approached the upper limits associated with such quotas.

Sugar from Brazil and imports of rice from Thailand are among the agricultural and fishery products with rising imports and falling prices. Governmental policies exist in these two sectors but do not appear to be major factors in the rise. (In Brazil's case, other factors are at work, and in Thailand's case, the program involves government-to-government sales, which do not occur for the United States). However, the United States has identified Thailand's subsidies on some government-to-government sales of rice in its annual inventory of foreign trade barriers. Orange juice

³² The investigations are fact finding in nature, as opposed to investigations into unfair trade practices.

³³ Total U.S. imports of textiles and apparel rose by 20.1 percent from 1996 to 1997 and by 13.3 percent in 1998. Imports from three of the four IMF countries rose: by 14 percent from Indonesia, the U.S.' 10th ranking import supplier; by 27.8 percent from South Korea, the 7th ranking supplier; and by 29.7 percent from Thailand, the 9th-ranked supplier.

³⁴ Korea, for example, had fairly low "fill rates" for U.S. quotas on textiles and apparel items. The double-digit growth registered in the last several years has brought those fill rates close to 90 percent in certain categories.

imports from Brazil also rose considerably in 1998, but much of the rise appeared to be due to weather, which contributed to a bumper crop in Brazil and a poor crop in Florida, where 90 percent of U.S. orange juice is produced.³⁵

Chemical imports are causing price pressures on U.S. producers in the United States and other country markets. The 70-year record of U.S. surpluses in the chemicals trade was unbroken in 1998 but fell by nearly a third from 1997 levels, largely as a result of lower U.S. exports to Asia and other developing regions and higher U.S. imports from the EU. Industry analysts attribute most of the worsening to collapsing demand in Asia, which depressed U.S. and EU sales there. (U.S. exports of chemicals to Asia fell by more than 15 percent from 1997 to 1998.) However, capacity expansions that reflect both ongoing globalization of production activity by U.S. and other firms and government policies in such nations as Korea and Thailand preceded the onset of the crisis. For example, the chemical industry is the leading manufacturing sector recipient of loans from the Korean Development Bank, and Korea's production capacity in the chemical industry rose by more than 27 percent between 1995 and mid-1998. Even so, Korea supplied just 1.3 percent of total U.S. imports of chemicals in 1998.

In autos, competition to U.S. firms from Korean auto exports is rising. The 25 percent plunge in domestic demand in Korea in 1998 halved domestic shipments. Production fell by 30 percent, and Korean auto makers were forced to turn increasingly to overseas markets for sales. According to statistics by the Korean Automobile Manufacturers Association, fully 75 percent of Korean cars were exported in 1998, versus 50 percent the year before, and the total number of units exported rose slightly. The U.S. market is Korea's second largest for car exports, but Commerce officials report that competition with U.S. makers is particularly intense in European markets.³⁶ Meanwhile, despite Korea's compliance with a bilateral agreement with the United States on Korean market access for autos, there has been a virtual halt of import purchases in Korea's shrinking market.

³⁵ However, the ITC recently determined that removing an existing antidumping duty order on Brazilian orange juice would mean a continuation or recurrence of material injury to the U.S. industry from such imports.

³⁶ Passenger cars were among the leading U.S. imports from Korea in 1998, but the number of units imported fell by 5 percent.

Auto parts imports from Brazil are also increasing and could in principle be related to government policies, which require firms that make cars in Brazil to meet minimum export performance and local content levels in order to receive tax and other benefits. However, in accordance with a bilateral agreement with the United States, the Brazilian government policy is due to change by January 1, 2000, and Commerce officials we contacted were unaware of current complaints by U.S. industry. The few products that show substantial import increases appear to be original equipment parts made in Brazil and destined for their U.S. auto manufacturing facilities.

Imports of pianos, string, and other musical instruments also show large increases. The ITC recently released a report analyzing factors contributing to rising imports from Asian suppliers.³⁷ However, the ITC reports that there were no claims that the rising imports were due to export policies of those countries.

The situation in the tire and synthetic rubber industries shows how firm structure, customers' responsiveness to price, and the globalization of sourcing affect industry attitudes toward surging imports. Three of the four companies making tires in the United States are multinational firms that produce and sell tires globally; the three control 65 percent of the world tire market and reportedly have increased production and imports from such countries as Indonesia since mid-1997, when the rupiah (Indonesia's currency) plummeted. A fourth firm sells all of its production in the larger U.S. retail (consumer) market, where Korean, and to a lesser extent, Brazilian firms, compete largely on the basis of price. This firm is concerned about the 60 percent increase in imports of Korean tires. The firm has, however, filed briefs opposing findings of dumping against Brazilian and Korean suppliers of synthetic rubber³⁸ because it needs such low-cost inputs to remain competitive with tires from Korea, Indonesia, and Brazil.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from the Departments of the Treasury, Commerce, and State; the IMF; the Office of the U.S. Trade Representative; and the ITC. The Treasury provided written comments on a draft of this report, which are reprinted in appendix III. The comments characterized the report as balanced and informative. All six organizations

³⁷ U.S. International Trade Commission, Pianos: Economic and Competitive Conditions Affecting the U.S. Industry (investigation No. 332-401), USITC publication 3196 (Washington, D.C.: May 1999).

³⁸ At the time, emulsion styrene-butadiene rubber was the subject of a dumping investigation, which has since been terminated.

also provided technical and clarifying comments, which we incorporated as appropriate. For example, the IMF and USTR asked that we clarify the role that trade liberalization plays in IMF financing arrangements. At the IMF's suggestion, we have pointed out that facilitating the balanced growth of international trade is part of the IMF's core mission as embodied in its Articles of Agreement, and that, according to the IMF, trade liberalization is an integral part of IMF programs and surveillance activities. At USTR's request, we have noted that, in addition to trade and investment liberalization, other policy measures that Brazil, Indonesia, Korea, and Thailand are taking under their IMF financing arrangements to restore economic stability should also contribute to market opening; for example, Korea has committed to end government-directed lending.

We are sending copies of this report to Senator Connie Mack, Chairman, and Senator Charles Robb, Ranking Minority Member, Joint Economic Committee; Senator William Roth, Chairman, and Senator Daniel Moynihan, Ranking Minority Member, Senate Committee on Finance; Senator Phil Gramm, Chairman, and Senator Paul Sarbanes, Ranking Minority Member, Senate Committee on Banking, Housing, and Urban Affairs; Representative Benjamin Gilman, Chairman, and Representative Sam Gejdensen, Ranking Minority Member, House Committee on International Relations. We are also sending copies of this report to the Honorable Robert Rubin, the Secretary of the Treasury; the Honorable Madeleine Albright, the Secretary of State; the Honorable William M. Daley, the Secretary of Commerce; the Honorable Charlene Barshefsky, the U.S. Trade Representative; the Honorable Jacob Lew, Director, Office of Management and Budget; the Honorable Allan Greenspan, Chairman of the Federal Reserve; and the Honorable Michel Camdessus, the Managing Director of the IMF. Copies will be made available to others upon request.

This report was prepared under the direction of Harold J. Johnson, Associate Director, International Relations and Trade Issues, and Susan S. Westin, Associate Director, Financial Institutions and Markets Issues.

Please contact either Mr. Johnson at (202) 512-4128 or Ms. Westin at (202) 512-8678 if you or your staff have any questions about this report. Other GAO contacts and staff acknowledgements are in appendix V.



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Abbreviations

ASEAN	Association of Southeast Asian Nations
CVD	Countervailing duty
EU	European Union
GPA	Government Procurement Agreement
GSP	Generalized System of Preferences
IMF	International Monetary Fund
IPR	Intellectual property rights
ITC	U.S. International Trade Commission
MERCOSUL	South America's common market
NAFTA	North American Free Trade Agreement
OECD	Organization for Economic Cooperation and Development
POSCO	Pohang Iron and Steel Company
SEO	Subsidies Enforcement Office
TRIPS	Trade-related Aspects of Intellectual Property Rights
USTR	U.S. Trade Representative
WTO	World Trade Organization

Priority Import Policies of Korea, Brazil, Indonesia, and Thailand

The U.S. government has focused considerable attention in the last 3 years on eliminating or modifying certain import policies in Brazil, Indonesia, Korea, and Thailand that had restricted U.S. exports to those countries. The United States has had more concerns about Korea's import policies than about the other three countries in our review. For example, the United States has invoked World Trade Organization (WTO) dispute settlement procedures against Korean policies concerning beef, distilled spirits, airport procurement procedures, and import clearance procedures. In Brazil, the United States was involved as a third party in a WTO dispute over Brazilian policies that allegedly discriminated against automobile imports and that restrict the availability of import financing. In Indonesia, the main U.S. concern has been over protection of intellectual property rights (IPR). In Thailand, U.S. priorities have included high import duties on certain agricultural and food products, high automobile tariffs, inadequate protection of intellectual property rights, and inefficient customs operations.

Korean Import Policies

Korea has historically been considered one of the most difficult export markets in the world because of its many market access barriers. Even before its 1997 financial crisis and the establishment of financial arrangements with the International Monetary Fund (IMF), however, Korea had already begun to address some of its trade barriers because of its growing international trade links. These links, which implied a stronger reliance on international trade rules and principles, have gradually encouraged a more active role for Korea in international trading organizations that require greater market openness and trade liberalization among their members, particularly the WTO and the Organization for Economic Cooperation and Development (OECD), which Korea joined in 1996.

The United States has identified a wide range and number of barriers that impede the import of U.S. goods and services into Korea. Within the last 3 years, U.S. government agencies have been particularly active in reporting on and trying to address Korean import barriers related to the following practices:

Pharmaceuticals: Korea's treatment of foreign, research-based pharmaceuticals is one of the top priorities on the U.S. trade agenda with Korea. The Office of the U.S. Trade Representative (USTR) named pharmaceuticals trade issues as a bilateral trade expansion priority in a 1999 report to Congress. Under its national health insurance system, Korea

does not give national treatment¹ to imported drugs in terms of listing and pricing on the system's reimbursement schedule. The current system discourages medical providers from dispensing imported drugs by allowing them a higher profit margin from reimbursement for domestic drugs and by requiring additional administrative procedures for reimbursement from imported drugs. According to USTR, U.S. pharmaceutical producers also face nonscience-based requirements for clinical testing, inadequate and ineffective protection of test data against unfair commercial use, and lack of coordination between Korean health and IPR authorities that allows patent infringement. In response to high-level bilateral consultations and correspondence, the Korean government has indicated that it is taking steps to address some of the U.S. government's and industry's concerns. According to a U.S. Commerce Department official, Korea has also agreed to reimburse medical providers for imported drugs in the near future. The executive branch is continuing to work with the Korean government to address concerns related to trade in pharmaceuticals.

Beef Market Access: Korea restricts the quantity, distribution, and display of imported beef through a variety of measures, including requirements that imported beef be sold in separate retail establishments and be imported by certain designated entities. Since 1990, the U.S. government has negotiated several agreements with Korea that provide for annually increasing market access levels for beef imports; guarantee direct commercial relations between foreign suppliers and Korean retailers and distributors; and ensure that increasing volumes of beef would be sold through commercial channels instead of through a quasi-government agency. Korea has also pledged to remove all nontariff barriers on beef by 2001. In 1997 and 1998, however, Korea did not meet its quota commitments on the importation of foreign beef. In February 1999, after failing to reach agreement with Korea on reforming its beef importation practices, the United States initiated WTO dispute settlement procedures alleging that Korean regulations discriminate against and constrain opportunities for the sale of imported beef in Korea. The United States also alleged that Korea imposes sale markups on imported beef, limits import authority to certain groups, and provides domestic support to the Korean cattle industry in amounts that cause Korea to exceed its aggregate measure of support as reflected in Korea's WTO tariff reduction schedule. A panel to consider the matter was established in May 1999. Australia also

¹ National treatment is a commitment to treat imported goods no less favorably than domestically produced goods.

initiated WTO dispute resolution procedures against Korean beef practices on April 13, 1999.

Airport Procurement Procedures: Foreign companies had traditionally been limited in their opportunities to bid on government procurement contracts until Korea became a signatory to the WTO Government Procurement Agreement (GPA). During negotiations over Korea's accession to this agreement, the U.S. government reportedly received a commitment from Korea that entities responsible for airport construction would be subject to GPA disciplines. However, soon after negotiations were concluded, Korea created another entity--the Korea Airport Construction Authority--to manage procurement for the new Incheon international airport, one of the largest public works projects in Asia. The Korean government has subsequently changed the construction authority to the Incheon International Airport Corporation. Korea now asserts that, because neither the airport construction authority nor the airport corporation are expressly listed as covered entities in its GPA schedule of concessions, procurement for the Incheon international airport is not covered by the GPA. USTR reports that U.S. firms have repeatedly faced discriminatory tendering practices that hamper their ability to compete effectively for related procurement practices in the airport project. In February 1999, the United States requested consultations with Korea under WTO dispute settlement procedures. In May, the United States requested the establishment of a WTO dispute settlement panel on Korea's procurement practices after WTO consultations held on March 17 failed to resolve the issue.

Anti-import Activities: Over the years, the U.S. government has reported that frugality campaigns by Korean civic groups and media organizations have encouraged Koreans to avoid imported products and services and that the campaigns may have involved some Korean government support. In addition, the U.S. government has identified some Korean government practices that have specifically targeted imports. For example, in the past, the Korean government selected Korean lessors of imported automobiles for tax audits. Since the spring of 1997, the Korean government has publicly announced that it does not support anti-import activities and has promulgated guidelines to its officials on ensuring nondiscrimination against imports. In addition, the Korean president has urged Koreans to base their purchasing decisions on price and quality, rather than on the country of origin of the goods, and a 1998 U.S.-Korean auto memorandum of understanding states that the Korean government will effectively and expeditiously address all instances of anti-import activity associated with motor vehicles. The U.S. government, however, continues to watch for

reports of anti-import activity, and raises instances of such activity with the Korean government.

Motor Vehicles: As a result of market access barriers in the automotive sector, foreign automobiles comprised less than 1 percent of the Korean motor vehicle market in 1998, compared to about 6 percent in Japan, over 25 percent in the European Union (EU), and about 30 percent in the United States. In an October 1997 report to the Congress, the United States identified Korean barriers to motor vehicles as a priority foreign country practice, the elimination of which is likely to have the most significant potential to increase U.S. exports. Although the United States and Korea had already signed a memorandum of understanding on improving market access for foreign motor vehicles in September 1995, the United States had subsequently failed to reach agreement with Korea over remaining market access concerns. The concerns involved tariff and tax disincentives on imports, onerous and costly auto standards and certification procedures, automobile financing restrictions, and a pervasive anti-import climate for imported vehicles. After a U.S. Section 301 investigation² and bilateral negotiations over these concerns, the United States and Korea concluded a memorandum of understanding in October 1998 to improve market access for foreign motor vehicles in Korea. Under the agreement, Korea agreed to broaden coverage of the 1995 memorandum of understanding to include minivans and sport utility vehicles; streamline Korean standards and certification procedures and adopt self-certification procedures by 2002, lower and/or eliminate taxes on automobiles, bind Korean tariffs on vehicles in the WTO at 8 percent (formerly, Korea's tariff was 80 percent), introduce secured automobile financing, and implement a program to improve public perceptions of foreign automobiles. The executive branch is monitoring Korea's compliance with the agreement.

Distilled Spirits Taxes: Korea applies lower taxes to its domestically produced distilled spirit, called "soju," than to imported alcoholic beverages. As a result of various Korean taxes and tariffs on foreign distilled spirits, the tax burden on imported liquor is higher than that for soju. In fact, according to the U.S. government, the tax burden on U.S. whiskey in Korea is more than four times greater than that on soju. In 1997, the United States and the EU brought the matter to the WTO, arguing that Korea levied discriminatory taxes against imported distilled spirits.

² Section 301 of the Trade Act of 1974 (19 U.S.C. 2411), as amended, provides the U.S. Trade Representative with the authority to enforce U.S. rights under bilateral and multilateral trade agreements and respond to unjustifiable or discriminatory foreign government practices that burden or restrict U.S. commerce. Section 301 investigations can be initiated by USTR or pursued by USTR in response to a petition filed by a person, firm, or association.

Both the WTO dispute settlement panel in July 1998 and the WTO appellate body in January 1999 ruled in favor of the United States and the EU in the case. In March 1999, Korea informed the WTO that it was considering options for implementing the WTO's recommendations. In April 1999, the United States and Korea requested that the period of time for Korea to implement these recommendations be determined by arbitration. Korea requested 15 months, which the United States and the EU opposed. The arbitrator subsequently determined that Korea had 11.5 months to comply with its WTO commitments in this case.

Movie Screen Quotas: By requiring Korean movie theaters to show domestic Korean films at least 106 or 146 days each year, Korea in effect imposes a quota on foreign films, thereby deterring trade in films and cinema construction and the expansion of theatrical distribution in Korea. The U.S. government has repeatedly raised this issue with the Korean government, including during a March 1999 trade mission to Korea. Currently, this issue is under discussion in negotiations over a bilateral investment treaty.

Intellectual Property Rights: IPR-related concerns in Korea have involved limited retroactive copyright protection, incomplete trademark laws; inconsistent interpretation and implementation of patent laws; software piracy; production and export of counterfeit goods; and deficient laws on countering unfair competition and protecting trade secrets. Although Korea remained on the U.S. government's Special 301³ "watch list"⁴ in 1997, 1998, and 1999, the U.S. government acknowledges that Korea has made significant efforts to strengthen its IPR laws and enforcement. For example, pursuant to its obligations under the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), Korea passed four acts on patents, utility models, designs, and trademarks in 1995 and implemented new copyright, computer software, and customs laws in 1996. In March 1998, Korea's revised trademark law became effective and a new patent court was established. Nevertheless, in negotiations over a bilateral investment treaty, the U.S. government has asked Korea to resolve some remaining inconsistencies involving its TRIPS obligations.

³ Under the "Special 301" provision of the Omnibus Trade and Competitiveness Act of 1988 (19 U.S.C. 2242), USTR performs an annual review to identify countries that do not provide adequate or effective protection for intellectual property rights. If a country is designated as a "priority foreign country," USTR must decide within 30 days whether to initiate a Special 301 investigation into the country's IPR practices.

⁴ USTR has created a "priority watch list" and a "watch list" under Special 301 provisions to indicate countries where particular problems exist with respect to IPR protection or enforcement or market access for persons relying on intellectual property.

For example, according to USTR, Korea still does not provide full retroactive protection to existing copyrighted works. Similarly, Korea's trademark law still does not protect some famous U.S. cartoon characters because they have not been registered with Korean authorities. Also, the U.S. government has raised Korea's failure to provide TRIPS-consistent data protection and full coordination between Korea's IPR and health authorities to preclude patent infringements.

Telecommunications: U.S. equipment and services companies have traditionally encountered a range of market barriers in the Korean telecommunications sector. The United States first cited Korea in 1989 as a priority foreign country for trade barriers in the telecommunications field involving discriminatory procurement practices, "buy local" policies, lack of transparency (openness), and inadequate trade secret protection. Despite a 1992 bilateral agreement and a 1993 exchange of letters addressing Korea's telecommunications trade barriers, in July 1996 the United States designated Korea as a "priority foreign country" under Section 1374 of the Omnibus Trade and Competitiveness Act of 1988. Subsequent bilateral negotiations resulted in a July 1997 agreement in which Korea agreed to implement a range of policies to address remaining U.S. concerns and enhance U.S. market access. These policies included national treatment for foreign companies; government nonintervention in private sector procurement; increased transparency in criteria and procedures relating to services licensing, equipment certification, and type approval; increased foreign ownership in domestic service providers; enhanced protection of intellectual property and proprietary information; clear guidelines for technology transfer; transparent procedures for satellite services authorization; procompetitive regulatory measures; and an enhanced independent regulatory role for the Korean Communication Commission. Korea also agreed to eliminate tariffs on information technology products and to increase limits on foreign ownership of domestic telecommunications services companies. As a result of the agreement, the United States revoked Korea's priority foreign country designation as of August 1997. The United States is continuing to monitor Korea's implementation of the agreement as well as U.S. industry concerns over possible Korean government involvement in promoting the consolidation of private cellular telecommunications operators and wire-line companies under current conglomerate restructuring plans.

Financial Services: Korea has traditionally restricted foreign participation and involvement in its insurance, banking, and securities sectors. However, Korea has been liberalizing many of these restrictions in recent years, particularly in the context of its WTO, OECD, and IMF

commitments. According to the U.S. Treasury Department, under its IMF financing arrangements, Korea has agreed to a fundamental overhaul of its weak and noncompetitive financial system. The prudential regulatory framework is being strengthened and restructured, and banks and other financial institutions are now expected to operate in a more transparent and financially sound manner. Additionally, Korea committed to the IMF to make its OECD commitments on financial services liberalization part of its WTO commitments, which would make them subject to the WTO's binding dispute settlement mechanism. For the insurance industry, Korea included expanded market access and national treatment of foreign insurers in its WTO schedule of liberalization measures as part of the 1997 WTO financial services agreement. Similarly, in consultation with the IMF and the World Bank, Korea is implementing considerable structural reform in its banking sector to ensure that it operates on a fully commercial basis. The Korean government has also committed to the IMF to refrain from interfering in bank lending or managing decisions, to open its capital markets significantly to foreign participation, to permit foreign financial institutions to participate in mergers and acquisitions of Korean financial institutions, to allow foreign banks to establish subsidiaries or branches in Korea, and to liberalize foreign exchange controls. Under its IMF financial arrangements, Korea is also implementing considerable liberalization of its securities market by removing or lifting ceilings on foreign investment in Korean stocks, bonds, or commercial paper.

Import Clearance Procedures: The U.S. government reports that Korea's import clearance procedures often delay entry of U.S. imports into Korea. For example, certain sanitary and phytosanitary⁵ barriers frequently delay some U.S. agricultural and food exports from entering Korea for 2 to 4 weeks, and sometimes up to 2 months, except for perishable fruits and vegetables, which take a maximum of 5 days. Problems with import clearance procedures involve Korea's ingredient listing requirements, sanitary and phytosanitary rules, standards and conformity assessment procedures, and arbitrary actions by Korean inspectors. Korea has addressed some of these issues in response to U.S.-initiated WTO dispute settlement procedures. Specifically, Korea agreed to expedite clearance procedures for fresh fruits and vegetables, to use the concept of scientific risk assessment in developing a quarantine pest list and setting fumigation requirements, to revise some of its food additive standards to bring them closer to international standards, and to eliminate sorting requirements

⁵ Phytosanitary measures refers to various regulations governments may adopt to protect human, animal, or plant life or health. Although phytosanitary measures may result in trade restrictions, governments generally agree that in certain cases they are necessary and appropriate. However, governments may disagree about the need for or appropriateness of particular phytosanitary measures.

and requirements on ingredients listing by percentage for all ingredients. Under its IMF financial arrangements, Korea also presented a plan in August 1998 to streamline various import certification procedures and bring them in line with international practices.

Cosmetics: The U.S. government has identified several impediments to the entry and distribution of foreign cosmetic products in Korea. These include requirements for the Korean Food and Drug Administration to approve imports of the same cosmetic products if they have different countries of origin, the Korean government's delegation of authority to the domestic industry association to screen advertising and information brochures, the mandatory provision of proprietary information on imported cosmetics to Korean competitors, redundant testing, restrictions on sales promotions involving gifts with purchases, and burdensome import authorization and tracking requirements. The executive branch cited Korea's cosmetics-related trade barriers as a bilateral priority in a 1997 report to the Congress because the Korean government had not fully addressed U.S. concerns despite consultations between the two governments. In January 1998, the Korean Food and Drug Administration abolished the annual testing requirement for imported cosmetics and authorized importers to perform the required self-testing. Nevertheless, significant delays still remain for final government approval for the local sale of products developed outside of Korea, and cosmetics are still subject to the same rigorous and time-consuming approval process as pharmaceuticals and nutritional supplements. The U.S. government is working in conjunction with the EU to address cosmetics trade issues with the Korean government.

Brazil

According to the Brazilian government, trade liberalization is a key element in its efforts to consolidate the country's economic stabilization process. Brazil's economic liberalization—initiated in 1990 and accelerated with the Real Plan in 1994—has resulted in a more open trade regime with generally lower tariffs and reduced nontariff barriers. Alongside its liberalization efforts, Brazil has pursued further economic integration through MERCOSUL (South America's common market) and negotiations to establish the Free Trade Area of the Americas. The 5-year-old Real Plan, introduced after nearly a decade of economic stagnation and periods of hyperinflation, was the key element underpinning Brazil's efforts to stabilize its economy.

Access to Brazilian markets in a significant number of sectors is characterized as generally good—with competition and participation by foreign firms through imports, local production, and joint ventures.

However, some key liberalization measures introduced by the government of Brazil since 1995 have not been fully implemented—including some measures to eliminate government monopolies and to remove the distinction between foreign and national investors. In addition, the Brazilian government implemented temporary restrictive measures during 1996-98 to slow increasing trade deficits. Since 1990, Brazil has relied primarily on tariffs to regulate imports, rather than on nontariff barriers. Although Brazil's average import tariff increased from about 12 percent in 1996 to about 15 percent in 1998, it remained significantly below the 1990 level of 32 percent.

Within the last 3 years, U.S. government agencies have been particularly active in reporting on and addressing trade barriers related to Brazilian protection of IPR, import financing restrictions, phytosanitary restrictions on wheat, discriminatory automobile policies, and customs valuation practices and import licensing system.

Intellectual Property Rights: In April 1993, USTR identified Brazil as a priority foreign country under "Special 301" because Brazil failed to provide adequate and effective intellectual property rights protections. Later that year (May 1993), USTR initiated a Section 301 investigation of Brazil's IPR regime and requested consultations. As a result of Brazil's commitment to improve the protection of intellectual property and provide greater market access for intellectual property products, USTR terminated its investigation in early 1994 and removed Brazil's designation as a priority foreign country. However, because of Brazil's lack of progress in implementing changes to its IPR regime, Brazil was placed on the priority watch list in April 1995. Subsequent improvements in IPR protection resulted in Brazil being first moved down to the watch list in 1996 and eventually being removed from the list entirely in 1997, when a series of IPR laws was promulgated.

While the new laws represent progress in Brazil's IPR regime, deficiencies in the TRIPS-consistency and enforcement of some of these laws resulted in Brazil being placed back on the watch list in 1999. Specifically, USTR has identified problems with Brazil's Industrial Property Law, which includes a domestic working requirement for patents that is not consistent with TRIPS. In addition, USTR reported that Brazil's uneven enforcement of copyright laws is a serious and growing concern. Deficiencies in the Brazilian government's efforts to improve copyright enforcement have contributed to increasing piracy rates. Problems were particularly acute with respect to sound recordings and videocassettes—with virtually all audiocassettes sold in 1998 being pirated copies. Overall, the sound

recording industry saw its piracy losses double in 1998. The U.S. government contends that the Brazilian government's efforts to patrol its border and ports have been inconsistent (a significant amount of the pirated material enters Brazil through Paraguay) and that the Brazilian government has not provided police the tools or training to enforce the laws. Furthermore, proposed legal changes that could reduce criminal penalties for intellectual property crimes and remove police authority to initiate some searches and seizures have become a particular concern for the U.S. government. According to USTR, Brazil's generally inefficient courts and judicial system have complicated the enforcement of intellectual property rights. The U.S. executive branch believes that Brazil should increase fines so as to create a true deterrent to copyright infringement, increase the effectiveness of the criminal enforcement system, and decrease delays in the judicial process.

Import Financing Restrictions: In April 1997, Brazil-imposed requirements effectively prohibited import financing for less than 180 days on purchases from non-MERCOSUL countries and raised costs for any import financing of less than 1 year. Specifically, Brazil required importers to purchase foreign exchange for financing purposes at least 180 days in advance of the due date for short-term supplier credit (that is, less than 360 days in duration). Brazil also prevented export credit agencies such as the U.S. Export-Import Bank from offering short-term credits for certain categories of purchases (for example, raw materials, spare parts, and others). According to a Commerce Department official, these restrictions were implemented as a reaction to Brazil's burgeoning trade deficit and to combat currency speculation. It is estimated that these measures added 3 to 5 percent to the cost of affected imports. The U.S. government raised its concerns bilaterally with the Brazilian government regarding the WTO-consistency of this policy and joined as a third-party observer in the March 1998 WTO dispute settlement consultation between Brazil and the EU. The EU requested consultations with Brazil in January 1998. Although WTO consultations are still pending, Brazil eliminated its import finance restrictions in March 1999 for most practical purposes, according to the Commerce Department.

Phytosanitary Restrictions on Wheat: The access of U.S. wheat to the Brazilian market was removed in September 1996, when the government of Brazil effectively banned U.S. wheat imports due to concerns about the wheat fungus *Tilletia controversa* Kuhn. Prior to 1996, U.S. growers exported about 750,000 tons of wheat to Brazil—a leading importer of wheat. However, the United States and Brazil reached agreements on U.S. hard red winter wheat after Brazil eliminated its phytosanitary restrictions

on this type of wheat in April 1998. Brazil's decision was based on strong scientific evidence presented in a pest risk assessment. Although Brazil's government published an executive order to allow entry of U.S. hard red winter wheat into Brazil in November 1998, the United States has not made any wheat sales to Brazil since the executive order was signed. The United States continues to work bilaterally with Brazil to resolve outstanding issues that restrict market access for other types of wheat as well as other U.S. exports such as poultry.

Automobile Program: In December 1995, Brazil enacted an auto program that offers automobile manufacturers reduced import duties on automobiles and automobile parts, and other benefits if they export certain quantities of parts and vehicles and meet local content targets in their Brazilian plants. This program adversely affects U.S. exports of autos and auto parts to Brazil by distorting investment, sourcing, and production decisions. The United States also believes that the program violates the WTO's provisions on trade-related investment measures. As a result, the United States requested WTO dispute settlement consultations with Brazil on these measures in August 1996. In October 1996, USTR initiated a Section 301 investigation of Brazil's practices. In January 1997, USTR requested additional consultations with Brazil in the WTO, focusing specifically on new aspects of its auto regime that were introduced following the earlier consultations. These included tariff rate quotas⁶ for Korea, Japan, and the EU, and incentives to establish production facilities in specific regions of Brazil.

The United States and Brazil signed an agreement settling the dispute in March 1998, and USTR terminated its investigation. In this regard, Brazil committed to eliminate the trade- and investment-distorting measures in its auto regime by December 31, 1999, and agreed not to extend the WTO trade-related investment measures to MERCOSUL partners when they unify their auto regimes in the year 2000. Currently, USTR is monitoring Brazil's implementation of the March 1998 agreement, and Brazil is negotiating with its MERCOSUL partners to establish a new auto regime. The U.S. government is monitoring Brazil's MERCOSUL negotiations.

Customs Valuation and Import Licensing: In January 1997, Brazil's Secretariat of Foreign Trade implemented a computerized trade documentation system to handle import licensing. According to USTR, as

⁶ Tariff rate quotas allow a set quantity of a commodity to be imported at a guaranteed low tariff rate called the "in-quota" duty. Imports in excess of this quantity are subject to an agreed higher tariff rate called the "out-quota duty."

of January 1, 1999, the system charged a fee of Real\$30 per import statement and Real\$10 per product added to the statement. An increasing number of products are exempt from automatic licensing. In addition, beginning in October 1998, Brazil issued a series of administrative measures that required additional sanitary and phytosanitary, quality, and safety approvals from various Brazilian government entities for products subject to nonautomatic licenses. The October measures and the use of minimum price lists in conjunction with licensing have been characterized by Brazil as a deepening of its existing import licensing regime and as part of a larger strategy to prevent under-invoicing. However, according to USTR, the use of minimum price lists raises questions about whether Brazil's regime is consistent with its obligations under the WTO, and these practices have proven to be a barrier to U.S. exports.

Indonesia

According to U.S. government and WTO sources, in recent years Indonesia has liberalized its foreign trade and investment systems and has taken a number of important steps to reduce protection. The Indonesian government has done so by issuing periodic deregulation packages that have incrementally reduced overall tariff levels, simplified the tariff structure, replaced nontariff barriers with more transparent tariffs, and encouraged foreign and domestic private investment. According to USTR, Indonesia's average unweighted tariff⁷ has fallen to 9.5 percent from 20 percent in 1994, and about 160 tariff lines remained subject to restrictive import licenses, down from 1,112 lines in 1990. A November 1998 WTO report on Indonesia's trading system commended Indonesia for its trade and investment liberalization. However, the report noted that the pace of trade and investment liberalization had slowed during 1994-96. It added that, prior to its financial crisis, Indonesia had made limited progress in removing nontariff import barriers and export restrictions and that liberalization in agriculture and forestry had lagged reforms in other sectors.

Despite this progress, Indonesia still maintains a number of restrictions to imports and foreign investment, according to the U.S. government and the WTO. In recent years, Indonesian barriers to imports included high tariffs on certain items; quantitative restrictions on some agricultural and other goods; and barriers to service imports, including restrictions on wholesale and retail distribution. Barriers to foreign investment have included restrictions and prohibitions in certain sectors, such as film and video distribution and forest concessions. Since 1996, the most prominent import

⁷ Unweighted tariffs are the simple average applied tariff rate across the entire tariff schedule unadjusted for trade volumes.

barrier issue between the United States and Indonesia has concerned Indonesia's IPR protection. Since April 1996, Indonesia has been on the U.S. government's priority watch list for inadequate intellectual property protection. The U.S. executive branch has cited the following reasons for this designation: (1) trademark infringement, including software, book, video, videocassette disk, drug, and apparel piracy; (2) audiovisual market access barriers; (3) inconsistent enforcement and ineffective legal system; and (4) amendments to the copyright, patent, and trademark laws that the U.S. government believes are not fully consistent with Indonesia's obligations under the WTO TRIPS agreement. In June 1998 the U.S. executive branch presented to the Indonesian government a plan for improving IPR protection that could result in Indonesia's removal from the priority watch list. However, according to USTR, Indonesia has not been able to devote significant resources to improving or enforcing its IPR regime due to its severe economic crisis.

Thailand

Thailand's average tariff rate in 1998 was about 18 percent. In addition, as one of the 10 members of the Association of Southeast Asian Nations (ASEAN), Thailand has pledged to reach and maintain tariffs on trade with its ASEAN partners of between 0 and 5 percent by 2003. Generally, the Thai government has continued to lower tariff rates pursuant to goals established in 1994. However, USTR and other U.S. government agencies have identified several of Thailand's trade policies and practices that affect U.S. exports to Thailand, such as weak IPR enforcement. These barriers include the following:

Inadequate Protection of Intellectual Property Rights: This is the leading trade issue between the United States and Thailand. In this regard, USTR initiated Section 301 investigations in 1990 and 1991 regarding Thailand's lack of adequate protections over intellectual property. Both investigations found Thailand's copyright and patent protections to be unreasonable and burdensome to U.S. commerce. Thailand made significant improvements to its IPR legal regime and enforcement efforts in the 1990s. Despite this progress, Thailand has remained on the U.S.' Special 301 "watch list" since November 1994 because of long-standing IPR enforcement weaknesses. According to USTR's 1999 National Trade Estimate report, the U.S. copyright industry estimates it lost nearly \$200 million from intellectual property rights infringements in Thailand. In response to these concerns, the Thai government implemented a series of legal reform initiatives, established a special Intellectual Property and International Trade Court, and concluded an intellectual property enforcement action plan with the United States. However, U.S. government officials maintain that significant enforcement problems remain, piracy rates continue to climb, and

monetary penalties or jail sentences are rarely imposed to deter such crimes. In February 1999, a new enforcement strategy was implemented, but at the time of our report no information regarding the success of this effort was available.

High Tariffs on Automobiles: In addition to currently applied domestic auto sector protections (local content restrictions), which must be removed by January 1, 2000, pursuant to Thailand's commitments under the WTO agreement on trade-related investment measures, Thailand imposes significantly high tariffs on automobiles. While Thailand's overall average tariff rate is relatively low when compared with its ASEAN neighbors, its tariffs on automobiles remain high at 80 percent. However, Thailand's automobile tariffs have never risen to an actionable level, in part because Thailand's tariffs are bound in the WTO, and Thailand actually applies lower tariffs ranging from 42.5 to 68.5 percent. Furthermore, some U.S. car manufacturers assemble automobiles in Thailand, thus avoiding the higher tariffs. These manufacturers, however, pay tariffs up to 35 percent on automotive parts imports. Thailand recently announced its latest plans to bring its national car policy into conformity with its agreement on trade-related investment measures obligations as required by January 1, 2000. The plans are being studied by U.S. government officials.

Inefficient Customs Operations: USTR and the State Department report that Thailand's customs clearance processes are arbitrary, irregular, and inefficient. In 1997, the United States and nine other chambers of commerce, including Japan's, vigorously and publicly complained about Thailand's customs procedures. The U.S. government is concerned about excessive paperwork and formalities, lack of coordination between customs and other import-related agencies, and lack of modern computerized processes. However, Thailand has made progress in reforming some areas of its customs operations, such as express shipment handling, payment procedures, and document simplification. The U.S. embassy in Bangkok, the U.S. Customs Service, the IMF, and others have provided the Thai government with technical assistance to improve the customs clearance process.

High Duties on Certain Agriculture and Food Products: Specific duties for most agricultural and food products, with the exception of wine and spirits, no longer exist, but import duties on high-value fresh and processed foods remain high at about 60 percent. As a signatory to the WTO, Thailand committed to reduce tariffs and began to do so in 1995. However, by the end of the tariff reduction phase-in period in 2004, duties

will still be in the 30 to 40 percent range for most consumer-oriented food products, with the notable exception of apples and raw tree nuts. In addition to high tariffs, time-consuming and cumbersome licensing and registration procedures can delay the entry of new products into the Thai domestic market.

Investment Restrictions: Thailand's agreement with the IMF contains a commitment to accelerate privatization of state holdings in the areas of energy, public utilities, telecommunications, and transportation. Progress in this regard has been slow, but the Thai parliament has recently passed significant bankruptcy, foreclosure, and privatization laws that are aimed at expediting the privatization process. This, in turn, is expected to increase opportunities for U.S. investors to gain market access to those service sectors. Under the 1966 Treaty of Amity and Economic Relations, with the exception of a few sectors, the United States is exempted from restrictions on foreign equity investment in Thailand. However, there are still Thai government restrictions in the communications, transport, and banking sectors; the exploitation of land and natural resources; and the trade of domestic agricultural products.

WTO Disputes and U.S. Countervailing Duty Cases Involving Export Policies of Brazil, Indonesia, Korea, and Thailand

U.S. countervailing duty (CVD) laws and the WTO Agreement on Subsidies and Countervailing Measures provide redress mechanisms against the adverse effects of subsidization. U.S. companies may file CVD petitions directly with the Commerce Department. Commerce and the International Trade Commission (ITC) separately determine if the subsidies are countervailable and have harmed U.S. industry. To obtain redress through the WTO's subsidies agreement, a U.S. firm informally brings its concerns to the U.S. government, which investigates the matter and then, if warranted, raises the issue in the appropriate WTO forum.

We reviewed the export policies of four current IMF borrowers: Brazil, Indonesia, Korea, and Thailand. Since 1996, the United States has formally invoked the WTO's dispute settlement procedures over a number of Brazilian, Indonesian, and Korean subsidies and has found subsidies in Brazil, Korea, and Thailand to be countervailable under U.S. trade law. For example, the United States invoked dispute settlement procedures against Korean subsidies to its beef industry and a Brazilian subsidy to its auto industry, and determined that both countries were providing countervailable subsidies to their steel industries. Among other actions, the United States invoked WTO dispute settlement procedures against Indonesia's automotive subsidies and determined a variety of Thai subsidies to be countervailable.

Mechanisms Available to Anticipate and Remedy Adverse Effects of Foreign Export Policies

Under the Tariff Act of 1930, as amended, U.S. firms that are materially injured by foreign subsidized goods in the U.S. market can obtain relief from certain actionable subsidies by seeking to have countervailing duties levied on the subsidized imported goods.¹ CVD laws are administered jointly by the Department of Commerce and the ITC.

An interested party may file a CVD petition with Commerce alleging that a U.S. industry is materially injured, or is threatened with material injury, by reason of imports that are being subsidized by foreign governments. If the petition demonstrates a reasonable indication that a subsidy exists and is causing material injury, Commerce and the ITC conduct separate but parallel investigations. The Commerce Department determines whether the imported product is being subsidized, either directly or indirectly. An actionable subsidy exists when the foreign firm making or exporting the product (1) receives a "financial contribution" by a government or public body, (2) receives a "benefit" from that contribution, and (3) receives a financial contribution that is "specific" (that is, it is based upon export performance or limited to a certain industry or group of industries).

¹ 19 U.S.C. 1671, et seq.

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WTO Disputes and U.S. Countervailing Duty Cases Involving Export Policies of Brazil, Indonesia, Korea, and Thailand

The ITC determines whether a U.S. industry is materially injured, or threatened with material injury, or that the establishment of an industry in the United States is materially retarded, by reason of imported subsidized products. Material injury is defined as a harm that is not inconsequential, immaterial, or unimportant.² In determining the threat of material injury, the ITC considers whether the subsidy practice indicates the likelihood of substantially increased imports and whether such an increase would result in material injury to U.S. industry.

If the Commerce Department finds an actionable subsidy and the ITC finds material injury, Commerce will then issue a CVD order instructing the U.S. Customs Service to collect additional duties on the imported product in an amount equal to the subsidy margin determined by Commerce in its investigation.

The WTO Subsidies Agreement

While U.S. CVD law addresses foreign subsidized imports in the United States, under the WTO's Subsidies and Countervailing Measures Agreement, U.S. industries have a redress mechanism against foreign subsidies that affect U.S. business in markets outside the United States, including the subsidizing government's market. Under the subsidies agreement, a subsidy is defined as a financial contribution that imposes a cost on the government providing it, and confers a benefit to certain enterprises. The subsidy must be causing serious prejudice to a U.S. industry.³

In 1995, the U.S. Commerce Department created the Subsidies Enforcement Office (SEO) to assist U.S. businesses by monitoring foreign subsidies and identifying subsidies that can be remedied under the WTO's subsidies agreement when they adversely affect U.S. business interests. One of the focuses of the SEO's subsidies monitoring program is to ensure compliance with the subsidy-related conditions of the IMF stabilization packages and to uncover subsidy practices that are actionable under the WTO's subsidies agreement.

Unlike U.S. CVD law, a concerned U.S. business does not file a formal petition with the SEO to allege a foreign subsidy in violation of the WTO subsidies agreement. Instead, the SEO receives information concerning foreign subsidy practices through informal contacts with U.S. businesses, trade associations, U.S. embassies, and the SEO's own monitoring efforts.

² Section 771(7) of the act (19 U.S.C. 1677(7)).

³ Article 6.1 of the Agreement on Subsidies and Countervailing Measures.

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Once the SEO has evaluated all available information on the particular alleged subsidy, SEO will confer with USTR on how to proceed. In many cases, an effective way to proceed is through informal channels, bilateral meetings, and in WTO subsidies agreement committee meeting discussions. However, formal enforcement mechanisms are also provided for under the WTO subsidies agreement, including dispute settlement action in the WTO.

The WTO Committee on Subsidies and Countervailing Measures also provides regular surveillance. In May 1999, the United States participated in review by the committee of the full notifications submitted to the WTO by countries that were due on July 1, 1998. Korea's notification was among those that were discussed at that review. Over the past 2 years, the United States has posed a series of questions to all four IMF borrower countries in our review regarding their WTO subsidy notifications. In addition, it invited the three Asian borrowers to discuss their IMF financing arrangements at a special meeting held in April 1998.

The U.S. government tracks export and domestic policies of various countries for possible subsidization and routinely examines subsidies notified to the WTO for conformity with the subsidies agreement. The SEO also has created a "Subsidies Enforcement Library" that contains such WTO notifications, Federal Register notices associated with past U.S. CVD cases, and other information. Commerce and USTR jointly prepare an annual report to Congress on the WTO subsidies agreement. In addition, USTR, State, and Commerce include export policies in their regular reports on trade barriers. Finally, an interagency task force under the leadership of the U.S. Department of the Treasury is reviewing trade policies of key IMF borrower countries, including export policies. All of these rely heavily on industry to identify and make known potential problems.

U.S. WTO and CVD Cases Involving Korea

In February 1999, the United States requested consultations under the WTO dispute settlement mechanism concerning Korean government support to its beef industry. The United States alleged that Korean regulations discriminated against and constrained opportunities for the sale of imported beef in Korea. The United States also alleged that Korea provided domestic support to its cattle industry in amounts that exceeded its WTO tariff reduction schedule. The United States contended that such support amounts to domestic subsidies that contravene the WTO Agreement on Agriculture. A panel was formed to consider the matter on May 26, 1999. Australia also initiated WTO dispute settlement procedures against Korean beef practices in the WTO on April 13, 1999.

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WTO Disputes and U.S. Countervailing Duty Cases Involving Export Policies of Brazil, Indonesia, Korea, and Thailand

Also, within the last 5 years the Commerce Department has conducted three CVD investigations, all involving potential Korean government subsidies to its steel industry. Commerce launched the first of these investigations in April 1998 to determine whether Korea was providing countervailable subsidies to certain Korean producers and exporters of stainless steel plate in coils. In its final determination in March 1999, Commerce ruled that the subsidy existed but that it was not countervailable due to its small size. Nevertheless, prior to Korea's recent IMF financing arrangements, the Commerce Department found certain other Korean subsidy programs to be countervailable. These subsidies involved

- government-influenced lending,
- government infrastructure investments at a port facility used predominantly by a state-owned steel company,
- short-term export financing,
- tax reserves for export losses,
- tax reserves for overseas market development,
- investment tax credits, and
- electricity discounts from a government-owned power company.

In July 1998, the Commerce Department began another investigation to determine whether Korea was providing countervailable subsidies to certain Korean producers and exporters of stainless steel sheet and strip in coils. In its final determination in June 1999, Commerce ruled that such countervailable subsidies were being provided. These subsidies involved

- government influenced lending;
- the purchase of one steel company's divisions by another state-owned steel company;
- government-supported infrastructure development at a port facility used predominantly by a state-owned steel company;
- export industry facility loans;
- short-term export financing;
- tax reserves for export losses;
- tax reserves for overseas market development;
- investment tax credits;
- utility rate discounts from the government-owned electricity provider;
- loans from the National Agricultural Cooperation Federation; and
- two-tiered pricing structure for domestic customers of one steel company.

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Finally, in March 1999, the Commerce Department initiated an investigation to determine whether Korea, among other countries, was providing countervailable subsidies to certain manufacturers, producers, or exporters of certain cut-to-length, carbon-quality steel plate. As part of the investigation that was still ongoing as of April 30, 1999, the Commerce Department is reviewing alleged countervailable subsidies involving

- a two-tiered pricing structure to domestic customers of one steel company;
- government-directed credit programs;
- Korea's Private Capital Investment Act;
- government-supported infrastructure development at a port facility;
- certain tax programs and asset revaluation under Korea's Tax Reduction and Exemption Control Act;
- special cases of Tax for Balanced Development Among Areas;
- certain industry promotion and research and development subsidies;
- Overseas Resource Development loan and grant programs;
- free trade zones;
- excessive duty drawbacks;
- port facility fees;
- preferential utility rates;
- a scrap reserve fund;
- export insurance rates by the Korean Export Insurance Corporation;
- short-term export financing;
- Korean Export-Import Bank loans;
- Export Industry Facility Loans and Special Facility Loans; and
- loans from the Energy Savings Fund.

Brazil

Since 1996, the United States has participated in two WTO dispute settlement proceedings involving Brazilian subsidies. The United States invoked WTO dispute settlement procedures and held consultations with Brazil regarding various aspects of its automotive regime in August 1996, including provisions in its WTO-notified subsidy program for automobiles. In March 1998, the United States and Brazil signed an agreement settling the dispute. (See app. I for more details.) Japan and the European Union have also invoked WTO dispute settlement procedures in response to various aspects of Brazil's automotive regime. These consultations were pending as of April 30, 1999.

In a second dispute, in June 1996, Canada requested consultations with Brazil regarding its claim that export subsidies granted by PROEX, a Brazilian government export financing program, to foreign purchasers of Brazil's Embraer aircraft were inconsistent with the WTO's Agreement on

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Subsidies and Countervailing Measures. Canada later requested establishment of a WTO dispute settlement panel to review the matter. The United States and the European Union reserved their rights as third parties in the dispute. One of the many U.S. submissions to the panel challenged Brazil's position that it could provide export subsidies to counter nonexport credit subsidies offered by another WTO member. In April 1999, the dispute settlement panel found that Brazil did not meet the conditions that allow developing nations more time than developed nations to remove prohibited export subsidies, such as PROEX. The panel declared that PROEX's interest equalization program was a prohibited export subsidy and that it must be withdrawn without delay.

In addition to the WTO disputes, the U.S. government has preliminarily determined one Brazilian subsidy to its steel industry to be countervailable. In October 1998, the Commerce Department began investigating whether Brazil was providing countervailable subsidies to manufacturers of certain hot-rolled flat rolled carbon-quality ("hot-rolled") steel products. In its preliminary decision in February 1999, Commerce ruled that some equity infusions and debt-to-equity conversions provided to several of these manufacturers were countervailable because they were inconsistent with the usual investment practices of private investors. The net subsidy rate for these manufacturers ranged from 6.62 percent to 9.45 percent. The Commerce Department also preliminarily ruled that tax deferrals that were provided to some of the same steel manufacturers were not countervailable because they were not limited to any specific industry.

Indonesia

According to USTR, since 1996, Indonesia's most controversial trade policy has been its efforts to develop an indigenous automotive industry. Two programs were involved. One program, which was begun in 1993 and was to be continued until the year 2000, granted import duty relief to certain automotive parts and accessories for use in assembling or manufacturing motor vehicles based on the percentage of local content in the finished vehicles. The other subsidy related to the 1996 establishment of a national car program. Under this program, Indonesian companies designated as "pioneer firms" were permitted to import tariff-free finished automobiles designated as "national cars," and to sell the national cars luxury tax free for 3 years. A single Indonesian company was granted pioneer status, and in 1996 it began importing finished national cars from Korea, where they were produced by a company that was jointly owned by the Indonesian company and a Korean firm.

In October 1996, 6 months after Indonesia announced the establishment of its national car program, the United States and the European Union

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initiated WTO dispute settlement procedures against the program and against the other automotive sector subsidy, the local content tariff exemption.⁴ After its financial crisis began and while the WTO dispute settlement procedure still was ongoing, Indonesia committed to the IMF to eliminate the national car program by removing its special tax, customs, and credit privileges. In January 1998, while the WTO dispute was ongoing, Indonesia revoked these privileges as a commitment to the IMF. Indonesia also pledged to the IMF to phase out tariff privileges tied to local content levels, although a WTO panel had not reached a final decision. In June 1998, the WTO panel issued a final ruling against Indonesia, and Indonesia was given until July 1999 to eliminate the second subsidy. In January 1999, the Indonesian government announced that it would formulate a new national car policy that would conform to its WTO obligations.

In addition to the national car program, during 1997-99 the U.S. government has investigated one other Indonesian export subsidy under U.S. CVD law. In response to a complaint from a U.S. company regarding extruded rubber thread, on March 26, 1999, the Commerce Department found that the Bank of Indonesia's rediscount export financing program was a subsidy because, during 1997 under the program, "special" exporters received financing at a lower rate than was available to other firms. However, the Commerce Department determined that the subsidy provided to the two Indonesian producers of extruded rubber thread products in question was not countervailable because the subsidy amounted to less than 3 percent of the value of the products.

Thailand

Since 1996, the United States has not formally raised concerns about Thai subsidies in the WTO; however, in the past the U.S. government has found a number of Thai subsidies to be countervailable. Some of these programs were found to be countervailable with regard to certain apparel, steel pipe and tubing, ball bearings, and pocket lighters, but no CVD order was issued with respect to pocket lighters because the ITC did not find material injury to the competing U.S. industry. These programs were found to be countervailable:

- Export packing credits, which are short-term, preshipment export loans, provided and recorded on a shipment-by-shipment basis, and approved new export packing credit loans totaling \$500 million to stimulate export activity in reaction to Thailand's lagging exports were countervailable. The Commerce Department determined that this program was countervailable

⁴ At the same time, Japan initiated WTO dispute procedures against the national car program only.

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in the context of investigations of certain apparel, steel pipe and tubing, and other products.

- Tax certificates for exporters, which are issued by the Thai government to exporters, and which are transferable, were found to be countervailable; these certificates also rebate indirect taxes and import duties levied on inputs used to produce exports.
- Tax and duty exemptions that allow exporting companies to import machinery and equipment free of import duties and business and local taxes were countervailable.
- Income tax exemptions that allow companies to obtain 3 to 8 year exemptions from payment of corporate income tax on profits derived from net profits for losses incurred during the tax exemption period were found to be countervailable.
- Goodwill and royalties tax exemption status, which is granted to promoted businesses for income arising from goodwill, royalties, and other payments for a period of up to 5 years were countervailable.
- Tax deductions for dividends that allow promoted businesses receiving tax exemptions to receive an additional deduction from taxable income for dividends received from promoted activities were found to be countervailable.
- Assistance for trading companies, which the Board of Investments authorized in 1978 to provide certain incentives to eligible trading companies, were countervailable.
- Duty exemption for raw materials that allows companies to import raw and “essential “ materials used in the production, mixing, and assembly of exports, free of import duties were found to be countervailable.
- Permission to maintain foreign currency bank accounts, which allows a Thai company to hold a foreign currency account, is countervailable in the event the account is denominated in U.S. dollars.

Comments From the Department of the Treasury



UNDER SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON

June 10, 1999

Harold J. Johnson, Jr.
Associate Director
International Relations and Trade Issues
National Security and International Affairs Division
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Johnson:

Thank you for your letter of May 26, 1999, and the opportunity to review the draft report entitled "International Monetary Fund: Trade Policies of IMF Borrowers."

We believe the draft provides, overall, a balanced assessment that will contribute to a better understanding of the issues that it addresses, and hope that you will be able to reflect in the final report the technical comments that Treasury staff has already transmitted to your staff.

We look forward to seeing the final version of your report.

Sincerely,

A handwritten signature in black ink, appearing to read "Timothy F. Geithner".

Timothy F. Geithner
Under Secretary (International)

Objectives, Scope, and Methodology

This report (1) identifies the extent to which current International Monetary Fund (IMF) borrower countries restrict international trade and the countries whose trade has the greatest potential to affect the United States; (2) describes in detail the reported trade barriers and export policies of four IMF borrowers that are among those with the greatest capacity to affect the United States—Brazil, Indonesia, the Republic of Korea, and Thailand—and recent actions reported to have been taken to reduce those barriers or modify policies; (3) identifies actions, in the context of their current IMF programs, the four countries have taken or are committed to take to liberalize their trading systems; and (4) determines the extent to which the impact of the four countries' export policies on the United States can be predicted and measured and which U.S. industry sectors might be affected by changes in trade from these countries. Except where otherwise noted, we included information as of April 30, 1999.

We defined IMF borrower countries as those 98 member countries that had IMF credit and loans outstanding in calendar years 1997 or 1998.¹ These 98 countries have used IMF credit at some point during the past 10 years and still have outstanding obligations.

Assessing Borrowers' Trade Restrictiveness

To determine the degree to which current IMF borrower countries restrict international trade, we analyzed several indicators of restrictiveness, including average tariff rates;² nontariff barriers;³ and indexes constructed by the IMF, the Heritage Foundation, and the Fraser Institute. The IMF index is composed of three measures: an index of average tariff rates and other duties on imports, an index of nontariff barriers, and an overall index that rates trade restrictiveness on a 10-point scale that weights nontariff barriers heavier than tariff barriers. The overall index classifies countries as either "open" (1 to 4), "moderate" (5 to 7), or "restrictive" (8 to 10).

¹ This includes credit from the use of the IMF's General Resource Account, as well as from loans made under three concessional (below-market-interest-rate) programs, the Structural Adjustment Facility, the Enhanced Structural Adjustment Facility, and the Trust Fund.

² Average tariff rates are the average of the applied rate across the entire tariff schedule. We obtained information on average tariff rates from various sources, including the World Trade Organization (WTO), the United Nations Conference on Trade and Development, the Asia-Pacific Economic Cooperation forum, the Interamerican Development Bank, the International Trade Commission (ITC), and the Office of the U.S. Trade Representative (USTR).

³ Nontariff import barriers include quantitative restrictions, state trade monopolies, restrictive foreign exchange practices that affect a country's trade system, and quality controls and customs procedures that act as trade restrictions.

Although these indicators do not comprehensively measure the wide variety of policies that countries may use to restrict trade, they do reflect important barriers and provide information on the relative restrictiveness of countries among each other and over time. We also collected information on borrowers' tariff levels from other sources.

We then compared how the IMF index rated countries to the way the Heritage and Fraser Institute measures did so. We found that the three organizations' measures rated countries similarly and that the tariff rates used by the three indexes were similar to the tariff rate data we collected independently. Finally, we supplemented this information with information from USTR and the WTO on membership in the WTO, the existence of other multilateral and bilateral trade agreements with the United States, formal market access disputes filed, and types of barriers identified in USTR's annual National Trade Estimate Report on Foreign Trade Barriers.

Four Countries' Import Barriers and Export Policies

We selected four of the eight current IMF borrowers for more detailed study—Brazil, Indonesia, Korea, and Thailand. We selected these four countries because, in addition to being important U.S. trading partners, they are among the 10 top current borrowers and currently have IMF financing arrangements. Mexico is the largest U.S. trading partner among current IMF debtors, and Mexico is the fourth largest current IMF debtor. We did not select Mexico for our study, however, because Mexico is not currently in an IMF financing arrangement and thus is not currently eligible to borrow more funds from the IMF, and because U.S.-Mexican trade is governed by the North American Free Trade Agreement.

To identify the priority⁴ import barriers and export policies of Brazil, Indonesia, Korea, and Thailand, we relied principally on USTR's most recent three (1997-99) National Trade Estimate Report on Foreign Trade Barriers. These reports identify those foreign import policies and practices that have the greatest potential to affect U.S. exports. We also relied upon USTR's Trade Policy Agenda and Annual Report of the President of the United States on the Trade Agreements Program. These reports identify the executive branch's annual trade priorities. We also used recent State Department Country Reports on Economic Policy and Trade Practices. In addition, we interviewed U.S. government officials from USTR, the Department of Commerce, and the Department of State. We reviewed the results of countervailing duty reviews and investigations by the ITC and the Department of Commerce's International Trade Administration, which

⁴We use "priority" to characterize these policies because the U.S. government has been particularly active in reporting on and addressing certain trade practices in specific sectors.

were reported in the Federal Register. And we met with officials from the Department of the Treasury and the IMF to discuss import and export policies in the context of each country's current IMF program. Information on foreign laws and policies does not reflect our independent legal analysis but is based on interviews and secondary sources.

Trade Liberalization in Four Countries' IMF Programs

To identify and determine the status of trade liberalization measures that Brazil, Indonesia, Korea, and Thailand have undertaken or have committed to undertake within the context of their recent IMF financing arrangements, we defined their "recent" IMF programs as those that started since June 1997 when the Asian financial crisis began in Thailand. Several of the countries technically have had more than one IMF financing arrangement since then because their original programs were expanded. We considered a measure to be trade liberalization in nature if it involved eliminating or lowering either tariffs or nontariff barriers to imports; concerned policies that promote exports, such as subsidies; or involved export restrictions. We reviewed public and nonpublic country and IMF documents, including the countries' letters of intent and memorandums of economic and financial policies. We also reviewed IMF staff reports on the countries' progress in attaining the objectives of their financing programs and met with IMF and U.S. government officials.

Assessing the Potential U.S. Impact of the Countries' Export Policies

We based our general discussion of the potential impact of export policies on economic literature and reports that explain how the U.S. government analyzes the impact of imports and export policies on trade. We identified the rank of Brazil, Indonesia, Korea, and Thailand as exporters among IMF borrowers by examining data prepared by the IMF. The latest available data cover 1997. We identified the four nations' ranks as world exporters by examining the WTO's April 1999 report on world trade in 1998. Exports net of intra-European Union trade were used. We identified the rank of Brazil, Indonesia, Korea, and Thailand as suppliers of specific product groups by examining the U.S. Department of Commerce's 1999 Industrial and Trade Outlook report and the ITC's 1998 annual Trade Shifts report.

To identify which of the four countries' export policies might harm U.S. industries, we reviewed the results of countervailing duty reviews and investigations by the ITC and the Department of Commerce's International Trade Administration, which were reported in the Federal Register. We looked exclusively at subsidies; that is, financial contributions by a government that confer a financial benefit to selected companies, or that are prohibited by WTO agreements. We also relied on the Commerce Department's Electronic Subsidies Enforcement Library to review countervailing duty cases filed, and spoke with officials from the

Department's Subsidies Enforcement Office to discuss those cases. In addition, we reviewed each of the four countries' most recent export subsidy notifications to the WTO's Committee on Subsidies and Countervailing Measures. However, information contained in these notifications was dated. To determine which subsidies were subject to the WTO dispute settlement activity or investigations under U.S. countervailing duty law, we reviewed the most current Overview of the State-of-Play of WTO Disputes in addition to the Commerce Department sources previously cited. Where practicable, we identified overlaps and linkages between the various types of policies and issues, but the available information was not always clear or detailed enough to identify such linkages.

We identified products that showed rising imports and falling prices by examining trade data for the years 1997 and 1998. Specifically, we identified product sectors showing large increases in U.S. imports from the partner by analyzing all U.S. imports from these nations at both the 4- and the 10-digit levels of aggregation of the U.S. Harmonized Tariff Classification System. Products that met certain value, market share, and import increase thresholds were analyzed further.⁵ First, we netted out import surges that appeared to be coming at the expense of other foreign suppliers, instead of U.S. producers.⁶ Second, we determined whether price declines had occurred for the remaining items by calculating unit values of imports at the 10-digit level.⁷ The result of this screening process was that 62 4-digit items, amounting to \$4.1 billion in imports, showed the specified increases in imports and price declines, as did 300 10-digit harmonized schedule products, accounting for \$5.3 billion in imports.

In reviewing whether a domestic U.S. industry exists, we examined regular monitoring reports and secured staff-level insights by selected industry experts at the ITC, the U.S. Department of Commerce, the U.S. Department of Agriculture, and other sources. A limitation of this approach is that it is somewhat imprecise and based on at-hand information, which may be limited. However, it was not practicable to use other currently available

⁵The criteria used at the 4-digit level were (1) value, \$500,000 minimum value of imports of the product category from the partner in 1998; (2) market share, the partner accounted for at least 5 percent of total U.S. imports of the product; and (3) import increase, imports of the product from the partner had increased by 15 percent or more in value terms from 1997 to 1998. The criteria used at the 10-digit level were: (1) minimum value, \$1 million; (2) market share, 5 percent of the U.S. import market; and (3) import increase, 20 percent in value or quantity terms.

⁶Specifically, only product sectors that showed increases in overall U.S. imports were further analyzed.

⁷At the 4-digit level, unit values at all of the 10-digit product categories were calculated and then averaged to determine whether prices fell for the 4-digit category.

information on U.S. production because it is dated and did not neatly match the classifications used for trade and tariff analysis. We identified products that were eligible for Generalized System of Preferences treatment by examining codes in the U.S. tariff schedule identifying such treatment.

We discussed the leading import surges and price declines identified with staff at the U.S. Department of Commerce and the ITC. We relied upon these informal contacts as well as information on export policies developed in a previous section and information on formal petitions for import relief made under U.S. trade law to identify products where concern exists by U.S. producers about harm from imports and/or unfair trade practices by Brazil, Indonesia, Korea, and Thailand. Such information is instructive but must be recognized as indicative only. Fully identifying and analyzing the factors contributing to rising imports; the nature, extent and impact of competition from imports on U.S. producers; and the extent of export subsidies would require information that is beyond the scope of this report.

We performed our work between November 1998 and May 1999 in accordance with generally accepted government auditing practices.

GAO Contacts and Staff Acknowledgments

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